

The following note was sent to heads of participating USS employers on Tuesday 27 October

Colleagues,

I want to thank you for your engagement on the critical issues that will influence the outcome of our 2020 valuation – and to address some common themes that have emerged in our recent discussions.

I hope our programme of engagement to date has been beneficial and will support a clear and informed response on your behalf from UUK to our Technical Provisions (TP) consultation. The window for providing UUK with your comments closes on Friday 30 October. UUK will then have until 11 November to provide us with a consolidated response.

UUK's response to the TP consultation will help us to progress to the next phase of the valuation and to identify the contributions needed to continue to offer the benefits currently provided by the Scheme (the 'future service cost'). The Trustee Board will consider these matters, alongside the outcome of further work on the covenant review, towards the end of November. Discussions with UUK and UCU, and engagement with the Joint Negotiating Committee (JNC), will follow thereafter.

For now, I want to say thank you to you all for your time, your engagement, and your constructive challenge in what we recognise are incredibly difficult times for the Higher Education sector.

Since the start of September, we've held 24 briefings with a wide range of individual institutions and employers who collectively represent almost 50% of our active membership.

At the start of October, representatives from almost 50 institutions took part in our [live webinar](#). This followed a [pre-recorded presentation](#) circulated earlier in the month.

We are very grateful to employers who have taken part in some in-depth analysis of their financial position and business outlook to support our updated covenant assessment. This has been a significant time commitment and has been a key element in enabling us and our advisors to assess the post-COVID-19 outlook. We have recently asked HEI employers to provide some supplementary notes on asset restrictions and valuations which, again, are helpful and for which we are very grateful.

Thousands of members joined us for live and interactive [webinars for members](#), introducing [the basics of the Scheme](#) and [our role in protecting their pensions](#). These webinars have included presentations from Trustee Directors and the Scheme Actuary alongside members of the USS executive. More than 5,000 members have registered for our next webinar on 6 November, which will focus on what their USS pensions provide.

Over the course of these engagements, employers told us that clarification on a few common themes has been helpful. So, I would like to address them in the round here for everyone's benefit, and ahead of you finalising your responses to UUK.

Covenant support measures

We have listened to the concerns you have raised over the course of our consultations and discussions over the past few months in respect of the proposed debt monitoring and *pari passu* framework. UUK has indicated that it will shortly share further views with the Trustee. In the meantime, it may be helpful to clarify our approach in the following areas:

- There has been a concern expressed that the Trustee may use these provisions to interfere unduly in the day-to-day running of institutions or that we would seek to automatically penalise employers for breaching the metrics. This is not the case: our objectives are limited to supporting and protecting the Scheme's covenant where the debt levels of employers are increased and we would act where actions are considered to be material to the covenant. The *pari passu* provisions are critical, although we have sought to emphasise that we do not seek to intervene where the use of debt is clearly enhancing the covenant. We recognise that we may need to provide more detail around that. The remaining elements of the framework are designed largely to flag where we may need additional information and, in some cases, we may seek to discuss and understand an employer's position more deeply and possibly to work together to address any significant covenant concerns.
- We have developed the framework to be applicable to a wide range of employers. Some areas can be addressed to reduce anomalies – Oxbridge colleges being one example – and we will also review the impact of the framework on very small employers.
- We believe that this framework will work most effectively as a joint and cooperative process between the Trustee and employers. UUK has confirmed that it intends to review the feedback it has received on the covenant support measures, informed also by its specialist employer working groups, and will make further representations to the Trustee.

We hope to be able to write to you again on this framework soon but, in the meantime, we can confirm that the first data collection will be in early 2021. With the exception of new/additional secured debt (including grants of security for existing unsecured debt), we are not expecting engagement under this framework before then. We do continue to expect to be informed of any intention to take out new secured debt and are grateful to those employers who have done so.

The deficit recovery plan

We are consulting UUK on the inputs, assumptions and methodology to be used in setting the Scheme's Technical Provisions that will **drive** the valuation outcomes – not vice versa.

So, we are not consulting formally on the contributions which are required to fund the future service cost or repair the deficit at this stage.

