



**USS response: PPF Levy Rules 2024/25 consultation
October 2023**

The Universities Superannuation Scheme (USS) welcomes the opportunity to respond to the PPF's consultation on the Levy Rules 2024/25. Our responses to the consultation questions are set out below.

Universities Superannuation Scheme (USS) was established in 1974 as the principal pension scheme for universities and higher education institutions in the UK. We work with around 330 employers to help build a secure financial future for 528,000 members and their families. We are one of the largest pension schemes in the UK, with total assets of around £75.5bn (at 31 March 2023).

Q1: Do you agree that our approach to charging a minimum levy is appropriate given the legislative framework?

No.

The costs and expenses of running USS, including the payment of the various levies it is subject to, are drawn from the fund that is used to pay members' benefits, so it is central to its role in managing the scheme that the USS trustee keeps tight control of costs. It also has a legal duty to consider and report on the value achieved for the money it spends. Levy-paying pension schemes accept they are an important part of the pensions community and should provide appropriate support, but this responsibility should be shared fairly and equitably.

Our view is that selecting £100m on the basis of unknown and unquantifiable events potentially requiring future levy increases, and setting that figure as a 'minimum levy', feels unnecessarily cautious.

In terms of the justification for this proposal, we understand that unexpected 'funding challenges' could arise in future, for example due to changing longevity expectations, large claims, or even changes in compensation levels. However, in our view the need to raise funds through immediately increasing the levy to the maximum allowable levels would not necessarily be an immediate one:

- the PPF now has significant reserves (sufficient to cover the aggregate deficit of the UK's DB schemes in deficit several times over according to the latest 7800 index) and so could clearly cover additional cashflows falling due for some time, even in extreme downside scenarios. This in turn would allow PPF the time to increase a lower levy up towards the required levels over the available time; and
- because of the size of the fund's assets, PPF's investment strategy has become a far more powerful lever than the levy. So if additional funding needs to be raised in the future, it may well be more feasible and more effective to review the investment or funding strategy than to seek to ratchet up levies again.

It is also relevant to consider how the overall role that the levy plays might change going forward. Indeed, it may simply be unfeasible to go back to charging a levy of £400m (as it was in 2021/22 before the PPF started taking active steps to reduce the amount payable) across a reduced number of levy-paying schemes. As the PPF-eligible scheme universe continues to shrink, its ability to act as a

Universities Superannuation Scheme Ltd

"USS" and the USS logo are both trade marks of Universities Superannuation Scheme Limited. All rights reserved.

Head Office: Royal Liver Building, Liverpool L3 1PY Tel: +44 (0)151 227 4711 Local: 0845 068 1110 Fax: +44 (0)151 236 3173 Website: www.uss.co.uk

Registered in England & Wales No. 1167127 Registered Office: Royal Liver Building, Liverpool L3 1PY Regulated by The Pensions Regulator

mutual insurer, sharing and socialising risks between schemes may fall away. As a result artificially inflating the levy due now on the basis that it will allow quicker stepping back up to these levels is potentially backward-looking.

In summary therefore, we find it difficult to support the proposed use of USS members' funds to pay a greater levy than is absolutely required, especially if it is primarily in the name of caution. Instead, if the PPF feels it needs the ability to address future 'funding challenges' through immediate levy increases, the cause of the issue (the restrictive legislation in relation to future levy increases) should be addressed.

Q2: Do you agree with our approach to introducing simplifications to the levy over time?

Yes.

We agree simplification and stability of the levy is desirable. However we caution that this must not be achieved by methods which inevitably allocate more cost to larger schemes just because it is a simpler calculation. This is also a concern we expressed in our response to the proposals contained in the 2023/24 levy consultation, which we note have not been explicitly taken off the table. These schemes have already played a major part in the PPF achieving a positive funding position through payment of large levies (even though in many cases these will be the better governed and stronger schemes, and thus less likely to fall into the PPF). We therefore strongly feel that well managed larger schemes with good covenants, which represent less risk to the PPF, should not necessarily take on a greater proportional funding burden.

Regarding multi-employer schemes, USS is of course such a scheme. However as a last-man-standing non-associated employer scheme, an approach where insolvency risk is based on a single perceived 'dominant employer' is likely to be both inappropriate and difficult to do in practice. (We would also suggest that whilst 80% of schemes may have a 'dominant employer' that percentage would likely be much lower if weighted by scheme size or liabilities).

