Dear Colleagues,

The USS Trustee has issued a discussion document on the approach it proposes for the 31 March 2020 valuation of the USS scheme, and has asked for employers’ views by 17 April. Following discussion at the Pension Communications Group, I am now writing to seek your views to inform the University’s response to this latest consultation. I apologise for contacting you during this exceptionally difficult time, and for the length of this email, but it remains important that the University’s views on pensions are shaped by input from across the University community.

My last email of 4 February sought your input to the University’s response to the second report from the Joint Expert Panel (JEP) of UCU and UUK representatives on the way ahead for the USS pension scheme. Feedback received supported the overall direction of travel proposed by the report, and we relayed that message to UUK. Since then, discussions have been ongoing between UUK, UCU and the USS Trustee, facilitated by the JEP chair, Joanne Segars. These have focussed on building a common understanding on the future of the scheme, the 2020 valuation and governance issues. Joint statements have been issued following each meeting, available on the JEP website, and reported progress includes:

- The drafting of a new scheme purpose statement;
- The development of shared valuation principles;
- The establishment of a 2020 Valuation Methodology Discussion Forum, with representation from the USS Trustee and nominees from UCU and UUK;

The consultation documentation now issued by the USS Trustee is separate from these talks, and relates to the methodology proposed by the Trustee for the March 2020 valuation. It is available on the USS Website and the University’s Pensions webpage. It describes a complex set of moving parts, with trade-offs between risk appetite, investment strategy, volatility and benefit design. The Trustee has proposed a dual discount rate, reflecting one of the main recommendations of the JEP2 report, but beyond that it is not readily apparent the Trustee’s proposed approach will reduce the volatility that proved so problematic with Test 1. Overall, there appears still to be a reluctance to acknowledge that the unique nature of USS justifies a different, and much longer-term focus.

The consultation poses five questions for employers. Following discussion at the Pension Communications Group, the following outline responses are proposed, and your comments on these would be welcome.

1. **What are your comments on the proposed new methodology?**
   
   [The new methodology is an improvement but issues remain. Although Test 1 has been dropped, apart from the welcome acceptance of the principle of dual discount rates, it is not apparent how the new valuation methodology addresses the oversensitivity of Test 1 to short term market fluctuations. In particular the approach to choosing the discount rates will be critical. The work of the JEP’s Valuation Methodology Working Group needs to be concluded and feed into these considerations before the 2020 valuation methodology is finalised].
2. Do you support the measures to ensure the covenant is “Strong” agreed as part of the 2018 valuation on: i) the permanent rule change on employers exiting the Scheme to underpin a 30-year covenant horizon; ii) debt monitoring arrangements; and iii) pari passu security on new secured debt?

[Few if any employers are in a position to consider exiting the scheme given that, under the scheme rules, they would have to pay their full forward liabilities running into many millions (known as Section 75 contributions). Efforts would be better invested into agreeing a valuation methodology that reflected the unique nature of the scheme. We have already indicated that debt monitoring arrangements are no more intrusive than other existing reporting requirements. On Pari Passu (an arrangement whereby the USS Scheme would have first call on any new secured debt), we have accepted this in principle, but need assurances on how the regime would work in practice, in particular how it would interrelate with non-standard debt and finance structures. The working group of UUK and USS representatives is making progress towards this, but has not yet reached a final position. Overall, we have concerns that the boundary between “strong” and “tending to strong” in relation to the Covenant does not adequately reflect the particular characteristics of the USS scheme, in particular in relation to the disproportionately severe measures that kick in under the “tending to strong” categorisation.]

3. Do you wish to consider additional tangible covenant support measures to further strengthen the covenant and potentially support additional risk?

[In principle we are not opposed to this, but believe it should be for the Trustee, not individual institutions, to set out what the options might be, and to be clear about any broader consequences, for example on scheme rules]

4. Do you have initial views on whether you would be comfortable with an investment strategy that took a moderately larger amount of risk in the long term?

[In principle yes, but only if this were accompanied by the kind of governance reforms envisaged in the JEP2 report]

5. Based on the example approach to managing risk, as set out in this document, what is your risk appetite? In other words, do you have initial views as to how much of your risk capacity you are comfortable for us to rely on in supporting the Scheme, in the knowledge that there are adverse scenarios in which this may be called? (You may wish to express this as a contribution of x% of salary, or a monetary amount, paid over y years.)

[The way this question is posed places the onus on employers, when it should be for the Trustee to set out realistic options. If taken at face value, this would mean institutions setting aside funds that would otherwise be invested in staff and infrastructure, which is not necessarily conducive to the long term health of the sector, or indeed of the Scheme.

The Pension Communications Group also discussed whether, in the light of recent turmoil in global stock markets as a result of the Coronavirus emergency, we should call for the March 2020 valuation to be postponed. A range of views was expressed. Under legislation, a revaluation is not strictly necessary until 31 March 2021 and it could be argued that the exceptional circumstances that we are currently facing would render a 31 March 2020 valuation unrepresentative of the longer-term situation and further damage the scheme for the subsequent three years.

Against that, pension schemes should be able to demonstrate their resilience against bad news, and it could be seen as misleading to choose a valuation date on the basis of economic circumstances. Whilst the Coronavirus crisis has had huge impact on everyone’s daily lives, the decline in asset prices over the last few weeks, whilst steep, is not (so far) without historic precedent - (the fall in the US market has returned it to the level it was at the end of 2018, a smaller fall than the crisis in 2007/8).]
In addition, a postponement to the 2020 valuation would certainly trigger the Trustee’s “backstop” contribution increase to 34.7% from October 2021 for at least a year until a 2021 valuation was finalised.

We would welcome your views on this, and on the outline responses to the questions above, by close of business Friday 10 April. Please send your response to vpgov@st-andrews.ac.uk and title it “USS Pension Consultation”.

Kind regards,

Alastair Merrill

Vice-Principal (Governance)