The 2020 valuation - An update from the Trustee (webinar transcript)

Helen McEwan: Good afternoon, everyone. My name's Helen McEwan, chief pensions officer at USS. Welcome to the latest in our series of member webinars. We've done three of these so far.

The first one, we provided an introduction to USS. And the second one, we explained our role in protecting members' pensions. And in the third one, we talked about what your USS pension provides.

All of those webinars are available on our website. So you are very welcome to go and look at those. We also put together a list of Q&A's based on the questions we were asked at that time. So they're well worth checking out, if you would like to find out more. This webinar will also be recorded and will be on the website in about a week's time.

So if you do miss it first time round, or if you'd like to look at other parts of it, then clearly it will be on the website for you to be able to do that. Today, we're covering the announcements that we made last week on the contributions required for us to keep providing the benefits that are offered by the scheme, what's gone into them and what happens next.

It's really important to note that this webinar is not a technical presentation or intended to provide technical information in great detail. It's really aimed at members who want to find out more and who want to understand what's happening next with the pension. If you do want the technical information, there's a wealth of that on our website so I would welcome you to go and explore that.

We've also just today put some member Q&As on the website, which try to explain in a very simple way, everything that's happening. So that will be supplemental to the information that you will find today. And hopefully you will find those helpful as well. The format of today's webinar will be the same as the others that we have done.

I will ask my panel of speakers who are with me a series of questions for the first 20 to 30 minutes. And then we'll move on to answer all your questions and everything that you would like to know about the scheme. So I'd like to introduce my speakers today. I'm very delighted to welcome Dame Kate Barker, who's the chair of a trustee board and also Bill Galvin, who's chief executive off USS.

I'm going to come to you first, Kate, and ask if you could, please, where we have context, talk us through what's been happening behind the scenes and the announcements that USS have made recently, please.

Kate Barker: Thank you, Helen, and good afternoon, everyone. Thank you for joining us. I think the first thing I want to say is that I'm well aware having only taken over as chair about a year ago, that for members, you must feel that you've been on a very difficult journey in recent years, in which you've repeatedly been asked to pay more.

And I think all of us at the trustee wish that was not the case, but of course we know that in the private sector, most defined benefit schemes closed several years ago. We've tried really hard to retain a meaningful level of defined benefit in the scheme. But the truth is, the challenges that have brought those other schemes to an end are greater than ever, today.

Over the past 18 months or so we've engaged very extensively with all our stakeholders, with universities UK, with universities and college union, individual employers, and indeed the regulator. We've taken a lot of advice from our actuary, from USIM, our investment house, and indeed from our covenant advisors, PwC.

The truth is, when we've taken all this advice, we're left looking at some pretty hard truths. Employers promise you, USS members, a set inflation-linked income for life in retirement, regardless of what happens to the economy or indeed to the sector in the future. Trends in financial markets are making that promise increasingly expensive.

So that means for us to continue to provide the current benefits, contributions from members and employers in total would need to rise to between 42 and 49% overall. And the reason for that gap is that it depends on the, kind of, commitments that employers feel able to make to support the scheme. UUK asked us if we'd provide some examples of what the benefits structure might look like at the current combined contribution rate of 30.7%.

And we did so in the document that came out last week, but I want to be clear that it's now a matter for our stakeholders to look at the pricing that we have put out and to consider how they want to deal with it. So what does all that mean?

Well, at present, you contribute 9.6% of your salary out of that combined rate of 30.7%. This is already set to rise to 11% in October under the terms that the trustee agreed with UUK and UCU at the last valuation. It's now for the Joint Negotiating Committee, which comprises people from UUK and UCU to decide what happens next.

We're certainly not at the end of this discussion. I'd like to put this in a bit of context. These numbers do sound very high, but a member of the teacher's pension scheme, earning the average USS salary of £44,000 would be contributing 9.6% today. The same as USS members pay now, while employers in that scheme pay over 23 and a half percent into the scheme.

That's 2% more than employers pay into USS at present. And it's actually pretty much in line with what we're scheduling to move the contributions to in October. I want to be really clear about something, benefits that people on this call have already earned or built up are protected by law. They're not affected by this valuation.

Equally, further support from employers and material benefit changes are very likely to be needed to avoid the, kind of, increases we talk about here in future and get us towards a potential solution. And we want a solution, of course, that members and stakeholders can both support, even if they don't entirely like it and that ensures the future sustainability of the scheme.

We are trying to look for the long-term, but I do think it's important to remember that these figures we're sharing today are not by any means the end of the discussion. Back to you, Helen.

Helen McEwan: Thanks Kate. Bill, I'm going to come to you now. And I think many of the members will be asking themselves and therefore I will ask you, what's going on here and why has the cost of funding to the scheme increased so much in just two years?

Bill Galvin: Thanks, Helen. And I think those are very reasonable questions for members to ask. And everybody, I think, will be aware that these are quite difficult times, and this is quite a difficult backdrop against which to be doing a pension scheme valuation. Like all assets from your own houses to stocks and bonds from which we manufacture the pension payments, the USS pension has become more expensive.