We would also suggest some caution about the potential for using TPR's covenant grade information, even against a backdrop of reduced emphasis on insolvency risk. TPR's covenant assessment is based on information provided to it by pension scheme trustees and its own analyses and advice received. Therefore the resulting assessment won't necessarily reflect the trustees' own covenant assessment, developed over time based on greater experience and familiarity with sponsoring employers and their businesses. There may also be inconsistencies across schemes.

Therefore our strong view on both the proposals above is that they should not be taken further following this consultation.

Q3: Do you consider there are any areas where simplification should be considered more urgently?

Yes.

It appears that the legislation around the ability of the PPF to increase levies to meet future 'funding challenges' is a key barrier to a more pragmatic and proportionate approach to levy-setting. In our view therefore it must be an early priority to seek changes in these restrictive rules.

Q4: Do you agree with our proposal to minimise changes (delaying the introduction of A11, and the updating of asset and liability stress factors) to limit adjustments to the levy scaling factor (LSF) for 2024/25?

No.

We do not believe the factors should be manipulated to generate a specific proposal to set the 2024/25 levy at £100m. As per our response to Q1 we don't believe £100m should be set as a minimum ongoing levy for prudence purposes, but also (and resultingly) don't believe it is appropriate to set a figure of £100m for the 2024/25 levy. Given the PPF's robust balance sheet and the declining aggregate funding risk in the universe, it appears that a substantial levy reduction beyond the figure that would automatically arise if the levy rules were unchanged, would arguably be more appropriate and fairer. Instead what is proposed is effectively a small levy increase (given the amount payable under the unchanged rules would be c£90m).

Further, this increase would be achieved at least partly through an increase to the Scheme-based levy multiplier (SLM), meaning larger schemes would bear a higher proportion of this unnecessary increase. We do not agree with this; in our response to Q1 and Q6 we have stated that we believe fairness should be a key consideration in levy policy, especially given some schemes will have contributed more to the current surplus position but, under some proposals, may be asked to contribute even greater proportionally in future.

Finally, there is a risk that maintaining a higher levy now simply exacerbates the PPF's future surplus position at the cost of reducing USS pension scheme assets now. We would like to see some thought given to how PPF surpluses might be managed and reduced in future (recognising the role levy-payers have played in funding the PPF surplus) if the position continues.

Note, for completeness we do agree that both the introduction of the A11 assumptions should be delayed, and that updating the asset and liability stress factors prior to a wider review of the approach to these is not appropriate.

Q5: Do you agree that focusing the risk-based levy on a diminishing pool of risk-based levy payers is undesirable?

Yes.

We agree that charging the RBL across a reducing group of schemes is undesirable, and this is particularly relevant for large open schemes such as USS where we already potentially bear some or all of the PPF's tail risk for investment underperformance and/or unexpected claims where most current schemes have exited the PPF eligible universe. And as stated earlier, we also believe it is inappropriate for the PPF to look to raise a minimum of £100m when it is not required.

But we also make the point about fairness throughout our response: seeking to instead charge more through the SBL would disproportionately affect larger schemes which we believe would be unfair.

Q6: Do you agree with our proposed criteria to assess the different options?

Yes.

Note, whilst we broadly agree with these criteria, we believe fairness should also be a consideration. It

appears that PPF may move towards a model where it is disproportionately funded by levies paid by larger, lower-risk schemes. These larger schemes will have paid larger levies in the past and therefore have contributed more towards the achievement of the current funding position. Larger schemes are also arguably likely to have more mature governance and risk management frameworks, potentially stronger and more diverse covenants, and in some cases will be structured in a way that means they are relatively less likely to need to call on the PPF in the future. It would therefore be unfair to proportionately increase the burden of funding the PPF towards those schemes.

Q7: Should we add an additional factor to the liabilities to limit the scale of increases in the levy scaling factor (LSF)? If so, do you have comments on how we should balance using the levy scaling factor and an adjustment factor for liabilities?

Yes.

We believe we could be broadly supportive of this approach (subject to the detail being made clear), as it appears more fair to larger schemes by sharing the required levy across a higher number of schemes and thus requiring lower proportional levy increases.

We do not have any view on the balance between the LSF and a liability adjustment factor, save that we would expect the level of each (and any year-on-year changes) to be set bearing in mind the principles in 6.5.1 including fairness as suggested above.

