Employers Pension Forum briefing: USS and related Q&As for HEIs

1. Why are changes to pension schemes being proposed?
Increasing life expectancy (longevity) and a range of other factors mean that changes have been necessary for pension schemes all over the UK. This has not only affected private sector pension schemes. All pension schemes which operate on a "final salary" basis, like the USS, TPS and LGPS have been under increasing pressure in recent years.

Initial reforms have already been put in place for a range of public sector schemes, including the Teachers' Pension Schemes (TPS and STSS), the Local Government Pension Schemes (LGPS and LGPSS), the NHS scheme and the Civil Service Pension Scheme. These reforms have included, for example, increasing the retirement age to 65. However, further changes to these schemes are expected to deal with their rising cost pressures, as the Chancellor indicated in the December 2009 Pre-Budget Report.

The Universities Superannuation Scheme (USS) scheme was set up in 1974 and has not been reviewed since then. USS has therefore been operating for over 35 years, largely unchanged, and is, inevitably, in need of modernisation.

Most final salary schemes for private sector companies (around 90%) have already been closed to new entrants and replaced by either a different kind of 'defined benefit' pension arrangement, such as career average or, more commonly, organisations have chosen to adopt money purchase schemes, described as 'defined contribution' schemes, instead.

2. Why are changes to USS being considered now?
Changes will be needed to ensure the sustainability of all the major pension schemes operating in HE but it is the USS that is facing the most immediate challenges. USS has been a very successful scheme over the last 35 years, and this is an opportunity to ensure the scheme's future for the next 35 years. If we fail to act now, then the financial pressures on the scheme will increase and may threaten future sustainability.

USS operates as a fully-funded private sector scheme. In fact, it is the second largest such scheme in the UK that is still open to new members. The most recent valuation of the USS in 2008 demonstrated that it does face a significant funding gap and additional anticipated cost pressures for the coming years have indicated further funding challenges that will have to be addressed. It is now essential that the HE sector acts to ensure the viability of USS, as an important and valued benefit for both current and future members.

The increasing cost pressures on USS have arisen for three main reasons: USS beneficiaries are living longer and investment returns have not been as good as anticipated. In addition the significant pay rises for HE staff from 2001 to 2008, including the increases in pay under Framework Agreement and the 2006–09 pay deal, were well in excess of the funding assumptions made by the USS actuaries.

3. Why is longevity a problem for the USS?
When the scheme was established in 1974 the average retirement age for a man was 65, and life expectancy was between the ages of 67 and 71. Now the average retirement age for USS members is 62, and life expectancy is between the ages of 77 and 81. What this means is that initially the scheme needed to build up a fund that would pay out benefits for 2 to 6 years, but the scheme now needs there to be sufficient funds to pay a pension for a period of between 15 to 19 years.

However, longevity isn't just a USS issue. For example, in response to our ever-increasing life expectancy, the Government plans to increase the state pension age in stages from to 65 for all women by 2020, and then to 66 for those men and women born in the 1960s, 67 for those born in the early 1970s and 68 for those born from 1978 onwards by 2046. These changes in the state pension age are expected to be matched by similar changes in pension ages in occupational pension schemes. In addition, the Government has indicated that it will review compulsory retirement age issues.

An increase in the retirement age to 65 in USS is under consideration by the Joint Review Group (JRG). Although this is an essential change in helping to account for increased longevity other reforms are needed to meet the wider cost pressures facing the scheme.

4. Is doing nothing an option?
No. The present scheme will become unaffordable. Every 1% increase in employers' contribution costs USS institutions in excess of £60m each year. Employers have already been obliged to fund a 2% increase (from 14% to 16%) in contributions from October 2009, a figure calculated as a necessary increase following the last valuation in March 2008. The current employer contribution rate is close to the limit of what is affordable. Adopting the changes to the scheme proposed by the employers will mean that the scheme will be affordable and sustainable in the future.

However, it is important to note that current USS members' pension benefits already accrued up to the date of any changes would be protected. The proposed changes relate to how future service is accrued.

5. Why can't employers continue to pay the increases to make up the USS funding shortfalls?
The pressures on HEIs' funding are such that the current employer contribution rate is up to the limit of what is affordable. The employers, represented by the Employers Pensions Forum, are seeking to retain a high quality and attractive pension scheme while containing cost pressures and ensuring that it remains affordable.

There are wider political considerations that need to be taken into account. The sector will find it difficult to justify using public funds to meet further increases in pension costs particularly when the Government has recently announced that, from 2012, employer contributions to the public sector schemes will be capped.