Of course, for members who have accrued a significant amount of pension in the USS scheme, I guess from one perspective, that's good news. You're sitting on a pension promise that’s much more valuable than was thought when it was being made and would be usually more expensive to provide now.

But of course, the flip side of that coin and the one which concerns us all, is that it would cost very much more to deliver that same quality and quantity of pension promise into the future. You might well be of the view that that's a difficult outcome from an intergenerational perspective. And I don't think many people here would disagree.

We see similar effects on the housing ladder, for example, and we are concerned that some of our members are opting out amongst the lower paid in particular. In some quarters, that's as high as one sixth of members who could join the scheme and about one third of that claim, that it's for affordability reasons.

So we've raised this point with stakeholders and we've discussed it a number of times. So those are the challenges. We are constrained, however, in our decision-making, as a trustee. In particular, the trustee has to make sure that the valuable pension promises already made, are secure. That's a duty under law, fiduciary duty to the trust. It is the trustee's primary objective to make sure that a USS pension promise is a secure promise.

And our members know that as Kate said earlier, regardless of what happens, that promise will be paid. Another constraint is we operate within a regulatory framework. And the regulator of the scheme has made clear that for us to charge any less than the proposals that are laid out here would, in the regulator's view, be not compliant with the law that sets a requirement for a prudent funding level.

And the third constraint is the degree of support we can get from employers. Employers are providing less in terms of commitment to the scheme than we were able to secure under the conclusion of the

2018 valuation. We're working through the precise terms of how we can quantify employer support to the scheme.

And I'll talk through that in a little bit more detail later on, but some of those constraints make for a very difficult decision-making background for us. That is why we are here. The answer cannot just be the contribution increases that Dame Kate outlined earlier, the answer must be that a combination of employer support to the scheme contribution discussions and benefit reform discussions must come together now to find a way forward to deal with these very significant challenges. Back to you, Helen.

Helen McEwan: Thanks, Bill. So, you know, I think what you're seeing there is that obviously the numbers voted are not the final outcome and Dame Kate was very clear on that as well. So can you explain to the members what happens next? What are the key considerations and when will things be clearer for the members listening today?

Bill Galvin: Okay. Well, let me explain how we're going to work through some of the challenges and constraints we've just outlined. So I think, Kate I'd add, the USS promise is a set inflation-linked income for life, regardless of what happens. The trustee, in order to create that must invest the contributions from you and your employer, and assume that they'll grow in value to create those payments that will deliver the pensions.

These expected returns now look lower and more uncertain than from previous vantage points, as we've been looking at previous valuations, you can see that the guaranteed return that we can get from investing in very secure investment, like, for example, government bonds pay back very significantly less than the expected inflation, as we look forward.

A loaning to high quality companies doesn't provide a much higher return. We do expect higher returns from stocks and shares and from investing in, for example, a slightly riskier company debt, but such returns are not contractual. They're less certain. They could fall even further short of meeting the promises that have been made by employers to our members.

So we need to understand how much we can depend on employers to stick with the scheme and make commitments to pay. Should we continue to pursue these investment strategies and should they not pay off as we expect them to do? The more investment risks that we take, the lower our current contributions can be, but the higher our dependence on employers for potential future contributions, should they prove to be insufficient.

Let me be very clear. We believe that USS employers are robust. They are some of the best positioned universities in the country. However, they are increasingly operating in a competitive marketplace. They are taking on more debt to invest in their offerings. That's clear, but nevertheless, the demand for higher education has proven to be strong.

We believe will be strong going forward. University employers have a very strong commitment to their core mission of providing an education. Our job is to ensure that they understand the commitment to the pension scheme alongside that, and particularly for the stronger employers. There is some asymmetry in the employers that support the scheme.

We've got- some employers have very strong balance sheets and on whom we can depend quite significantly. And other employers who have a slightly less robust balance sheet position, that's fine. It is a mutual covenant to the scheme. So the trustee has been determined to make sure that the commitment that the employers are making to the scheme is articulated and we can depend on it as we lay out our funding strategies going forward.

This has been echoed by the regulator. I'll talk about the regulator in more detail a little later, but there's a letter on our website from the regulator to the trustee where they also say that in their view, the clear capacity of employers to support the scheme has yet to be evidenced by the levels of demonstrable commitment that they expect.

So what does this mean? Well, without getting too technical, the key things that we're asking are that employers will agree to stick with the scheme for the long term and not to reduce the potential value of the scheme's claim on the higher education sector. So the mechanisms for that are reasonably straightforward.

And if we can move on to the next slide, Joel please, the mechanisms suggest that- well, in 2018, it was agreed that employers who wish to leave the scheme would need the trustee's permission. And that was designed to give the trustee a chance to understand the implications of that and if necessary adjust the position of the scheme accordingly.

And the other provision was that employers committed that if they were to take on any further debt that was secured against the assets of the sector, that the scheme would be given an equal claim on the assets of the sector. Now that set of provisions allowed us to come to the conclusions in the 2018 valuation that Dame Kate outlined earlier, contributions that we'll ultimately set at 34.7% of payroll combined.

