The following note was sent to heads of participating institutions on 31 January 2020

Colleagues,

As we move closer to 31 March 2020, the point at which a snapshot of the Scheme will be taken for the next valuation, we wanted to provide you with a progress report following our update in December.

A reminder of the 2018 valuation

At 31 March 2018, there was a deficit on a Technical Provisions basis (the funding basis agreed with the Pensions Regulator) of £3.6bn in respect of pension promises already made. Assets were £63.7bn, liabilities were £67.3bn and the Scheme was 95% funded. The contribution required to fund future defined benefit promises, along with defined contributions and expenses, was 28.7% of payroll.

With additional contributions of 2% to address the deficit (rising to 6% from October 2021), the total payroll contribution rate was set at 30.7% (rising to 34.7% from October 2021).

What's happened since the 2018 valuation

We regularly monitor the core economic assumptions that underpin the Technical Provisions position, to make sure they remain valid. The picture at 31 December 2019 was mixed.

- The updated outlook for investment returns suggested that the Technical Provisions deficit had increased from £3.6bn to £5.6bn.
- The position on a low-risk "self-sufficiency" basis (a less-than 5% chance of having to ask for more money from sponsors in future) was largely the same – a £21.1bn deficit, up from £20.8bn.

The balance of the two would suggest no significant change – for better or worse – in the funding position. However, these conditions would indicate that the cost of funding new pensions has increased by around 3% (from 28.7% of payroll to 32%).

These figures are based on the methodology and demographic assumptions we used for the 2018 valuation. While they are indicative of market conditions as we move towards 31 March, all our assumptions will be reviewed in full as part of the 2020 valuation.

What's happening now

A working group involving members of the Board and Executive has been carrying out a fundamental review of our valuation methodology since September, with support from the Scheme Actuary and external expertise. We will be discussing the outputs of this work with representatives from UUK, UCU and the Pensions Regulator in a Valuation Methodology Discussion Forum – that will meet throughout February and beyond – as we look to identify a preferred approach for the 2020 valuation for wider discussion.

We have held constructive talks with UUK and UCU on the Joint Expert Panel's second report. Together, we have considered if and how its recommendations can be progressed in line with our respective roles and responsibilities (including our distinct statutory obligations as Trustee). Recently, members of the Board and senior executives have attended Joint Negotiating Committee (JNC) meetings as well as the discussions noted above.

We have created a dedicated section of the USS website to provide updates and background on the 2020 valuation.

What's next

We wrote to you in December to set out the key points in the process, and to share with you an early version of the timetable we will need to stick to so we can complete the valuation by or before the statutory deadline.

In line with this schedule, we will send you a discussion document in March to get your views on some of the main features of the valuation. These will include our **proposed methodology** and, in particular, overviews of the approach to the following key areas:

> **Covenant:** an assessment of the ability of our sponsoring employers to make good any funding shortfall if, for example, we don't achieve the investment returns we expect. It establishes the maximum amount of risk we, as the Trustee, could contemplate taking – our "risk budget" – when making promises to our members (promises that are ultimately paid for in cash). The stronger the covenant, the more confident we can be that we can keep pension promises even if investment returns are disappointing. As a result, we can invest more in assets that have a higher risk and potential return.
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> **Risk appetite:** This is a question of *determining* the level of risk that sponsoring employers are comfortable with. This could be short of the maximum we determine, as employers may need to consider other known or potential demands on their balance sheets and future incomes.

Key considerations

During the 2018 valuation, we discussed steps employers can take to reinforce the covenant – debt monitoring, *pari passu* arrangements and the rule change on employer participation (currently in place as a moratorium). Clear and collective financial commitments to the Scheme will be crucial in order to maintain the highest covenant rating possible for the 2020 valuation. The strength of the covenant has a significant bearing on the amount of risk we could contemplate taking and, in turn, the regular contributions we need.

While it is possible that we could contemplate an increase in the level of risk in our investment strategy, this would require employers to further reinforce their commitment with some form of security.

These issues, and their impact on potential valuation outcomes, will be explored in the discussion document and we are open to discussing the options available with UUK and employers.

Engagement

Following discussions over March and early April, we will need a clear statement from UUK of the support employers are collectively willing to provide to the Scheme. This will need to include clarity on the willingness to provide contingent support and commitment to mutuality through the proposed participation rule change, which we would need to conclude by mid-May. These issues will directly influence the outcome of the valuation: The Technical Provisions, the Schedule of Contributions and the Recovery Plan (which we will consult UUK on in July and August).

We will hold presentations and webinars to explore these points and hear your views, and we will be in touch with more details soon. In the meantime, please get in touch if you have any questions.

Professor Sir David Eastwood, *Chair, USSL Trustee Board*

Bill Galvin, *Group Chief Executive*