The following update was sent to heads of participating institutions on 1 December 2020

Colleagues,

This update comes as we consider the detail of UUK's response to our consultation on the Technical Provisions (TP) for the 2020 valuation and prepare for the next steps in the process.

Thank you again for your engagement during September and October, while you have had so many other issues on your plate. We held 24 briefings with individual employers representing almost 50% of our active membership. Almost 50 institutions also took part in our live webinar.

It was clear from those discussions and the questions raised that there is generally a very solid grasp of the challenges and of what is needed to achieve the best outcome possible.

The challenge of covenant support measures

We recognise the difficulties UUK faces in building a consensus across 340 individual employers, particularly in securing a uniform and long-term commitment to USS.

However, those commitments are no less critical today than when we were concluding the 2018 valuation. Assumptions of employers' mutual support and enduring commitment to the Scheme had been constants in the approach to all previous valuations. Prior to Trinity College Cambridge's decision to exit the Scheme, they were taken as read. We now need to evidence them and make them tangible.

Since the conclusion of the 2018 valuation, we have often said that covenant support measures would need to be addressed as early as possible in the 2020 valuation, if we were to have a firm basis on which to work through the process. We have also emphasised the likely consequences the covenant-related assumptions would have on risk appetite and, in turn, future service and deficit recovery contributions, if these measures are not implemented within the current valuation timetable.

UUK asked us to illustrate how implementing these measures could influence the outcome of the valuation. In the absence of a specific proposal being put forward, we illustrated a wide range of potential outcomes in our TP consultation, which demonstrated the significant impact they could have in aggregate on the total contribution rates.

We would have liked the TP consultation to include illustrations of future service costs and deficit recovery plans that were more focused and meaningful. But to do this we needed more tangible indications of employers' main issues and a covenant support package proposal, or proposals.

Progress in recent weeks

There has been some significant progress on these issues in recent weeks.

The impact of Covid-19 on the sector's financial resilience has been a real-life test for the strength of the covenant. So, I am pleased to report that PwC's and EY Parthenon's reviews have reaffirmed our view that the sector could support a 'strong' covenant.

This means that our position before the emergence of COVID-19 still stands: with the right support package in place, we believe we can still achieve a 'strong' covenant rating.

Early in November, UUK put forward illustrative covenant support measures. Our initial assessment of these is that they would not be enough to achieve a strong covenant rating and that some aspects, as currently framed, would significantly reduce their value.

This includes the suggestion that there should only be action on new debt where there has been a material impact on the covenant *overall* rather than on the covenant provided by individual employers. This could lead to the covenant being weakened in a piecemeal fashion before protective action has been taken.

The length of the illustrated 'rolling' six-year moratorium (reviewable at each valuation) on employers above a 'de minimis size' leaving the scheme is also some way short of the optimal 30-year period discussed to date.

We are in urgent discussions with UUK to confirm our understanding of these measures.

But, even with these limitations, UUK's illustrative measures – combined with the favourable covenant position – could mean we achieve an outcome towards the middle of the range illustrated for the TP consultation.

We have also asked UUK if there is scope for improvement, as we believe contributions towards the lower end of those illustrated are possible with the right commitments in place.

We acknowledge, however, that even this would sit outside what UUK considers to be the limit of affordability for employers, and that significant numbers of members are already opting out of the Scheme on grounds of affordability.

What happens next

The Trustee Board meets again in early December. The progress we make in the coming days will be reported to that meeting and reflected in a subsequent report to the Joint Negotiating Committee (JNC) that will set out the cost of funding the Scheme's existing benefit structure. That is an important part of the valuation process. We will provide you with a full update at the same time and we will, of course, continue to work with our stakeholders as they consider how to address that cost.

It is not our role to initiate or promote potential benefit changes. The Scheme's design is for UUK and UCU to consider through the JNC.

But, as requested, we will separately provide UUK with further analysis on different options based on their illustrative measures. We expect this to include the outcomes that alternative covenant support packages could achieve and an illustration of what could be achieved within the existing hybrid benefit structure for the current contribution rate. Ultimately, the options for mitigating the rising cost of funding the Scheme's benefits sit with UUK (through covenant support measures) and with UUK and UCU together through the JNC, which is responsible for considering how any overall increase to the contribution rate we identify is met.

Our role is to administer the benefits the JNC chooses to provide, and to ensure the pensions promised to members are secure. This important separation of duties underpins the integrity of the Scheme. We are always available to provide UUK and UCU with information and analysis on potential options. But it is for them to decide what options they want to explore – and whether (and when) to share with their constituents any analysis we have provided to facilitate those discussions.

It is clear from our **Financial Management Plan reports** that conditions have deteriorated since 31 March 2020. The valuation timetable is also now under significant pressure and we must keep the process moving forward in line with the statutory deadline. We will set out what this means in our December update, but we appreciate the challenges you are facing, and will be as flexible, collaborative and constructive as we can.

We are committed to engaging with you, our stakeholders and the Pensions Regulator, and to explaining our position and the key issues we have to take into account.

We want to achieve the best possible outcome for you and our members in the face of what continue to be very challenging conditions.

Bill Galvin, *Group Chief Executive*