They're currently set at 30.7, but they're due to rise to that number in October. As we work through the valuation for 2020, we have not, as yet at least, had the same level of support that we can work from. Rather than the indefinite rule change that I outlined earlier, the employers have proposed a six-year commitment to the scheme from the end of the valuation.

And that allows us to at least initially depend on that commitment for a period of 10 years and have proposed that they offer a security. But only once a further 20% of the net assets of the organisation could potentially be used to provide security to other lenders. Now, from the position of the trustee, that's a significantly weaker position than we were in for the 2018 valuation.

We have said, “Look, we would really like if you could do better,” if not at the same levels in 2018, at least stick with scheme to allow us to propose a longer recovery plan than the 10 year period, because we think there's a very strong link between the length of a recovery plan to repair the scheme's deficit and the commitment the employer has made to the scheme.

And please don't shift us further down the priority order then perhaps the ability to provide security over 10% of your assets before the scheme starts to get an equal claim. Now, neither of these are yet agreed, which is why we have some of this complexity and indeed the range of potential contributions that have been outlined.

And just to be clear, as it's not the role of the trustee to set the benefits that are offered to members of the scheme, that's a role of the employers who the Joint Negotiating Committee… neither is it the role of the trustee to say what level of commitment employers should absolutely make to the scheme.

That's clearly a judgment that can only be made by employers in the context of their other duties and commitments, but the impact of what I have painted there, hopefully in an understandable way, is quite significant. And the impact on the outcome does make contributions, as we've said earlier, look significantly more expensive.

And let me just explain how those covenants support measures play into the outcome of the valuation, in contribution terms. And perhaps if we could move on to the next slide, please. There are two components to the valuation contribution out turn. There is a contribution in respect of recovery. That means if the assets of the scheme are insufficient to provide for the pensions that have already been promised, then we need to fill that gap.

And if you've been reading some of the coverage on this, people have focused on that number, but in some ways the more significant number is the cost of providing pensions into the future. So the cost of month by month, the contributions that are required to make the equivalent level of promises that people have enjoyed in the past.

And depending on the level of employer support we get, it plays out differently in these two aspects of funding the scheme.

Most particularly, going to that issue of how long employers will absolutely commit to sticking with the scheme, if we can propose a longer recovery plan to The Pensions Regulator, and if we can, over the period of that recovery plan, look to count on some investment returns, helping us to close that deficit, then the increase in deficit recovery contributions under the more best case employer support scenarios that we've laid out is not as significant as the increase in the future service costs.

So at the 42.1% total contribution figure, you can see that that is 8.5% to pay into the deficit recovery plan for pensions already promised, that's an increase of 2.5% and not immaterial increase or an increase of 2.5% over the 6% that was ultimately allocated to this area in 2018.

But the cost of future service under that situation has risen from a 28.7% to 33.6%. So that's an increase of 5%. So with the employer support that's required, approximately two thirds of the increasing contributions is in respect to future service in the scheme. And approximately one third is going into deficit recovery.

Some of the really challenging contribution outturns appear when we have less employer commitment to the scheme, because if the deficit recovery plan needs to be paid off over 10 years, and if we are constrained in the level of extra outperformance, we can count on in closing that deficit recovery, the deficit recovery contributions do look quite high, and you can see there that the contributions required under the lesser degrees of employer support, almost 15% of payroll in respect of deficit recovery contributions.

And a similar type of outcome in respect of future service costs. So the challenge for the trustee and for Universities UK on behalf of the employers, is to work through exactly how these things will fit together and I'll talk a little bit later perhaps about the process by which that will be worked through.

Before I hand back to Helen, let me just explain that one other part of the constraints that we're operating under. We mentioned The Pensions Regulator. The Pensions Regulator is a reasonably significant player in this valuation. USS is the biggest pension scheme by Assets in the UK. The Pensions Regulator has an objective of protecting the benefits of members of pension schemes and indeed protecting the pension protection fund, which is the insurance scheme for pension schemes.

The regulator has the power to do many things. It can ask for or expert opinions if it's discontent with the outcome of an evaluation, it can ultimately set the answer if it feels that the proposal is put to it by a trustee are deemed to be non-compliant with the required legislation. We have in the process of putting this valuation together, worked intensively with The Pensions Regulator, we've explored quite robustly, USS

several areas that they eventually came back and told us would, in their view, be noncompliant with the legislation that governs this area.

The proposals that are in this document are not non-compliant with the legislation, if you'll excuse the double negative, but the regulator has made it clear that it's at the very limits and perhaps even slightly beyond what they would regard as being acceptable. So, again, as we work through the next part of this evaluation, the engagement with Universities UK, the further engagement with The Pensions Regulator, will be a significant component of where we ultimately get to.

So, Helen, I've spoken for quite a while. Let me pause there and hand that back to you.

Helen McEwan: You have, Bill. So in terms of what happens next, I think we can take from that, that there's a fair bit of employer consultation to be taken from UUK and a few other steps in the process that needs to happen.

