



Professor Julia Buckingham CBE
President – Universities UK

Mr A Jarvis
Chief Executive, Universities UK

Professor Adam Tickell
Chair of Employers Pensions Forum

Your ref	
Our ref	DKB/JMR
Date	29 March 2021

By email only

Dear Professor Buckingham, Mr Jarvis and Professor Tickell

Request for a review of the illustrated outcomes for the 2020 actuarial valuation of USS

I am writing further to my initial response of 17 March, having discussed with the board at its meeting on 25 March the issues and requests raised in your letter of 9 March.

I would first like to thank you for the ongoing engagement we are having with UUK (as the representative body for participating employers in the Scheme), and with other employer bodies. We also welcome your clear recognition of the significant challenges involved with the 2020 Valuation, the responsibilities and duties of the Trustee, and the constraints of the legislative and regulatory environment within which we are operating.

We have separately received letters from individual employers and have proactively contacted established employer groups to discuss the outcomes in the Rule 76.1 Report. While many of the themes being raised are similar to those raised by UUK, we recognise individual employers may have slightly different perspectives. Fundamentally, we understand the strength of feeling surrounding the 2020 valuation.

The Trustee welcomes your objective of seeking a solution to the valuation that is affordable and sustainable while still delivering meaningful benefits to the employees of the higher education sector. We wish to work with stakeholders to make sure that the optimal position can be reached on covenant support, the contribution rate and benefit structure to deliver against this objective. We hope that the next stage of the valuation process will allow us to examine these issues in concert.

You raise four substantive points in your letter, relating to: the **level of prudence in the valuation assumptions**; the issues around **covenant strength and covenant support measures**; our **engagement with TPR** on the Rule 76.1 Report outcomes; and your **request for a review of the illustrated outcomes** within that report.

I have addressed each of these in turn below. The enclosed Appendix goes on to address the additional points and initial questions raised by employers.

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The level of prudence in the valuation

The points raised by UUK in response to our consultation on the proposed Technical Provisions have been considered in detail – as set out in Appendix C of our Trustee Update. We also recently published [a briefing note](#) on this issue to make our perspective clear.

We have also discussed these issues at length with the Joint Negotiating Committee (JNC) and in the Valuation Methodology Discussion Forum (VMDF). Discussions at the VMDF were detailed comprehensively in Appendix A of the Technical Provisions (TP) consultation document. We would, however, highlight again that the proposals put forward – essentially less prudent assumptions combined with no de-risking from a position of 65% growth assets – could not be considered unless there were tangible material mechanisms in place to address the short-term risk position.

We also note that the Joint Expert Panel (JEP) included pre-retirement discount rates in its second report to show how a dual discount rate approach could work. Importantly, it recognised that the appropriate discount rates must reflect the financial conditions at the time. As is made clear on pages 66 and 67 of its report:

- *...the Panel did not propose these as appropriate levels, but rather sought to provide illustrative outcomes. Other discount rates or rate structures could be used which would produce different outcomes and would need to reflect views on conditions and future returns.*
- *The numbers are all as at 31 March 2018. Market conditions have changed significantly since then so the numbers give, at best, a partial guide to the impact of adopting a dual discount rate as at 31 March 2020.*
- *The material impact of varying the assumptions about CPI are just one indication of the additional work that would be required before definitive conclusions could be drawn.*
- *USS was not asked to give any opinion of what, if any, investment strategy could be appropriately linked to the discount rates. The Panel has not sought to infer any particular investment strategy, the different assumptions are merely intended to illustrate the sensitivities of changing the discount rates.*

Since the JEP published its second report in December 2019, the global economy has been deeply affected by the Coronavirus pandemic. The Trustee's choice of discount rates reflects the financial conditions at 31 March 2020, with the post-retirement discount rate in particular higher compared to gilts yields than it would have been at other dates.

If stakeholders believe less prudent assumptions are appropriate given the current funding position and prevailing investment outlook, they have options available that could support a greater level of risk-taking by the Trustee. For example, pledging contingent contributions or assets and/or agreeing on conditional benefits. These are steps that could change the Trustee's position and would be one way of addressing the points you have raised regarding pricing and intergenerational concerns.

The value of the covenant support measures

To further support understanding of how we have priced the covenant support measures discussed to date, we have published a separate briefing note [here](#).

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In summary, the covenant is weaker in each of the scenarios considered to date for the 2020 valuation than was expected for the 2018 valuation. This is due to the absence (or significant weakening) of the longer-term commitments we assumed, in good faith, would follow.

A weaker covenant corresponds with taking less risk which, all other things being equal, means higher contributions. Economic conditions have also since deteriorated. The two issues together lead to a comparatively poorer outcome.

We fully understand and are very sympathetic to the issues faced by employers and scheme members in these circumstances – but the scale of the challenge before us has been clear since at least September 2020, when we published the TP consultation document. We engaged extensively with employers and stakeholders before, during and after that point and are in no doubt that the key issues were made very clear.

Recall that the range of outcomes we set out in the TP consultation was 40.8% to 67.9% of USS payroll. The rate of 40.8% was based on stronger covenant support measures than are currently being contemplated. Scenario 3 (42.1%) is based on the minimum covenant support measures required to achieve a strong rating (but not as strong as assumed under the 2018 valuation). Scenario 1 (56.2%) is more than 10 percentage points lower than the highest rate from the TP consultation (67.9%).

