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Dear USS Trustee,

cc Pensions Ombudsman, MPs on Work and Pensions Committee, UUK, USS Members

We are writing to collectively raise a complaint through the USS Internal Dispute Resolution procedure which operates under Section 78 of the USS Scheme rules.

We are seriously concerned that the changes to the USS valuation methodology proposed by the Trustee in the USS Valuation Consultation 2020 have little empirical or theoretical justification. The proposals could lead to the scheme overcharging USS members and employers including many UK universities.

Particular concerns relate to the proposed increases to the "level of prudence" compared to the 2018 valuation that the Trustee has not justified. Sensitivity analysis suggests this change increases the deficit by £7.4bn-£9.5bn. In addition there are potentially misleading and inaccurate statements in the documentation, and a lack of transparency over quantitative methods used to estimate key parameters in the valuation. There has been a consistent failure to meaningfully address concerns raised by stakeholders. The valuation does not implement many of the proposals made by the Joint Expert Panel jointly convened by UCU and UUK.

The Trustee can resolve our complaint by publicly providing full details of:

1. evidence and justification for why the level of prudence should be increased from the previous valuation, or return it to its previous level (67th centile);
2. justification for setting the pre-retirement discount rate on a gilts+ basis, rather than the CPI+ basis recommended by the Joint Expert Panel, or use a CPI+ discount rate;
3. a robust account as to why a recovery period of 15-20 years as recommended by the first JEP report is not appropriate for the scheme, or revert to such a recovery period;
4. how the mortality assumptions have been updated in light of the COVID-19 pandemic;
5. how post-valuation experience of asset values has or will be accounted for in the 2020 valuation.
6. and how the proposed changes for the 2020 valuation would affect USS members who are differentiated by age, disability, gender, race, migrant status, or permanent or casualised employment.

We include an appendix that provides full details of our concerns. We look forward to your response within 4 months required by legislation.

Yours sincerely,

Appendix: Serious concerns and open questions

A. Level of prudence

The Trustee is proposing significant changes to the “level of prudence” in the 2020 valuation compared to the 2018 valuation. Prudence on a gilts+ basis has been increased from the 67%/67% centiles, to the 78th/73rd centiles for pre and post-retirement discount rates for a “strong covenant”, and to the 85%/73% centiles for a “tending to strong covenant”. These changes in the level of prudence decrease the discount rate from 4.5%/1.2% and 3.4%/1.2% to 3.5%/1.0% and 2.0%/1.0% for the pre and post-retirement discount rates respectively.

Table 1: The level of prudence and discount rates for the 2018 valuation and proposed by the Trustee for the 2020 valuation. (Table 3, p18, USS TP Consultation 2018 and Table 8.4, p25, USS TP Consultation 2020)

Valuation	Covenant rating	Level of “prudence”		Discount rate (“gilts+”)	
		pre-retirement	post-retirement	pre-retirement	post-retirement
2018	Strong	67%	67%	1.33%	1.33%
2020	Strong	67%	67%	4.5%	1.2%
2020	Tending to strong	67%	67%	3.4%	1.2%
2020	Strong	78%	73%	3.5%	1.0%
2020	Tending to strong	85%	73%	2.0%	1.0%

On page 26 USS TP Consultation 2020, with reference to the discount rates corresponding to the 67% centile, the Trustee states “However, these rates fall outside the range we are prepared to accept for the valuation based on advice from the Scheme Actuary, taking into account our views of the employer covenant, the factors outlined above, and the proposed RMF risk metrics.” However, the Trustee presents no credible evidence to justify this change beyond asserting what assumptions the Trustee would accept.

The Trustee’s choice to increase the “prudence” reduces discount rates used in the TP in the valuation. This increases the estimated value of the liabilities. Appendix H (p79, USS TP Consultation 2020) suggests that each percentage point reduction in the pre-retirement discount rate results in a c£5.2bn increase in the deficit. Each 0.2 percentage point reduction in the post-retirement discount rate increases the deficit by c£2.2bn. The Trustee’s decision to increase the “level of prudence” therefore increases the deficit by c£7.4bn for a strong covenant and c£9.5bn for a tending to strong covenant.

Given the changes to the valuation methodology, we were surprised that the valuation document states in Appendix G (p78, USS TP Consultation 2020) that the majority of the increase in the estimated deficit (£14.9bn) from 2018 to 2020 was due to a “change in gilt yields”, i.e. entirely due to external market based factors, for which the Trustee had no responsibility. However, the estimates above suggest that if the Trustee had retained the 67% “level of prudence” deemed acceptable for

the 2018 valuation, the estimated deficit would have been c£7.4bn and c£9.5bn smaller than the figures presented under a strong and tending to strong covenant respectively.