Do we want to briefly, kind of, go through those and then move on to another couple of questions before we open up to the audience?

Bill Galvin: It's back to me again. So, right, Helen- the process going forward is about how we bring all that together. Now UUK have made it clear that they wish to consult employers.

Again, Universities UK have a role in the scheme, by the way, that under the rules of the scheme, they speak on behalf of all of the employers for these matters. That's not an easy task. And I certainly don't underestimate the difficulty they have in bringing together a group of very diverse employers with different views on these issues and coming up with a single response to us, the trustee, but they wish to consult employers, again, we believe on the issues about which we are speaking.

The levels of covenant support and the contribution rates. That there is an appetite to pay. We also believe they will ask employers about the levels of benefits that they believe can be afforded within the constraints laid out by these assumptions.

UUK having considered that and come up with a view, the Joint Negotiating Committee, which is a committee made up of equal numbers of employer and union representatives will need to consider these proposals. The Joint Negotiating Committee is not a part of the trustee, it's separate from the trustee.

The members are appointed by Universities, UUK to represent the employers and by UCU to represent the union. The fiduciary duties that apply to the trustee to act in the interests of members don't apply. This is where the interest of the employers and the union are brought onto the table in the consideration of what the pension benefits and contribution rates should be going forward.

Ultimately, it is the Joint Negotiating Committee that will decide on the level of contribution and the type of benefit arrangements that will apply to the scheme going forward. We stand ready to support those discussions and we very much hope that there'll be a constructive approach to a set of very, very difficult challenges going forward.

Helen McEwan: Thanks, Bill. I think there's a question that's probably really central to a lot of members' minds, which is, why are we holding a valuation based on data, at the start of the pandemic. And I wonder if you would care to tackle that for the members listening today, please?

Kate Barker: I think it's an undeniable that it wasn't the greatest time to hold the valuation and to form a view about the future starting from the 31st of March, 2020. But I also think there's some misunderstanding about the effect that's actually had on the valuation. So if we look back to the end of 2019, it was already the case that the USS funding position had deteriorated since the 2018 valuation was settled.

And that was beginning to become a challenge to the trustees in the agreements that were made, particularly with the regulator, you know, there were certain points of deterioration in funding, where actually the trustee has to act. Now, the trustee didn't want to act by suddenly and unilaterally pushing contributions up.

It seemed more sensible to react by taking a step back and holding a valuation in March 2020, as was agreed. Now then of course, the pandemic came along and, sort of, threw the financial markets around that time, into a bit of a jig. And that meant that it wasn't that easy to fix the data at that time.

But when we look at where we are now, in terms of the data, there's a couple of things that have happened since March, 2020. One is, of course, that our asset values have recovered. Equity markets particularly have been strong and our asset values have picked up and picked up a long way.

On the other hand, and this is, sort of, weighed against an improving picture since March 2020, the payment on government bonds, the safe rates of return, have fallen, and also certainly over the early years of the valuation, expectations for investment returns and for growth in the global economy have deteriorated because the pandemic has proved more serious and more long lived than I think we all appreciated last March.

I was then certainly idiot enough to think that by June we'd be having meetings in person. I would have been amazed to learn that almost a year later, I'd be having to talk to you in this virtual environment.

So the truth is that we really did need to halt to move into holding a valuation because otherwise we are just month by month having member promises that are just systematically being underfunded, we can't really let that continue into the long term future. And that's why it was important to keep to that valuation date of the 31st of March, 2020.

The disadvantage of course, is that because universities have been very disrupted, very difficult to run, probably the time that employers needed to look at what was coming out of the pensions, was more difficult to get and more difficult for us to get the attention that it needed, but there wasn't anything really fundamentally wrong with striking that valuation date and the experience we've had since doesn't suggest that it was uniquely unfavourable.

Helen McEwan: Thanks Kate. And I think related to that question and I might come to you both on this one, are expectations for future investment returns, realistic or unjustifiably pessimistic, which is resulting in these, you know, large increases in contributions from a member perspective?

Kate, I'll come back to you if that’s okay, on that one, please?

Kate Barker: Well, I have an economics background and any economist is going to say that when you're trying to look ahead over very long periods these numbers are, you know, very uncertain. We do, of course, look at what other people's expectations are, other asset managers. We look at investment consultants and certainly the expectations we have are not out of line with those. And as Bill has already set, out some investments, particularly the equity investment, investments in shares, they're pretty uncertain their returns. And so we have to also plan for the possibility that the central case instead of best estimate for those investment returns won't be realised.

And one reason that that's important is the thing that we have to protect against both for you and indeed for your employers is a very bad outcome in which the deficit in this scheme became very large and meant that it was really threatening the sector stability.

Helen McEwan: Thanks, Kate. Bill, would you like to see anything around the prudence and the trustee approach to prudence within the scheme?

Bill Galvin: Certainly, Helen. So prudence is one of the key issues in the evaluation. The trustee is required by law to make prudent judgements. But that, of course, is not defined in law.

