The following note was issued to heads of participating USS institutions on 30 March 2020

Colleagues,

Following the Trustee Board's most recent meeting on 26 March, I wanted to update you on:

- The latest funding position of the scheme
- The Trustee's response to these challenging circumstances
- The critical importance of the covenant you provide to the scheme and the corresponding importance of the proposed rule change on employer exits

The latest funding position of the scheme

Since the beginning of March, the value of the Scheme's assets has fallen – from £74bn to as low as £64.3bn (at 18 March). Our in-house investment team continues to work hard to navigate these extraordinary market conditions. See: USS Investment Update

Our funding position has been very volatile, reflecting recent market movements. The Scheme's 'Technical Provisions' deficit in respect of past service benefits has increased substantially from the £3.6bn established by the 2018 valuation, measuring over £11bn in recent days.

We have also seen a higher 'self-sufficiency' deficit. Under a 'self-sufficiency' strategy, the probability of requiring any additional contributions from employers (assuming the DB section is funded to the self-sufficiency level) is around 5%.

For several weeks, the deficit on this basis has consistently exceeded 85% of the net present value of 10% of payroll each year for 30 years. As this threshold has been breached for more than five business days, the Trustee Board is obliged to consider an appropriate response. This obligation is set out in the Monitoring and Action Framework established following the 2018 valuation.

The board met on 26 March to consider the trigger event, the funding position of the Scheme, the status of the March 2020 valuation, and the appropriate actions we could take to respond to these developments.

In recognition of the uncertainty of current conditions, and the challenges currently faced by all parties, the board decided against taking any immediate short-term actions but will continue to monitor the situation closely.

It agreed that the most measured approach to striking a balance between these competing pressures was to go ahead with the valuation, as planned, at 31 March 2020.

This will allow us to properly consider the support available to the Scheme from sponsoring employers in the long and short term. We can also re-assess the appropriateness of the funding assumptions used in the 2018 valuation, including the outlook for future investment returns and the contribution increases scheduled for October 2021.

The timescale for completing the valuation as at 31 March 2020 provides the time to develop a full understanding of these issues. It will also allow us to take into account what happens in financial markets and the HE sector over the following 15 months ("post-valuation experience").

Proceeding as planned with the 2020 valuation means we do not need to take more immediate action in response to the significant impact current conditions are having on the Scheme's funding position, as set out above.

We believe this is beneficial for employers navigating current difficulties and avoids short-term actions that could have much broader consequences for the sector.

We are facing extremely difficult short-term conditions. But rest assured that any decisions we take through this period will be consistent with our long-term strategy and our legal, regulatory and fiduciary duties: to ensure members' benefits that have been promised are secure and will be paid when due, and to protect the sustainability of the Scheme.

We note recent guidance from the Pensions Regulator reflecting a pragmatic approach to defined benefit schemes carrying out valuations in current conditions and this gives some confidence in moving forward on this basis.

The Trustee's response to these challenging circumstances

We recognise that all employers in the Higher Education sector are under significant stress and focusing their efforts on responding to current events.

We have implemented our own business continuity and resilience measures as we have worked through the operational challenges. While we have reduced some service levels, we have been able to maintain all core business activities. All pensions continue to be paid and all contributions continue to be processed, without interruption. More information is on our website.

The critical importance of the covenant you provide to the scheme and the corresponding importance of the proposed rule change on employer exits

Our primary job as Trustee is to protect the pension promises you have made to our members. The stresses on the Scheme's funding position set out above emphasises how much we rely on the Scheme's covenant to make sure these promises can be kept, and to underwrite the risks involved in making new promises.

We need to know we can rely on this support for the long term, if we are to keep taking significant amounts of investment risk in order to attempt to generate returns and pay members' accrued benefits now and in the future. As a result, we are very focused on the evidence of employers' clear, ongoing and enduring commitment to the Scheme.

We have set out in the discussion document the additional commitments that we need if we are to continue to take a long-term view and assess the reliance we can place on you over a covenant horizon of 30 years or more. This includes a rule change on employer exits that reinforces your commitment to the Scheme.

We will shortly be sharing additional information with UUK on the rationale for these measures and, specifically, the need for the permanent rule change to ensure we enter a Technical Provisions consultation on the strongest basis possible.

Current conditions illustrate starkly how important this is: without a rule change, we will need to reduce our appetite for investment risk. This will have a material impact on the valuation outcome.

This was a critical factor in concluding the 2018 valuation and is the most important issue for us in carrying out the 2020 valuation.

Next steps

We recognise that these are very challenging times for our sponsoring employers and the HE sector overall. We will continue to work with all our stakeholders on these issues and will keep the timetable and process for the valuation under regular review. We will be flexible where we can and will respond to regulatory guidance as it becomes available.

Bill Galvin, *Group Chief Executive*