We have emphasised to UUK and our stakeholders the central importance of covenant support measures throughout the 2020 valuation process. This is quite clear from the correspondence we have published on our website. It was also a theme of the 2019 Institutions' Meeting, our Discussion Document of March 2020, the TP consultation, and the Trustee Update and Rule 76.1 Report. It has been raised consistently in our HOI notes since the end of January 2020. As you will be aware, we have also raised these issues with the Employers Pension Forum and with UUK directly, with encouragement and specific requests for UUK to engage directly with the Pensions Regulator to present the covenant case. This was the case, for example, in January of this year, as a result of which you (UUK) wrote to the Regulator with your views.

These efforts were of course because covenant support will be most material to the outcome of the valuation. Our commitment to communicating the issues that will hold greatest sway was made in our briefing note to employers of December 2019. It has since been reinforced through the JEP tripartite talks.

We have responded to UUK's requests to price the value of the different covenant support measures now that specific proposals have been put forward. If the aim is to improve the valuation outcomes, we would suggest focusing on providing tangible and evidenced commitments to the Scheme that match your conviction as to the level of risk you believe should be taken in funding members' benefits.

These aspects will have greater impact than other issues that have been the focus of much of the stakeholder discussions to date, including matters such as the pace and level of derisking, or proposals for further smoothing of risk, given the overall risk position of the Scheme.

The Trustee's engagement with TPR and decision-making in relation to the Rule 76.1 Report outcomes

Our Trustee Update and TPR's own letter provide a clear and fair account of our discussions to date.

When we shared early stage emerging contribution rates with UUK prior to Christmas this was done in good faith and to be helpful. It was made clear, though, that they were still being considered and would be subject to further advice and review. We were still clarifying the details of UUK's illustrative package of covenant support measures to ensure we could attribute as much value to it as possible. We were also seeking to

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construct an alternative package (Scenario 3) to demonstrate what would be required for the Trustee to assess the covenant as Strong so that we could clearly illustrate the potential for better contribution outcomes. The details of these covenant scenarios were therefore not fully fixed, their contribution outcomes had not been concluded, nor had any of the work been approved by the Trustee Board.

In considering these complex and important matters, the Trustee Board accordingly took time to refine and finalise its position. It met a total of nine times between November and February to discuss drafts of the Rule 76.1 Report being produced by the Scheme Actuary. It considered a significant amount of additional analysis and advice from the Scheme Actuary and its covenant advisors in its deliberations and balancing all relevant factors to take account of. In addition, it observed and took proportionate account of the output of discussions with the regulator (as detailed in our Trustee Update and TPR's letter).

The overall contribution rate for Scenario 2 in the Rule 76.1 Report was subsequently **reduced** after UUK clarified the additional covenant support measures in its illustrative package. The rate for Scenario 3 **increased** following further consideration of the Scheme's overall risk position, and an increased understanding of the way in which the specific covenant measures supported risk taking over the period of any moratorium, and beyond.

Request for a review and progressing the 2020 Valuation

As set out above, time was taken between November and February to repeatedly explore and consider at a very granular level the pricing of the current benefits. TPR has also made clear its views on the illustrative outcomes for Scenarios 1, 2 and 3 in its letter of 26 February.

We note the request for a review. We also note UUK's proposals to consult with employers again on covenant support measures, contributions and benefit reform. We believe the most productive way forward would therefore be for us to work with you as you develop alternative packages. We can then look to assess their impact on the financial assumptions and the overall risk position in the round. The board will also consider the funding position as at 31 March 2021 in detail when it meets in May. This is ahead of when we expect UUK to have concluded their consultation with employers and finalise their proposals.

In light of the points above, and given the extent of professional advice taken to date, we have concluded that until an alternative proposal (or set of proposals) is forthcoming, or until new information materialises, we do not have any justifiable basis on which to review the outcomes illustrated to date. Demonstrable progress with the valuation also needs to be made, in line with the Scheme Rules and legislation, to ensure it is completed in a timely manner.

We are ready to engage further with TPR on these matters, and to consider post-valuation experience, if appropriate. We welcome UUK's substantial direct engagements with TPR in recent months, both through formal communications and through bilateral meetings, to represent the views of employers. As we have previously emphasised, this is a critical component of the valuation.

It would be very helpful to the Trustee and the valuation process if UUK's consultation answered the following key and interrelated questions, reflecting the valuation results as outlined in the Trustee Update:

- i) What covenant support and commitments can the Trustee depend upon in concluding the 2020 valuation?
- ii) What overall and specific benefit structure do employers wish to offer to their workforces in future?
- iii) What level of contributions do employers and members wish to pay to allow for those benefits to be provided?

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We cannot speak for TPR as to how it would view a reduction in the amount of DB risk building up within the Scheme. We are, of course, willing to consider this matter if and when a specific proposal is put forward by UUK.

As is always the case as we reach this stage in the valuation process, where the emphasis on decision-making shifts to the JNC, we are now actively supporting UUK as it prepares materials for consultation with employers. We have, of course, offered the same support to UCU as it considers its own position.

We will also provide more information to the JNC when it meets in April on the remaining timeline for the 2020 valuation, and the key decision-making milestones that would need to be met to allow increases in contribution requirements to be addressed within reasonable timescales.

We are also endeavouring to meet (virtually) with as many employers, both individually and collectively, as we can over this coming period to explain the Trustee's decision making in relation to the Rule 76.1 Report.

Yours sincerely



Dame Kate Barker
Chair of the USS Trustee Board

Encs

Cc: Mr M Birch – The Pensions Regulator

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