That is for the trustee to understand and determine. There are a number of different lenses on prudence and it can be quite a technical discussion. For those that are interested in the technicalities of that, there is a detailed note on the website amongst a lot of other material that I would direct you to.

But let me just summarise it by saying that there are at least two lenses on the question. One is that when we look at our best estimates for future expected returns from all the different asset classes about which Dame Kate was speaking earlier, we understand what the returns might be from our portfolio of assets and for different portfolios of assets that we might allocate to… look to see what our risk appetite is for investing in risky assets, which is dependent on the level of support from the employers amongst other things, and then determine what a prudent view against that expectation might be.

So it was like a best estimate minus a degree of prudence. And certainly on that perspective, some of the measurements of this valuation look as if we have been more prudent than in previous valuations. Another lens, however, for looking at prudence is to say, well, what would a low risk investment strategy look like if we were to depend more on contractual, sort of, payments from bonds and credit instruments from government and companies, and only a very small amount of equity risk and that was a very high certainty outcome.

How far away from that are we? So how much risk are we taking? And in this valuation, we find ourselves on one measure, being more prudent against our best estimates and on another measure, taking more risk against what a very low risk strategy would look like.

That's a challenging and difficult judgment to make. And it's intertwined with all of the other judgments of the valuation. And it is one of the challenges faced by all trustees looking to steward a defined benefit pension promise that we all value so much at this particular time with all of the challenges looking forward.

Let me leave that one there, Helen, if that's okay.

Helen McEwan: Yes. Thanks Bill. I do want to make sure that we get time for the member questions, but just before we pass over, Kate, I wonder if there's any final comments you want to make on this session before we move into the member Q&A section.

Kate Barker: Well, I guess I want to say something that I hope is obvious to anybody, which is that it's really important to me, that all our members do have a pension that they can rely on in later life.

And that when they've reached the end of their career, they will have the ability to enjoy their retirement and something that is a particular concern of mine and indeed of everybody's – Bill's already referred to that – is the fact that we now have quite a high opt-out rate from the scheme, particularly among younger members.

Now, I've already talked about the fact that benefit designed for the scheme isn't for us, it's for the employers and the employees through the joint negotiating panel to reach an agreement. But I point out that the joint expert panel, one of the many other three letter acronyms that litter this scheme, when they made their formal recommendations, one of them was that the employers and the union should look at moving away from a one size fits all scheme.

And I think that would be an important part to a lot of us of moving forward with this valuation so that we can carry on and keep more members in the scheme and benefiting from the value it can offer. And the last thing I'd say is I don't doubt the ability of employers to support the scheme.

But The Pensions Regulator has been somewhat worried about commitments. And that's why we talk so much about covenants in the document we put out last week and wanting to see a very clear, express commitment from the employers. Thank you for that opportunity, Helen.

Helen McEwan: Thanks Kate. I'm going to move to the member questions now. And Bill, I'm going to ask you to take the first one, which is from a lady saying that; I'm 56 and hope to take flexible retirement in the next few years. Would this deficit affect what I'm likely to get, or is the hope that over the next few years, the deficit would be made up?

Bill Galvin: So, Helen, thank you for that. And let me reassure, I think Dame Kate covered this point already. Let me reassure everybody on the call the benefits that have been promised in the USS scheme to date are secure. They're backed by a legal duty to pay them and all of the resources of all of the employers that participate in the scheme, which is some of the most significant employers in the higher education sector.

So a USS promise is a secure pension promise. And of course the main task of the trustee, as I've said earlier, is to keep it that way, to make sure that any deficit that emerges is within the capability of employers to address over time. As I hope I've explained earlier, one of the big challenges for this valuation is the cost of future service in the scheme, the cost of going out now buying the assets that are required to manufacture the pension cash flows that are going to be needed well into the future.

And could I just give our member there – is that Patricia? – some encouragement to go on to our website and to look at the information and support materials that we've got there for people who are approaching retirement, particularly, I think people who are contemplating flexible retirement as Patricia is. We hope that we have- we recognise, first of all, the changing patterns of work over the past period.

We've worked very hard to get as much decision support material on the website to provide some guidance opportunities for people to avail of as is increasingly the case, people take retirement in different ways than had been planned.

So I hope you find the material that we've produced in that area useful, and that the processes are helpful in helping you make those decisions. And if not, I'd like to hear about it.

Helen McEwan: Thanks, Bill. I think this one is for Kate and I think we've covered it, but I think we should restate; are our pension pensions safe? How much have the pension schemes been affected by the inflation caused by the pandemic and Brexit? Do you have any comment on that one, Kate?

Kate Barker: Thank you, it’s always very dangerous asking someone who used to work at the Bank of England a question with the word ‘inflation’ in because you risk getting a long, boring and probably incomprehensible answer.

I think I'd say two things. One is that so far, we haven't seen a lot of innovation coming out of the pandemic and Brexit, but I think actually that's quite likely that over the next year or two, we will see a little bit, but that's not really what your question is about. Your question is really about your pension.

And the answer is that the pension promise that is made to you by the sector is an inflation-linked promise to a very large extent and very high inflation may be an exception, but the sort of inflation we expect to see over the next few years will get passed on in your pension.

