3 March 2021

USS

USS briefing: Why we decided to proceed with the 2020 valuation

- In early 2020, when preparations for a valuation were already well under way, the Coronavirus pandemic began to take hold. Funding conditions were very volatile: financial markets reacted to the disruption and uncertainty, and entire sectors of the global economy shut down to help contain the spread of the disease.
- At that time, we believed that continuing with the 2020 valuation was the most measured response to addressing the Scheme's deteriorating funding position: it avoided more immediate and impactful measures, such as increasing contributions, and it is likely we would have decided to hold a valuation if preparations for one weren't already under way.
- Nearly 12 months later, we still believe that continuing with the 2020 valuation is the most measured response because we now expect investments to produce less income than we assumed in the past, which means our members' pensions are at risk of being under-funded. That is something we have to investigate and act upon.
- By law, a valuation would have been required by 31 March 2021 in any event.

Considering the 2020 valuation

When we filed the 2018 valuation in the autumn of 2019, we made a commitment to carry out another valuation in 2020.

This recognised the Pensions Regulator's (TPR) concerns about the economic backdrop at that time and gave UCU and UUK[1] the chance to consider the second Joint Expert Panel (JEP) report and potentially agree ways to mitigate or avoid October 2021's contribution increases (agreed as part of the 2018 valuation).

Considering the funding position

In its letter of October 2019, shared with UCU and UUK, TPR set out its high level expectations for the 2020 valuation. It also made clear that it expected us to put in place a monitoring and action framework due to a "significant deterioration" in the funding position since 31 March 2018 and "to react swiftly and in a meaningful way" to further deteriorations.

TPR expected a mitigating action to be triggered – such as increasing contributions or holding a full valuation of the Scheme earlier than planned – if a funding metric breached a predetermined threshold.

However, and as set out in our associated consultation, the Trustee Board did not wish to "fetter its discretion" under legislation and trust law through a pre-commitment to take a particular course of action on the occurrence of a specified event.

Instead, under our framework, any decision on mitigating actions involves first assessing and balancing a number of different factors and reviewing all the monitoring metrics in aggregate.

As a result, the most appropriate response to a deterioration in the funding position is not automated or prescribed and must be considered after assessing all the relevant facts, data and circumstances.

[1] At the completion of the 2018 valuation, UUK said: "This provides a fair, short-term solution, acceptable to The Pensions Regulator and the USS Trustee, which allows time for the Joint Expert Panel to suggest options for the longer-term. We look forward to working with UCU to jointly consider options for the 2020 valuation."

Considering COVID-19

In early 2020, with preparatory work for the next valuation already well under way, the Coronavirus pandemic began to take hold and the Scheme's funding position deteriorated further: in mid-March 2020, the value of assets backing existing USS pensions fell by £10bn to £64.3bn and a key funding metric – relating to the self-sufficiency deficit and employers' affordable risk capacity (see Appendix A) – hit a trigger for action.

We had to consider how to respond. The mitigating actions available to us under the monitoring framework included:

- holding a valuation with an effective date of 31 December 2019 or accelerating the 31 March 2020 valuation
- calling for higher contributions from employers sooner than October 2021
- accelerating the 'de-risking' envisaged under the 2018 valuation
- a combination of these actions

We took advice from the Scheme Actuary in deciding that the most measured response was to avoid taking any immediate short-term action and to continue with the 2020 valuation as planned. This meant we could assess all the relevant facts, data and circumstances in a calm and considered way and review our long-term funding assumptions.

Even if we had not planned to hold a valuation as at 31 March 2020, it is highly likely we would have concluded that a valuation was the most measured way to respond to and investigate the pandemic's impact on the Scheme's funding position.

Our decision avoided more immediate and impactful measures, such as increasing contributions, when the HE sector was under extraordinary pressure from the pandemic. We reported all of this to employers at the end of March 2020.

Considering the valuation date

There are several reasons why we haven't changed the effective date of the valuation, despite suggestions that doing so could mitigate the impact of the pandemic.

Firstly, TPR expressly cautioned trustees of schemes with valuation dates on or around 31 March 2020 against 'cherry-picking' more favourable dates in its 2020 Annual Funding Statement[2].

But, in any event, post-valuation date experience (positive or negative) will be considered in agreeing the funding assumptions and the Recovery Plan. This is consistent with TPR guidance and one of the core recommendations from the JEP's first report ('Ensuring the valuation uses the most recently available information').

So, even if we had decided to hold a valuation as at an earlier date, we would still have had to consider the subsequent impact of COVID-19.

[2] *"Trustees should consider very carefully why they believe [changing the valuation date] is in the best interest of their members and the impact of any such change on member security, for example if the current conditions prevail for a long period. If they decide to change the valuation date they should do so having obtained and considered legal and actuarial advice, and consider taking account of changes in the investment markets and employer's covenant since the new date of the valuation. Trustees who take this decision can expect us to question their reasons for the change."*

Conversely, a valuation held as at a *later* date would be based on conditions that, at 31 December 2020, were no less challenging. As is indicated by our Financial Management Plan (FMP) reports, a return to pre-pandemic asset values has been offset by a poorer outlook for future investment returns. This leads to a poorer funding position over all.

Considering our duties

We have specific duties under common law, statute and the regulatory regime, including ensuring that the Scheme has enough assets to cover its liabilities (as required under the statutory funding regime) so that members' benefits can be paid when they fall due.

Unlike 'unfunded' and so-called 'pay-as-you-go' schemes like the Teachers' Pension Scheme, we do not fund the Scheme on the basis that today's contributions pay today's benefits. If our own modelling and wider market sentiment suggests that investments will generate less income over the long-term than we assumed in the past, our members' pensions are at risk of being under-funded. This is reflected in the deficit (in respect of benefits *already* promised) and in the contributions we need to generate the returns that will pay benefits in future.

These are developments we would have to investigate and act upon in order to make sure that our members' benefits can be paid when they fall due.