Q8: Do you agree that it would be appropriate to align the levy methodology to the reason for charging the levy – to provide against highly adverse claims - by altering the asset and liability stresses?

No.

We presume that the reference to “schemes with growth-seeking portfolios” in 6.8.2 primarily references open DB schemes. Assuming that is correct, increasing asset stresses on this basis would potentially therefore penalise open schemes in the long run, adding to their own or their sponsors’ costs. And as closed schemes move towards greater maturity presumably the asset stresses applied to them would decrease further, shifting even greater levy demands towards the remaining open schemes. Open DB schemes (particularly large, open schemes) will likely have considered their sponsors’ resilience in stress scenarios, as part of determining their investment strategy, to ensure their overall integrated funding strategy is appropriate. They will have examined carefully, having taken expert advice, their capacity to target greater investment returns through the use of appropriate levels and types of growth assets. Therefore evaluating risk and applying stresses based on the asset classes invested in would not take into account the work the trustees of such schemes will have done in evaluating and protecting against the risks of such investments.

The potential move cited in the consultation of considering a stress of two standard deviations is more akin to a ‘value at risk’ test. In practice, market movements of this scale would also likely have varying effects on employer covenants, and large schemes may have proportionately more resilient covenants than others (in particular sector-wide schemes such as USS). We acknowledge that case-by-case covenant analysis would not be possible, but we do not believe that increasing the extremity of the market stress, without further consideration of the likelihood of falling into the PPF in such scenarios, fairly reflects the expected outcomes of highly adverse scenarios.

Finally, any attempt to link levies to risk via reference to investments held in growth assets would appear to work against developing government policy, which is seeking to encourage pension schemes to support the economy and infrastructure through investing in ‘productive assets’. Knowing that a higher

levy may result could disincentivise schemes from aligning with government aims and investing in these growth areas.

Q9: Do you agree that altering asset and liability stresses are more suited to a one-off adjustment rather than being adjusted every year to scale the overall levy up or down?

Yes.

If changes are made these should reflect a long-term levy approach tied to risk rather than short term levy demands.

Q10: Do you have any other ideas or suggestions to ensure a risk reflective approach to the levy in future years? Please provide more details below.

Schemes with funding deficits would generally be expected to pose more risk than schemes with surpluses and therefore one potential idea would be to use the recovery plan as an input – i.e. if a scheme doesn't have a recovery plan it should be considered to present lower risk than one that does. This needs further thought, but fundamentally it would rely on the scheme funding process (with tPR scrutiny) working as intended so as to avoid gaming. (Schemes that use less prudent assumptions can only do so because that risk is supportable.)

Q11: Do you agree with our approach to simplify the process for special category employers?

No opinion.

Q12: Do you have any other comments?

We would like to reiterate our main points, namely:

- Firstly, USS acknowledges levy-paying pension schemes are an important part of the pensions community and should provide appropriate support. However this responsibility should be shared reasonably, fairly and equitably.
- Proposing to set a minimum £100m levy threshold, on the basis of unknown and unquantifiable events potentially requiring future levy increases, feels unnecessarily cautious;
- In particular, proposing a £100m levy for the 2024/25 year, when a substantial levy reduction is possible feels inappropriate and unfair;
- USS makes these comments being particularly mindful that costs are met from scheme funds, effectively members' money, and the significant levies it has paid in the past have contributed to the current surplus position.
- PPF should seek changes to the levy legislation to allow it more flexibility to adjust levies up and down as needed, rather than seek to collect artificially high amounts year-on-year.
- Any consideration of future levy design should take into account fairness for schemes, again particularly for those schemes which will have made a significant contribution to the current surplus position (in relation to both absolute levy amounts and shares of total levies payable). Therefore we would strongly recommend PPF does not develop levy formulae or approaches which mean that larger schemes take on a disproportionate share of the levy burden.
- There should also be an exploration of reimbursement options for schemes which have paid levies which have proved not to be needed.

- Finally, PPF will be aware of the other ongoing related funding, investment and risk initiatives from various pensions stakeholders including the Pensions Regulator and the government. It would be helpful if all stakeholders could be aligned in their requirements or desires of trustees so that (for example) the PPF levy methodologies do not penalise or provide a disincentive for taking the appropriate funding or investment approaches.