Now, there may be issues if we get particular combinations of movements in assets and inflation, but there's no reason for you to be more worried about your pension because inflation is higher, a little bit higher for a short period. So I hope that can provide some reassurance.

Helen McEwan: Thanks, Kate. I'm going to come to you again, Kate, because I know this is an important one to you. Are you concerned that you may be pricing institutions and lower paid members out of the scheme, which will in turn only make the deficit worse?

Kate Barker: I've already touched on this by expressing my concern about younger members, in particular, opting out. Some…perhaps that we haven't made a bit more progress on looking at moving away from a one size fits all scheme, because we all know that our lives are very different and one size certainly doesn't fit all. At the moment, the rate of member opt-outs isn't such that it's leading to a threat to the scheme itself. So my worry here isn't really about the scheme. It's about individuals.

It's about individuals missing out on the valuable pension promise because they can't quite stretch that income to meet the contributions they need to put in. I hope that we will see the stakeholders think about that issue and that we can address it, if not immediately in this valuation, certainly I hope in the period when I'm chair of trustees.

Helen McEwan: Thanks, Kate. Bill, when does the trustee expect to receive confirmation from UUK regarding whether or not employers will connect to additional covenants interim measures and what effect might a positive response along with agreement on a longer than 15 year recovery period and contingent support that would allow more investment in equities have, on future service costs and the price of benefits? The, kind of, benefits.

Bill Galvin: It’s a very good question. It is largely a question for Universities UK. I must say, as I've said earlier, we believe Universities UK will consult with employers. Again, on some of the issues upon which they've consulted before the covenant support measures and contribution levels.

And also we hope on potential benefit structures. I'm not sure exactly when that consultation is due to start or finish, but we would expect that certainly now all this information is on the table, that it would start relatively soon. But these are complex questions and I understand that employers might need some time to work through.

What might the outcome be? It is difficult to speculate. We have worked very hard to understand what levels of support we can depend upon with UUK's current offer; the six years and the various proposals on debt monitoring and security. And we have put another set of proposals out there that would we believe extend the potential length of the recovery plan to 15 years.

It is not clear if employers feel that they will be able to offer us something longer than that. It is also clear that the deficit recovery period can't move into infinity. There are expectations from the regulator, not least, that deficit recovery periods are relatively short and indeed the 15-year one would be an extreme exception from their perspective.

But if employers came back with something longer, I would hope that we could look at that. That we could look at that again. And we also hope that employers will come back with confirmation that the debt monitoring and support measures that we've asked for to support the lower contribution rate, at the least, are possible to put on the table.

We think and hope that that will lead to better outcomes. But I do want to give Universities UK, I think, some time and space to work this through. I mentioned earlier what a difficult job they have to try to get all of the employers to come to a conclusion when there are very many different perspectives out there.

And I went and spoke to very many of the vice chancellors and heads of institution across our participant base. And certainly all of the larger ones in the past few months, there isn't a single view as to what the optimal way forward is here, because many of these institutions are in very different circumstances in terms of the amount of debt, for example, that they've already taken on, or indeed their concern about their exposure to the risk in the pension scheme.

So, I do think that Universities UK does need some time to work through these quite complex issues on behalf of the employers. And we hope that they'll come back with something that's at least as positive as the one that we've outlined in our scenario three.

Helen McEwan: Great. Thanks, Bill. Kate, I'm going to ask a good question that I'm sure a lot of members will be interested in: I don't understand the following, if the pension payment is based on the stock market, isn't it by definition uncertain? So how could you make any promises in the first place? And I think that probably strikes to the heart of why evaluation is so difficult.

Kate Barker: Yes. Yes, absolutely. It absolutely does explain why it's all so difficult. One of the things that we, sort of, need to step aside for a bit is thinking about longer term and shorter term movements in the stock market.

It's reasonably well established over long periods, stock markets produce good returns, but these are very long periods. So even when we're talking about 20 or 30 years, you can have periods of disappointment. But of course, that's exactly why we don't put all the assets of USS into stocks and shares. We also hold bonds and other types of investment that help us to protect against the risk of difficulties in equity markets.

And that means that we are able to make promises, but these promises to be solid for members, they are not completely risk-free for universities. I, sort of, referred to this earlier, when I said that one of the reasons we take relatively careful assumptions about things like how strong will equity returns be, is always the concern- It must be a worry for us and for the sector that if things go badly for the pension scheme, that the size of the deficit and the need for contributions would be such that it would make real financial difficulty to the sector even more than we see the strain today.

And that's what we're trying to avoid, but you're absolutely right. It's the uncertainties in financial markets that make that a worry. And indeed, Helen, as you rightly say, make the judgments we have to make when we're setting the valuation so very difficult.

Helen McEwan: Thank you, Kate. And a related question, I thin, for you Bill, is the deficit due to bad decisions on investing?

Bill Galvin: So I think members should all understand that the investments' returns from the scheme have done very well. In fact, the expectations that were set out in terms of returns for what we call our reference portfolio have broadly been met over the past period. The reference portfolio is effectively an allocation to stocks and bonds, according to the risk appetite, we think of the sector and the employers.