Questions

1. What process did the Trustee use to decide to recommend increasing the level of prudence from 67% used in 2018 to between 73% and 85% for the 2020 valuation?
2. What evidence did the Trustee use to inform its recommendation to increase the level of prudence for 2020 valuation?
3. Were the levels of prudence chosen to achieve specific values of discount rates?
4. Did the scheme actuary indicate that a 67% level of prudence would not be permitted for the 2020 valuation?
5. Did tPR indicate that a 67% level of prudence would not be permitted for the 2020 valuation?
6. Why did the Trustee not include “change in the level of prudence” in Tables G1 and G2?
7. The consultation document states: “Different assumptions could produce lower confidence levels.” What assumptions did the Trustee use to set the level of prudence?

B. Setting the pre-retirement discount rates relative gilts+ not CPI+

The JEP2 panel recommended setting the pre-retirement discount rate relative to CPI, not relative to gilts, as this could reduce the volatility of the valuation.

Question

1. Why did the Trustee choose not to implement CPI+ for the pre-retirement discount rate as advocated by JEP2?
2. What is the impact on the estimated deficit and future service cost of using gilts+ rather than CPI+ for the pre-retirement discount rate?
3. If the prudence level was set relative to CPI at the same centiles, how would this affect the estimated deficit?

C. Updating asset values for experience

The scheme's assets increased by £12.3bn, from £66.5 bn on 31 March 2020 (p 28, table 9.1) to £78.8 bn on 30 November 2020, while the discount rate used in the valuation assumed very low growth. This post-valuation experience has the potential to significantly affect the scheme's deficit.

Question

1. How will this post-valuation experience be accounted for while maintaining a valuation date of 31 March 2020?

D. Recovery period

The JEP1 report argued that the USS should use a recovery period of 15 years. This is supported by a unique employer covenant. Specifically, the scheme is underwritten by institutions that, unlike the British government, have the highest AAA credit rating and can borrow for 100 year terms.

Question

1. What is the basis for demanding a deficit recovery period of 8 or 10 years, rather than 15-20 years as proposed by the first JEP report (p55)?

E. Changes to mortality assumptions

The assumptions about mortality have been changed from 2018 and 2020, resulting in £2.7bn and £2.4bn decreases in liabilities for the tending to strong and strong estimates respectively. Concerns over this assumption were raised by one of the trustee directors (Jane Hutton) at a previous valuation.

There is evidence that COVID-19 has reduced longevity by up to a year, taking life expectancy back to 2010 levels.

Questions

1. Were the changes to the mortality assumptions made in response to the issues raised by Jane Hutton?
2. Were the mortality assumptions in the 2018 valuation invalid?
3. Would using the updated assumptions affect the estimated deficit and future service cost for the 2018 valuation?
4. If these assumptions were incorrect for the 2018 valuation, were members overcharged over the period 2018-2020?
5. Will the Trustee update the proposed valuation as more clarity on the effects on mortality of COVID-19 are known?

F. Discount rate comparison

The consultation document compares the proposed single equivalent discount rate for the 2020 valuation to discount rates in other schemes in Chart F1. The proposed valuation incorporates a single equivalent discount rate of gilts+1.4% for a tending to strong covenant and a maximum of gilts+1.9% for a strong covenant. Chart F1 implies that the 95% percentile SEDR among defined benefit schemes is 2.19%. The Trustee claims their proposed discount rates “are in the upper quartile of market practice, with the higher rates around the 95th percentile of the rates used since 2005”, i.e. they imply that the discount rates are relatively generous. However, this claim is misleading. The vast majority of Defined Benefit schemes are closed to new members or future accrual, and are likely to be mature schemes paying out to pensioners. In contrast the USS is a relatively immature scheme, whose members are relatively young. If the USS remains open it is likely to remain cashflow positive for many years, and its optimal strategy for members is likely to remain in assets which have a positive return, rather than assets such as gilts which can be expected to lose value after inflation. In contrast, closed schemes with short time horizons cannot invest in growth assets, and given current regulations are forced to invest in loss making assets like gilts. Therefore, a valid comparison would be the distribution of SEDR for defined benefit schemes that are open to new accrual, weighted by scheme size. Measured on a nominal or CPI+ basis, the proposed discount rates are likely to be lower than previously used.

Questions

1. Does the USS Trustee believe it is valid to compare its discount rates to closed schemes, or to valuations conducted before the 2008 financial crisis or the recent pandemic?

2. How do the proposed discount rates compare to the distribution of discount rates used in open schemes?

G. The expected scheme surplus

The Trustee's current strategy is to on average overcharge current members and employers, to build up a financial buffer to cover worse than expected outcomes. This means we can expect members currently contributing to the scheme will on average (i.e. 73% or more of the time or more for the proposed 2020 valuation, depending on the prudence level) be overpaying for the benefits they receive. With the scheme's cost-sharing rules, they may also end up paying a substantial proportion of large deficit recovery contributions that turn out not to have been required.

Question

1. Can the trustee justify that it is acting in the best interests of its active members in setting the prudence level and deficit recovery contributions in the way it proposes?