6. Are HEIs using the recession as an excuse to reduce the amount paid into the scheme?
No. The need for change had been identified prior to the current recession and the announcement of cuts to higher education funding. The changes proposed by the Employers Pensions Forum will reduce future risks to the scheme and to prevent employer costs increasing further. The employers are not seeking a reduction in their contribution rate. They will continue contributing at the current rate of 16%, which was increased from 14% in October 2009.

7. Are the employers planning to take money out of USS?
No. The HE employers have never taken 'a pensions holiday' – when employers suspend payments into a scheme - in the past and are not intending to reduce the 16% employers' contribution. The strict regulations introduced after the pensions scandals of the 1990s mean employers are unable to withdraw money from the scheme even if they wished to do so. However, these pensions holidays have been common practice across private sector pensions schemes.

8. The recession won't last forever. Shouldn't we just wait and see?
Doing nothing is not an option. Pension schemes always have to be funded on a careful assessment of future liabilities. There is accumulating evidence of funding pressures on the

scheme that need to be addressed now. For example, because pay growth between 2001 and 2008 exceeded the USS actuaries' assumptions the funds accumulated to pay for pensions were lower than they should have been (past service deficit). The scheme will need to secure the funding to plug this gap over time in order to ensure that the pensions based on these higher salaries can be paid out.

The current recession and recent stock market falls were unpredicted. Stock market values may recover over time, but nobody can be certain of this. In the meantime, the other challenges the scheme faces won't simply go away. Many of these challenges are not exclusive to USS and impact on all pensions schemes, for example increasing longevity, which means that we may all be drawing our pensions for longer.

9. Is there a danger that sector pension arrangements such as USS will collapse?
No, the changes currently under discussion will help to ensure the long term financial viability of the scheme. Without change, the cost of an unsustainable pension scheme would be disproportionate and unaffordable, particularly when the sector is facing significant cuts in public funding.

10. I am due to retire soon – are USS proposed changes of particular concern to me?
The benefits you have already accrued as a member would be unchanged. Proposed changes only relate to future service benefits. The purpose of the proposed changes to USS is to ensure the sustainability of the scheme for all.

11. What are the possible changes currently under consideration at the USS JRG?
The details of the discussions at the USS JRG are currently confidential. However, in a recent speech to key stakeholders Sir Andrew Cubie, the independent chair, said that the following areas of change were under consideration: looking at alternative benefit outcomes that could be offered through a 'Career Average Revalued Earnings' (CARE) scheme for future service; a later retirement age for payment of benefits; greater cost-sharing, for example offering members the opportunity to pay more to retain pension arrangements; and flexible retirement options that could enable employees in future to step their way into retirement.

The USS JRG will be preparing a communication to scheme members in January in which it will explain some of the issues under discussion

12. What is a CARE scheme?
CARE stands for 'Career Average Revalued Earnings', and, like a 'final salary' scheme, this is a type of 'defined benefit' pension scheme, i.e. scheme members are promised a defined level of pension when they retire or leave on a formula generally related to their salary and years of service. Under a CARE scheme a member's pension is based on the average pay earned over the period of membership, with each year's pay revalued in line with RPI. This means that someone who gets a big pay rise late in their career will not have their entire pension based on this higher final salary. However, the benefit outcomes for some members can be as good under a 'CARE benefit' approach as a 'final salary' approach. The 'CARE' method is considered to be fair and equitable because it reduces substantially the risk to USS from members who receive higher than normal pay increases, particularly near to retirement age.

13. Is there a big a 'black hole' in the USS scheme's finances?
There is no 'black hole' in USS. However, one of the consequences of the regulatory arrangements is that pension fund trustees are legally required to calculate the gap between a pension fund's assets and projected liabilities every three years. It really depends on the level of the stock markets on that specific valuation date as to how big a deficit or a surplus appears in the fund. The next valuation of USS is in March 2011 and if the markets have not

recovered sufficiently by that time, USS will have a 'deficit'. In other words, USS will be seen as not having enough funds to cover its projected past service liabilities. In these circumstances the Pensions Regulator would normally require additional employer contributions to cover this 'gap' although these can often be made over an extended period. This would be in addition to any increase in contributions to cover the cost of paying for pension benefits in the future.

It is expected that the Pensions Regulator will look favourably on USS as it has the strong support of the HEIs, but even allowing for this the Regulator is still likely to seek additional contributions. Currently, the increase could be as high as 8%, depending on the size of the funding gap and the length of time over which the Regulator allows USS to make good any deficit on valuation. To put that into financial terms, an 8% increase would cost the USS institutions as much as an additional £480m per annum. This is why the need for change is so compelling – this is about future accruals.