So that has performed as expected. And indeed the USS investment management team have outperformed that in terms of their own investment decisions over all periods, in fact, and very significantly over the past year. So the challenge has not been poor historic investment returns.

The challenge has been very much the lower prospective future returns from our asset classes that make for a challenge, both in the pricing of future service costs in the scheme, as we've mentioned earlier, and the prospective challenge in recovering the deficit.

Helen McEwan: Thanks Bill. Kate, I think this one's for you, although you might both want to consider it; what would you see to convince me to stay in the scheme?

Kate Barker: I think I'd put this very simply. If you don't remain in the scheme, you won't be getting money from your employer towards your pension, and that's worth a good deal. Employers after all, are paying over 20% at the moment towards your pension.

The other thing I think I'd say is take a step back and have a look at just how much money you have to put in. I have a defined contribution pension myself, and I'm really sharply aware of just how much money I have to build up personally, in order to get just a thousand pounds of income in retirement.

And if you look at that sum, you'll find it quite frightening and it will make the promise that USS is giving you, particularly given that that's inflation-linked, really valuable. So that's what I would say. You get the employer benefit and you get inflation linking. It's pretty hard to get that anywhere else these days, without saving a great deal of money.

Helen McEwan: Thank you, Kate. I'm going to move us on so that we can get through as many of these as we possibly can. Bill, I think this one's for you; USS is proposing to reduce the assumed rate of nominal returns from 2.8% per year, to between 2.1 and 2.3% per year. And to increase the assumed increasing life expectancy from 1.5 to 1.6% and 1.8% for women and men. The scheme's assets have increased by around a fifth to 80 billion and life expectancies was levelling off even before the pandemic. How do you justify that?

Bill Galvin: Thanks, Helen. I won't pretend to have absorbed all of those numbers as you were speaking, but let me respond in the general sense. First of all, in terms of the assumptions that are being made, just to demonstrate that our assumptions don't only go in one direction. We have, of course, looked at the mortality and longevity assumptions for the scheme in this valuation, as we do with all.

And the adjustments made this time around have reduced the value of the technical provision. So reduced the target funding level by several billions because of the latest data in the marketplace about advances in longevity, slightly slower than might have been anticipated in the past. That is not, I should be clear, that is not a COVID related statement. It's quite clear that the experience from COVID has been not usually significant in the context of the scheme and, indeed, it is very early to tell what the longer term impacts of that might be and how they might play out.

But the overall mortality assumptions have resulted in a reduction in the funding targets this time round. Of course, our expectations for future returns are lower than in the past. It is quite clear that we do believe that meeting inflation will be a challenging target over the next period. We certainly won't do it by investing in government bonds or indeed in other high quality debt. And that's where the risk seeking element of the portfolio, supported by an employer covenant will have to work hard, even to generate the type of returns that were indicated in that statement.

And I'm not quite sure if they're accurate but anybody who wishes to see what our expected returns are should go to the consultation material or the section- the trustee update on the website.

Helen McEwan: Okay, great Bill. I'm trying to get through as many of these as we can. As private sector companies have virtually all decided that defined benefit schemes are infeasible, how much confidence can members have that the scheme will remain feasible in future? Employers and members can't continue to pay more and more to fund it. Kate, would you like to have a go at that one?

Kate Barker: It's clearly for the employers and the union together in a sense to decide if they wish to pay more, to have this, kind of, pension. So far the preference has been to pay more, to continue to have a defined benefit scheme and that's not surprising given the way in which risks for defined contribution schemes, the sort I was just talking about, fall on individuals.

The point of a defined benefit scheme in a sense is it's a form of risk sharing so that you don't bear so much of the risk of what happens if we're going through a very difficult period for the economy and markets around the time that you're retiring.

But I agree that you cannot just continue to pay more and more for the scheme. It would be good to think that that won't be the case, but I have a terrible feeling, I would have thought that in 2017, that we had reached a point particularly of bond market yields, which were already, kind of, as low as they would go.

And they have, of course, defied to me by going lower, still. I think it is reasonable to think that from here, particularly given the work that we're doing and the approach we're taking to this valuation, that we are going to put the scheme on a sustainable footing. I commented on that at the beginning.

It's absolutely what we're trying to do. I don't think you can continue to kick cans down the road in this pensions world.

Helen McEwan: Thanks Kate. There is a question related to that. I don't know if you want to say a few words, which says; Dame Kate has mentioned that the 42% to 49% contribution range, isn't the end of the story, but the beginning of a discussion, how much lower could that rate go if employers fully signed on to the three covenant strengthening measures of which the 2018 evaluation was based, including the long-term commitment to remain in the scheme? How much slower still if employers agreed contingent contributions? I don't know if that's Kate or Bill, so I'll open it to either one of you that would like to volunteer.

Bill Galvin: Why don't I start and then Kate can correct me as she sees fit. I think the question is an open one. We would certainly like as much commitment as employers feel able to give. I tried to deal with this earlier. We do think there is value in what the employers have put on the table.