We have, nevertheless, illustrated in the TP consultation the total contribution requirements based on potential outcomes. These are dependent on UUK's response to the TP consultation and on progress around the covenant. In terms of what will influence the contributions required to recover the deficit, I would make the following points:

- We have illustrated deficit recovery plans spanning eight and ten years – eight being the remaining recovery plan length agreed as part of the 2018 valuation, and ten being the recovery plan length from 2018 but with the clock reset.
- This is consistent with comments made by the Pensions Regulator in its letter to the Valuation Methodology Discussion Forum (see [pages 50 and 51 of the consultation document](#)).
- If the right covenant support measures were in place, potentially combined with other measures, the Trustee may be in a position to consider a recovery plan longer than ten years. However, we are very conscious of not double- or triple-counting covenant support via the investment strategy, discount rate, recovery plan length, and any outperformance assumption.

- We will have a further opportunity to consider these issues in the coming weeks.
- Finally, the consultation with UUK on the Recovery Plan and Schedule of Contributions which will come later in the valuation process is the latest point at which post-valuation experience, both upside and downside, can materially be incorporated into the valuation before it is filed with the Regulator. Therefore, the Trustee will wish to keep these matters under review. However, we recognise the desire from the stakeholders to have as much information as possible when progressing their discussions through the JNC.

Greater prudence

Prudence is not just about “confidence percentiles”. It needs to be looked at in the round.

Importantly, we have not just looked at this through the single lens of future investment returns expected from USS Investment Management’s [model](#). We have also looked at those produced by the Scheme Actuary’s firm, other consultancies and other asset managers. Benchmarking over several years – including at the time of the 2007/2008 financial crisis, and when there were far more open schemes – shows we are proposing relatively high discount rates particularly in the strong covenant scenario (see [Appendix F of the consultation document](#)).

Given the level of uncertainty driven by current conditions it is not surprising that the range of views is wider than normal. So, the Trustee has applied judgement based on independent advice – including the advice of the Scheme Actuary. That said, the proposed investment return assumptions for a strong covenant are higher (relative to low-risk assets such as gilts) than the assumptions adopted in 2018. We also anticipate retaining a higher allocation to growth assets in the long-term than assumed in 2018.

Affordability and opt-out rates

We share your concerns about the sustainability of the Scheme and the number of members opting out.

The ‘historical norm’ for opt-out rates for USS specifically, based on data shared with us by participating employers, has been around 15%. Over the last 18 months, the opt-out rate among new joiners and auto-enrolment re-joiners has for some periods been slightly higher – in the region of 18%.

We know that amongst certain groups, or at some employers, opt-out rates can be much higher.

Scheme opt-out rates of between 15-20% suggest that there are aspects of the Scheme that are not working well for everyone it is seeking to serve, particularly younger members and lower earners. This was recognised in the Joint Expert Panel’s second report and we are keen to work with UUK and UCU to address this.

Members give a variety of reasons for opting out, but affordability has consistently been chief among them in the data we have been collecting from employers since the start of 2019. Between a quarter and a third of respondents put their decision down to affordability. The second and third most common reasons are being on a fixed term contract and having plans to move out of the UK in the future.

The contributions illustrated in the TP consultation are only likely to exacerbate this issue and could risk even more members effectively being priced out of the Scheme. We are acutely aware of how unwelcome the prospect of paying more will be to both employers and members – but the funding position is something we must address, because we have a legal duty to protect the benefits promised to our members.

Against the current financial and economic backdrop, the cost of the current, one-size-fits-all package of benefits has increased. The contributions required to fund them – even in our best-case scenario – have been driven up by the deteriorating and increasingly uncertain outlook for future investment returns and the need for greater prudence associated with that.

Finding a way forward

As we've already made clear, the financial and economic backdrop to the 2020 valuation is not favourable.

As Trustee, we are not involved in setting the benefits promised to our members or deciding how any increase to the overall contribution rate should be shared between them and their employers. These are questions for the UUK and UCU representatives on the JNC, as per the clear separation of duties that is embedded within the Scheme Rules and which is so important to the integrity of the Scheme.

However, we are here to support the stakeholders in their considerations as we work through this valuation process.

We hope we can continue to work constructively with you and our stakeholders to find a workable and sustainable way forward for the Scheme.

Thank you, again, for your time and engagement on these important issues.

Bill Galvin, Group Chief Executive