14. Other HE pension schemes, such as the Teachers' Pension Scheme, still operate on a final salary basis. Why won't this work for USS?
The Teachers' Pension Scheme (TPS) is a public sector government-backed scheme and it is not funded – i.e. funds are not built up to meet future pension payments. Contributions paid in by currently employed members are used to pay the pensions of retired members and the Government, through the taxpayer, pays for the shortfall. Currently the TPS is technically in deficit, as active members pay in £3 billion per annum, whilst £4 billion per annum is paid out to retired members. It remains to be seen if the unfunded public sector schemes will remain as 'final salary' schemes going forward.

The Chancellor announced in his recent Pre-Budget Report that public sector pensions schemes will be 'capped'. We don't yet know the details of this but it is likely to mean either greater cost-sharing by employees or changed benefits. All public sector pension schemes are under financial (and political) pressure and, in their present form at least, are increasingly being regarded as unaffordable, and it is likely that we will see proposals for further changes following the General Election.

USS is a private sector scheme and is not allowed to operate on an unfunded basis; USS has to carry out an actuarial valuation every three years to check that the funds built up are sufficient to meet the cost of pensions and benefits accrued by active members. Many pre-92 universities have local pension schemes for their support staff and these are facing most of the same cost pressures as USS. Each institution with such a scheme is autonomous and has to determine the most appropriate pension arrangements for their staff.

15. Is the USS scheme going to be closed to new members?
No. The aim is to maintain an affordable and attractive defined benefit scheme that remains open to all current eligible staff.

16. Is this the beginning of the end of the HE defined benefit scheme?
A number of pension experts have predicted an end for final salary pension schemes and this is a common headline maker in the media. Indeed 90% of final salary pension schemes have already closed in the private sector. However, EPF and the USS Joint Review Group are identifying measures that would help USS continue as a defined benefit scheme for the foreseeable future.

17. Why am I only finding this out now?
The JRG spent much of 2009 analysing the details of the complex challenges facing USS and studying the most up-to-date data. The EPF work is now moving into a new phase where the focus will be on decisions and outputs. The start of 2010 is significant because we are now at the point in the agreed timetable which requires agreement between the employers

and the UCU on the nature of the risks that face the scheme. This should provide the foundation on which decisions about the future changes will be made. A further EPF report to scheme members and updates on progress will be made as soon as possible.

18. What is the timescale and mechanism for any changes?
At this stage we can only confirm timescales for USS. These are: agreement on the packages of reforms for USS – April 2010; consultation with scheme members, May 2010; implementation of USS changes to begin – October 2010. However, other pension providers operating in HE are expected to be evaluated soon, LGPS and TPS are both due in 2010.

19. How would changes to USS be agreed?
For USS, any decisions on changes in the benefits under USS must be taken by the USS Trustees and Joint Negotiating Committee (JNC). The JNC is made up of 5 UUK appointed members, 5 UCU appointed members and an independent chair (currently Sir Andrew Cubie).

The UCU appointed members are there to represent all USS members, regardless of whether they are members of UCU. Sir Andrew has advised that it is his intention to secure an agreed way forward in the JNC on future changes and has the casting vote in this arrangement. The USS Joint Review Group has been set up as a sub-group of the JNC, and any final decisions, or proposals agreed within the Joint Review Group will be referred to the JNC. Assuming that agreement to the changes with UCU members in the Joint Review Group goes ahead, then the process at JNC level should run smoothly.

20. Where can I find out more about pensions in HE?
HEIs have named officers (usually the pensions officer) with specific information pertaining to that institution while pension scheme providers' websites carry more generic information. The USS website http://www.uss.co.uk houses information, including a section with its own set of Q&As http://www.uss.co.uk/UtilityPages/Pages/FAQs.aspx .

The following publications may be of interest:
The Hewitt report, Strategic enquiry into the pension arrangements for the higher education sector, was prepared for Universities UK/ UCEA/ GuildHE in 2007.
The Peter Thompson report, Pensions Provision in the Higher Education Sector, was prepared in 2008.
These can be found on UCEA's website: go to 'Pay and Conditions' and then 'Pensions':
http://www.ucea.ac.uk/index.cfm/pcms/site.Pay_and_Conditions.pensions.pensions/

The BUFDG (British Universities Finance Directors Group) Pensions Reports for 2006 and 2007, written by Professor Michael Bourn, can be accessed via BUFDG's website:
http://www.bufdg.ac.uk/special/pensions/reports/?a=cm

The Independent Chair of the USS JNC and JRG, Sir Andrew Cubie addressed the UCU, UUK and USS Institutions at meetings towards the end of 2009. At present Sir Andrew's speech can only be accessed on the secure area of the USS website, which can be accessed by HEIs' named officers (usually the pensions officer).

The Employers Pension Forum plans to construct a website with up-to-date information. This should be launched early in 2010 (as soon as funding is secured) and aims to host pensions information for all schemes within the sector.