Clearly, we think there is even more value if they were prepared to commit for the length of time that we're proposing, which would allow us to get a 15 year recovery plan. Is the ability to push that even longer with a longer commitment to the scheme? I think that's possible. We'd have to look at what the terms of that were.

I don't think we would get a, kind of, a one for one increase because there is a point at which the deficit recovery plan can't go much further. Contingent assets and contingent contributions for those that have been following the various funding discussions over the past number of years in valuations are both items that we have discussed and reviewed and explored in depth with employers.

There are challenges in a multiemployer scheme, the nature of which we are, in constructing something to put together in this space. However it would clearly be an additional commitment from employers to the scheme. And it is very- certainly the case that substantive commitments to contingent contributions, which would be contributions that go up if our investment returns are, for example, lower than we anticipated or contingent assets, which would be assets which would be released to the scheme if, for example, the funding level went lower than a certain amount.

Both of those would enable the trustee to have another look at some of the critical assumptions here and potentially push the required contribution rates down even further at this point in time.

Helen McEwan: Great. Thanks, Bill. There's a couple of other questions but I think, you know, we should pull out because we probably haven't spoken about that a lot during the course of the webinar. Does the 2020 evaluation take into account suggestions on valuation governance? If so, how would the numbers you've just mentioned, 42% to 49% look if these were not considered?

Bill Galvin: So, the joint expert panel made quite a lot of proposals. For those that have been following that there is another document on our website that I would direct you to where we do work through each of them and explain the response of the trustee. They weren't all for the trustee, of course, there were a number for the stakeholders.

We believe that the vast majority of the recommendations of the joint expert panel have been taken into account in this valuation, both that applied to the trustee and within our- so the removal of the thing that was a concern in the last valuation at the test one arrangement, the introduction of a dual discount rate, which is a significant change to the methodology of the scheme and is very suitable for a scheme like USS.

And we have agreed with that and moved it forward. All of the issues around valuation governance, setting valuation principles with the stakeholders, engaging in tripartite discussions, having a valuation methodology, discussion forum with the stakeholders and, indeed, we firmly believe that the outcome of the valuation or the framework for the valuation is very consistent with the joint expert panels' proposal for the type of long term funding objective that a scheme like USS might have.

The joint expert panel, I think couldn't have anticipated the challenges of working through the 2020 evaluation with the backdrop that we have. There were some aspects of the recommendations that, given the whole context of the things that we felt were much more difficult to take forward, for example, the smoothing of future service costs, which would mean for example, undercharging for pensions now in the expectation that they will get cheaper in the future; that would add to the overall risk equation in a way that we feel would be quite difficult at that time.

So it was one of the things that we felt we couldn't take forward, but all of the others we feel we've given very significant consideration to and fulfilled them broadly, in principle. There were other aspects which are matters for the stakeholders in terms of representations at the Joint Negotiating Committee, et cetera, which I think is for the stakeholders to work through.

Helen McEwan: Thanks, Bill. I'm conscious of time. So I think we've got time for one more question and quite an important one as are all the questions. So I would say to everyone watching that we will collate these and put the answers on the website. So all these questions will be answered in the fullness of time.

So you will have them when the recording goes on the website later on next week. But I think it is a good one to finish on to say; how does the valuation account for distortion due to the disruption of the money market during the pandemic? So I think that's one on, basically, how do we take into account post valuation experience? So Bill, Kate, I don't know who would like to take that one?

Kate Barker: I'm happy to take that. I touched on it really in the answer to the question about why we're persisting with the with the valuation date of March, 2020. One of the things you try to do when you're aware that there is this very specific, short run disruption, which was undoubtedly the case and you're looking at longer term returns, is essentially try and look through it.

And that's what we did. So when we were thinking about the returns that we thought we'd get in the future on, for example, the equity investments, investments in shares that we have, we'd set quite a high- a relatively robust number back in March because we thought that the markets were unusually low and would recover.

Of course, since then we have seen the recovery in markets, but that doesn't mean we can go on assuming high rates of return from today, because to some extent, the markets have clearly taken on board the prospects for recovery. They're already in the prices of shares, that's how the share market works, at least theoretically. It looks ahead and, you know, absorbs the expectations of what's going to happen.

So we can't assume further, very high increases or we would be double counting. And as I commented earlier, when we look at experience since the valuation, our asset values have increased, but the interest rates on safe assets on the whole have declined.

And when we look back and try and think about, you know, what do we expect going forward from today? We don't frankly find we're in a better position than we were in March, 2020. So we do look very hard at what's called post-evaluation experience. And can I just say if that's the last question, can I just thank everybody very much for giving their time today to listen to us.

Helen McEwan: Really appreciate that, and thank you to you and Bill, Dame Kate, for answering all those questions on the hoof, which can't have been easy. Can I direct everyone please from here to the short feedback survey that will come up, as soon as this webinar finishes. We'd be really grateful if you would complete that.

And can I echo my thanks for listening today and look forward to seeing you next time.

Bill Galvin: Thank you very much from me, as well.