H. TPR's responsibilities

The Pension Act 2014 updated TPR's remit to include an objective to minimise any adverse impact on the sustainable growth of sponsoring employers when exercising its functions relating to scheme funding.

Questions

1. How is this valuation, particularly the demands for additional covenant support, consistent with this objective?
2. Is the Trustee expecting TPR to raise any concerns about the impact of their proposals on the growth of the higher education sector?

I. Assumptions over the gilt yield reversion

There appears to be no mention in the Technical Provisions consultation document of whether or not a gilt-yield reversion assumption has been included in the valuation methodology. It appears that the employers' actuary, Aon, believed this assumption had been dropped in their advice to employers. However, it has since been clarified that this assumption remains in the valuation in some form, though details are unclear.

Question

1. Why did the Trustee not state its assumptions about the gilt yield reversion?
2. Why did the Trustee not provide a like-for-like comparison with and without the yield reversion assumption to aid understanding of its effect?
3. When will the Trustee publish such a like-for-like comparison for the benefit of the scheme's members and employers?

J. Absence of best estimates

The valuation document does not include best estimates of the expected deficit/surplus. This omission forces the reader to approximate and calculate these values themselves using reported sensitivity analyses in Appendix H, giving best estimates of a surpluses of £1.1bn and £8.8bn under a tending to strong and strong covenant respectively.

Question

1. What are the best estimates of the deficit and future service costs under the proposed valuation approaches?

K. CPI capping

Current future accrual has a cap of 5% plus half of any increase in CPI between 5% and 15%, and no further increase above this. This is potentially a risk for members.

Questions

1. How is the CPI cap integrated into the proposed 2020 valuation?
2. What is the impact on the future service cost and deficit of the CPI cap?

L. Transparency and accountability

For members to have confidence in the valuation it is essential that the analysis it is based on is reported in sufficient detail to allow replication and quality assurance. A greater level of transparency could help restore members' trust.

Members of the Joint Negotiating Committee (JNC) have requested explanation of how to reconcile the two tables breaking down the reasons why the estimated deficit changed from March 2018 to March 2020 (one in table G1 of the TP document, the other on p86 of the USS Report and Accounts 2020), and for a side-by-side comparison of the old methodology with updated assumptions as applied to March 2020. There is little reason this information should not be made publicly available, and would have expected the latter to have been included in the consultation document. To our knowledge, this information has not yet even been provided to the JNC.

Questions

1. When will the Trustee publish its working in sufficient detail for replication and QA?
2. When will the Trustee publish a detailed reconciliation of the deficits it estimated in March 2018 and March 2020?
3. Will the Trustee publish a comparison of old and new methodologies under the same inputs and assumptions?

M. "Low risk assets" and "derisking"

The valuation persists with a shorthand description of "low risk assets" and "derisking". These terms have the potential to be misleading. They refer to the strategy of focusing investments on corporate and government bonds, particularly inflation linked gilts. These investments are expected to provide far lower average returns, but have less variable returns than other assets. However, these assets are not necessarily useful in reducing the long-term risks that the we (employers and members) care about: 1) the risk that the scheme will have insufficient assets to meet its liabilities, and 2) the amount of additional cash the scheme will need if it has insufficient assets. Neither of these are equivalent to, or strongly related to the distribution of returns expected with investments in government gilts.

We understand that the Valuation Methodology Discussion Forum (VMDF) explored many questions related to the scheme funding position over time.

Question

1. Will the Trustee publish the paperwork from the VMDF for the benefit of all the scheme's members?

N. Providing documents on a non-reliance basis

The consultation was circulated to employers on a non-reliance basis (p10, USS TP Consultation 2020), and as far as we are aware does not aim to meet actuarial or professional standards, such as the technical actuarial standards laid down by the Financial Reporting Council. We are surprised by this.

Question

1. Will future valuation consultation documents be produced to adhere to accepted actuarial standards?

O. Proceeding with the 2020 valuation

A full valuation in 2020 is discretionary and not required by law. The next triennial valuation is due by 31 March 2021.

Question

1. Why is it in the best interests of members to proceed with a valuation based in the middle of the COVID-19 pandemic rather than use the flexibility of the legislation and published guidance from tPR to use a date less affected by market uncertainty caused by the pandemic?

P. The impartiality of the Trustee's proposals

The Trustee's proposals have a far larger impact on younger members of staff. F

Questions

1. How has the Trustee assessed the equity of its proposals?
2. Has the Trustee assessed how the proposed changes for the 2020 valuation affect those with protected characteristics under Equality Act 2010? This should specifically include the impacts on groups differentiated by age, race, disability, gender reassignment, sex, pregnancy and maternity, sexual orientation. Members would also need data on how the proposed changes would affect people on the basis of their migration status and their employment status as permanently or casually employed. If so, when will this be shared with members?