The following note was issued to heads of participating USS institutions on 29 July 2020

Colleagues,

I want to update you on plans for the 2020 valuation, publication of our Annual Report & Accounts, and Professor Sir David Eastwood's imminent retirement from the Board.

Valuation developments

The Trustee Board has now agreed the basis on which it will consult UUK over the approach to, and potential funding assumptions for, the 2020 valuation, and preparations are being made for consultation. We plan to launch the consultation in late August and for it to run until mid-October.

We will be proposing several changes as a result of the Board's careful consideration of the Joint Expert Panel's second report and representations from UUK and UCU via the Valuation Methodology Discussion Forum. Key among these include the use of a dual discount rate, removing 'Test 1 from the valuation calculation, breaking the 'mechanical' link between discount rate and investment strategy, and retaining 'self-sufficiency' as a key reference point.

Of course, the most significant factor in any valuation is the funding assumptions, as they directly impact the future service cost and the size of the deficit to be recovered. Most influential of these assumptions is the outlook for future investment returns.

Here, the Board has acknowledged the 'in principle' willingness of employers to take more investment risk over the long term, compared to the approach adopted for the 2018 valuation. This will be a critical consideration, as our financial management plan (FMP) reports make clear the degree to which the scheme is already relying on the employer covenant to underwrite funding risk:

- If market conditions at the end of June were read directly into the 2018 valuation's assumptions, the Technical Provisions deficit would be £20.2bn (£74.2bn in assets, £94.4bn in liabilities), the 'self-sufficiency' deficit would be £34.4bn, and the future service cost would be 40.1% of USS payroll.

However, the support measures needed to strengthen the employer covenant – the rule change on employer exits, and the debt monitoring and *pari passu* arrangements – are not yet in place. It is clear from recent engagement on these issues that more work is needed to get them over the line, and some uncertainty remains on what covenant support will be available to the scheme. This could have significant implications. For example, the covenant was rated 'strong' but on negative watch for the 2018 valuation as a moratorium on employer exits was in place, and it was assumed a long-term rule change would follow. A weaker covenant than assumed in 2018 would reduce the amount of risk that we could contemplate taking. All things being equal, less risk means higher contributions.

We are due to receive further analysis of the covenant from our advisers in the autumn. This will inform the overall contribution rate required for the 2020 valuation. The rate will also be informed by UUK's response to the Technical Provisions consultation and the status of the covenant support measures at that point.

Given the current level of uncertainty, we will consult UUK on a range of funding assumptions. This range will reflect different levels of employer support and, in turn, different levels of risk. We will also continue to engage with the Pensions Regulator to reinforce the key characteristics of USS and the sector it serves, and the long-term approach it can take to funding.

Annual Report & Accounts

Our Annual Report & Accounts will be published **on the USS website at 10:00 today**, covering the financial year to 31 March 2020. On that date, coronavirus lockdowns were sweeping across the world and financial markets were hugely uncertain about the potential outcome. Our report outlines the position of the scheme against this challenging backdrop.

Five-year investment performance was strong in absolute and relative terms, and we retained our cost advantage over our peers:

- Investment returns for the USS Retirement Income Builder fund averaged 6.19% pa over the five years to 31 March 2020 – worth £17.4bn and 0.91% pa above benchmark.
- According to the latest independent analysis, USS saves £49 million a year compared to its peers by managing most of its investments in-house.
- Total assets under management were £67.6bn (2019: £68.4bn). The USS Retirement Income Builder fund stood at £66.5bn, and assets in the USS Investment Builder totalled £1.1bn.

Consistent with the picture presented by our FMP reports, market conditions at 31 March had a significant impact on the funding deficit. The deficit was £12.9bn, compared with £5.7bn 12 months earlier.

The depth of the economic shock brought about by COVID-19 has highlighted the long-term challenges facing open DB pension schemes like USS. We intend to address these challenges working with UUK and UCU through the ongoing 2020 valuation.

Professor Sir David Eastwood

Professor Sir David Eastwood will retire from the Trustee Board at the end of next month. David first joined the Board in January 2007 as the Chief Executive of HEFCE and has served as a UUK-nominated Director since September 2009. He has been Chair since April 2015.

He has helped to steer USS through many challenges, including the global financial crisis, Brexit, and, more recently, the devastating impact of coronavirus. In that time, many schemes similar to USS have closed their doors – to new members, if not completely. Today, USS accounts for a third of the people still actively paying into private DB schemes in the UK that remain open to new members.

Instead, USS's membership continues to grow and the Scheme continues to play a vital role in attracting and retaining the highest calibre of academics and support staff to the HE sector – a sector of vital importance to our society and economy.

It has been a privilege to work alongside David. On behalf of everyone at USS, we thank him for his service and wish him the very best for the future.

In preparing for David's departure, we have welcomed Dame Kate Barker, who joined the Board in April as Chair-elect and will become Chair from September. Dame Kate was Chief Economic Adviser at the CBI before becoming a member of the Bank of England's Monetary Policy Committee from

2001 until May 2010 – and will bring all of her vast experience and expertise to bear in navigating the Scheme through these challenging times.

Bill Galvin, *Group Chief Executive*