Further challenges have arisen for the valuation process as a consequence of the USS pension scheme covenant assessor (PwC) highlighting that increasing debt levels within the sector, and the potential for strong employers to leave the scheme, are both threats to the strength of the collective employer covenant. PwC are recommending that the USS Trustee takes action as part of the finalisation of the 2018 valuation to better manage both of these issues through some changes to the USS Scheme Rules and associated regulations. The rationale for rushing through changes at this late stage is to uphold the ‘Strong’ covenant rating the PwC ascribes to the scheme. The Pensions Regulator has previously made its view known that it considers the USS employer covenant to be one notch lower on its four point scale at ‘Tending to Strong’. We believe that PwC are genuinely trying to be helpful.

A strong employer covenant enables the Trustee to take more risk in relation to the future funding of the scheme, as it has greater assurance that the employers will have the capacity to make up any future funding shortfall. For example, taking more risk typically keeps the cost of funding the scheme at a lower level. A more risky asset investment strategy can be adopted with higher expected financial returns to fund pension benefits earned. Failure to robustly maintain the ‘Strong’ covenant assessment in the completion of the 2018 valuation would risk moving contributions to the upper end of the range that the USS Trustee has been seeking.

Our consultation response is below for information. It’s sensible from our perspective to take appropriate action to protect the covenant assessment. There is no real downside in supporting UUK’s proposal for there to be a moratorium on employer exits until the next valuation is complete to enable a full consideration of the issues and associated future provisions as part of the 2020 valuation. Rushing changes rushed through now could have unintended consequences. However, we are unable to provide firm support at the present time for provisions relating to the proposal that universities agree that USS will rank equally as a creditor with any new lenders who have security over the University’s assets in the event that we are unable to pay the money we owe to USS and any future secured lenders. The proposals could have unintended consequences that could weaken the covenant. However, we are prepared to consider proposals containing sufficient information to make an assessment on the basis that it is recommended that such action is taken to protect the employer covenant assessment of the scheme.

University of Bristol response:

‘The University of Bristol is willing in principle to accept and support the package of proposed measures relating to managing employer exits to allow the covenant to be confirmed as “strong” and to conclude the 2018 valuation, subject to considering the detail of the USS Trustee’s proposals. USS’ proposal in relation to the ranking of creditors is more challenging to support without seeing the detail; however, we are willing to progress the conversation with USS. In particular, we are concerned that the provisions relating to giving USS pari passu status with new secured creditors could have a detrimental impact on the covenant if it is not carefully considered. For example, some grant funders require security to protect their capital grant funding. Receipt of that funding helps promote the success of institutions. The detail of the new arrangements will be critical and we would like to join any working group that considers the proposals in greater depth.’