Key Terms and Quick Summary

of the technical discussion document ‘Methodology and risk appetite for the 2020 valuation’ issued to USS sponsoring employers on 9 March 2020

Key terms we use

Assets

The investments the Scheme owns, like shares, property and government bonds. Assets generate the money we need to pay benefits and expenses now and in the future. ‘Assets’ can also mean the *total value* of our investments as a figure in pounds.

Covenant

The extent of the employers’ legal obligation and financial ability to support the Scheme now and in the future.

Deficit recovery contributions (DRC)

An estimate of the contributions required to repair any funding shortfall (deficit) in the Technical Provisions identified by a valuation.

Discount rate

A calculation applied to future liabilities to show their present-day value. We work out this rate using a prediction of investment returns and a margin for prudence.

Dual discount rate

A discount rate that combines two different rates: one for members’ benefits pre-retirement and one for members’ benefits post-retirement.

Future service cost (FSC)

An estimate of the contributions required to meet the ongoing cost of new benefits.

Liabilities

An estimate of the money that the Scheme has to pay out, now and in the future - calculated based on a ‘snapshot’ of the Scheme at the Valuation Date. When talking about Scheme funding, we express liabilities as the present value of the money we will have to pay out from a certain date onwards.

Methodology

The way we process information to produce the valuation outcome. The information that the methodology processes is about members, employers, the Higher Education sector, global financial markets, and the global economy.

Recovery Plan

A plan to repair any funding shortfall (deficit) at the Valuation Date in a set amount of time through the payment of deficit recovery contributions (DRCs).

Risk appetite

Willingness to take risk in the way the pensions promised to members are funded, now and in the future. This can be the willingness of employers, the Trustee, or members.

Schedule of Contributions
The contributions we need for the Recovery Plan plus the contributions we need to be able to fund future pension benefits being built up.

Technical Provisions (TP)
An estimate of the Assets we need to pay the pensions already promised. This estimate is based on the Schedule of Contributions and prudent assumptions about future investment returns.

Valuation
An assessment of the Scheme's financial position, carried out by our actuary. It is a budgeting exercise that establishes a plan for how, at the Valuation Date, the Scheme will generate enough money to be able to pay the pensions that members are expecting, now and long into the future. Schemes must carry out full valuations at least every three years.

Valuation Date
This is the date we must use by law to calculate the Scheme's Technical Provisions when carrying out formal valuations. For the 2020 valuation, this is 31 March 2020.

We/the Trustee/the Trustee Board
The people responsible for the management and administration of the Scheme.

You/Employers
The sponsoring employers of USS – the institutions whose employees or ex-employees are members (or prospective members) of USS.

Quick Summary of the discussion document

Introduction

The 2020 valuation will establish whether we (the Trustee) believe the Scheme will have enough money for us to be able to pay the pensions that members are expecting, now and long into the future. To do this we will use figures that apply on 31 March 2020 – the valuation date.

The discussion document sets out our thinking so far on how we could carry out the valuation in line with legal and regulatory obligations. It also discusses the key factors that will affect the result of this valuation.

We have taken no decisions at this early stage. We will formally consult Universities UK (UUK) on the Technical Provisions, the Schedule of Contributions and the Recovery Plan later this year.

This document is intended to encourage and focus discussions, and to build understanding and evidence, as we need to understand where employers stand on the issues it covers to inform our subsequent approach.

Methodology

The methodology sets out how we process information to produce the results of the valuation.

The methodology we have put forward for discussion follows certain principles about the level of risk, balancing long and short-term views, and being fair to members across generations. The methodology has to balance other factors too, so that the Scheme's structure can be transparent, flexible and stable.

We have also looked at the financial support employers give to the Scheme and the risks they, and we, could take.

The approach we've presented considers a 'dual discount rate'. This is potentially a way to better reflect the difference between pension promises that are not yet in payment and those that are; it could lower the contributions the Scheme needs for future pension promises, compared to using a single rate.

Covenant

We need to know how much support employers can give the Scheme in future – their 'covenant'. A stronger covenant means our investment strategy can take more risk, which can reduce the contributions we need from employers and members.

We are aiming to secure our 'strong' covenant rating and to be confident that it will stay strong for at least 30 years. This should be possible if employers agree to the package of measures discussed during the 2018 valuation. Otherwise, we expect the covenant to get a lower rating, which would mean taking less risk.

Risk appetite

The support employers collectively give the Scheme can be stated as the amount of money they could in theory provide if risks are not rewarded; for example, if investment returns are much lower than expected. To support this discussion, we have illustrated an amount of around £65bn for a 'strong' covenant rating and a lower estimate for the covenant not being 'strong'.

We know that employers wouldn't be able to commit that amount solely to USS, because they have other business risks to manage. So we need to understand how much they *would* be willing to support – their 'risk appetite'. This will be a key consideration for the valuation and is something we are asking them to consider in discussing this document.

Investment strategy

Our investment strategy guides our day-to-day investment decisions so that we meet the Scheme's goals. It is informed by views on the covenant, risk and economic trends.

The 'dual discount rate' approach we have put forward for discussion implies a lower risk, lower growth investment strategy covering members' benefit *from* retirement and a higher risk, higher growth strategy covering members' benefits *before* retirement.

Our main measure of the risk in the Scheme's funding is the cost of moving to a low-risk strategy known as 'self-sufficiency' – though we don't plan to actually make that move. We have illustrated a measure that ensures the cost of moving to such a strategy is kept within the 'risk appetite' of employers.

Indicative results

While no decisions have been made at this early stage, we have had to make certain assumptions in this document in order to illustrate the approach we've put forward for discussion. These assumptions are based on information we used for the 2018 valuation (demographics) and financial analysis from 31 December 2019. They show the effect of factors like the covenant, risk appetite, and the new way the Government plans to work out the RPI measure of inflation. The results we've illustrated may change when we review the analysis and assumptions based on a 'snapshot' of the scheme on 31 March 2020 (the valuation date).

There are extra measures that employers could take to strengthen the covenant with a view to potentially reducing the regular contributions we need.

What we are asking from employers

We are asking employers to share their views on the questions this document raises by 5pm on 17 April 2020.

The specific questions we're asking are in Section 8 of the full document.

The discussion document includes an Executive Summary, which gives more detail than this Quick Summary.