Proposed changes to USS – what the changes might mean for you

The employers’ proposals for reform of the USS were published on 9 October 2014. To illustrate how these proposed changes to USS might affect your pension, we have provided examples of possible outcomes for five different types of USS member. These generic examples were calculated by USS using assumptions about future salary progression and investment returns that have been jointly agreed in discussions between UCU and the employers.

When considering these examples it is worth bearing in mind some key points about the proposed new benefit structure:

• Around two-thirds of current members would build up future benefits on their whole salary in the Career Revalued Benefits (CRB) section; most of the remaining members would build up a significant portion of their future pension in this section. CRB provides a defined level of pension which increases each year in payment and is payable for life, plus benefits for your dependants on your death.

Figure 1: Relative proportion of salary covered by DB and DC

Abbreviations

CRB: Career Revalued Benefits (sometimes referred to as career average)
DB: Defined Benefit
DC: Defined Contribution
FTE: Full-time equivalent
USS: Universities Superannuation Scheme

Data source: USS

See page 5 for the legal status of this document
Figure 2: Salary profile of USS membership (currently in final salary section) at 31 March 2014
• Members currently in the final salary section, whatever their salary, would have their existing pensions protected at the point the changes come into effect. Benefits for past service (i.e. up to the date of change) for existing final salary members would be calculated based on their pensionable salary at the date of the change (calculated as if they had left service at that date). From this date these existing pensions would be revalued each year in line with the consumer prices index (CPI).

• Members currently in the final salary section at the point the changes come into effect would move into the CRB section for future accrual of their pension, up to a salary threshold of £50,000.

• Members currently in the CRB section would continue to have their past service revalued in line with the CPI. Those with salaries below the £50,000 salary threshold would see no change in the way their defined benefit (DB) pension builds up in the future.

• Those earning over £50,000 would build up future defined benefits in the CRB section on their salary up to the £50,000 threshold. Pension on salary above the threshold would be provided in a new defined contribution (DC) section with an employer contribution of 12% and an employee contribution of 6.5%.

• The DC section provides a flexible cash sum you can use as you wish on retirement. For example, you could take the entire amount as cash, though you would have to pay tax on part (generally 75%) of it, use it to buy additional pension, or keep it invested and withdraw ad hoc amounts as and when you need them.

• The DC fund illustrations in the examples which follow are based on an investment return of 5.5% a year; the actual rate of return could be higher or lower than this.

• In option (b) of each example we have shown how much pension you might be able to buy with approximately 75% of the DC fund used to purchase an annuity. If you decide to use your DC fund to buy a pension with different features, for example with no adjustment for inflation or provision for death benefits, it could be noticeably higher than that shown in the example. It is your choice how you use your DC fund.

• No matter how much you earn, you would have the opportunity, if you wish, to pay in an extra 1% of salary, which would be matched by your employer to build up an additional flexible DC fund.

• Most importantly, if USS continues as it is, unreformed, there is no doubt that it will rapidly become unaffordable for members as well as employers as contributions would need to increase significantly. The employers are proposing changes that will allow the USS to continue to provide members with
the security of knowing that a large portion of their pension will come from the defined benefit CRB section, plus the flexibility of DC benefits on any earnings above a salary threshold or provided through the 1% match.

- The employers’ proposals illustrated below aim to offer the best possible deal for employees, taking account of the funding position of the scheme and the constraints imposed by the USS Trustees. These proposals are subject to the employers being able to agree appropriate funding arrangements with the USS Trustees - and of course the Pensions Regulator - and separately to negotiation with UCU in relation to the final benefit design. There will also be a consultation undertaken by employers with affected employees, and so there may yet be further changes before a final decision is taken in 2015.

- In the next section we explain what would happen if it is not possible to agree an affordable package of reforms and the likely consequences.

These examples are purely for illustration. There are many ‘unknowables’ that will affect the eventual outcome – future salary increases, inflation, investment returns on DC funds – all of which have to be predicted for the purpose of these calculations.

**What happens if USS benefits are not reformed?**

Legal responsibility for making sure the USS can meet its liabilities lies with the USS Trustees. In turn, the Pensions Regulator is charged with making sure that the Trustees are managing the scheme in a prudent manner and has the power to require the Trustees to take certain actions, especially where there is a funding deficit.

Without significant reform of the USS the Trustees will need to sign off the 2014 triennial valuation based on their assessment of the cost of continuing to provide the current benefit package. Under the current cost sharing arrangements between employers and employees this would mean an immediate increase in employer contributions to around 25% and member contributions to around 12%. This would mean less take-home pay for scheme members, on top of the increased National Insurance contributions which the government will implement in 2016. Increasing employer contributions to USS by 9% (approximately £600 million per year) would also mean that USS member institutions would need to reduce their long term expenditure by actions such as a recruitment freeze, redundancies, salary restraint, deferring capital investment or by selling assets.

In addition, the Trustees concluded that some institutions might be unable to meet the cost of employer contributions if they rose above 25%. If the financial viability of these institutions was then threatened it is virtually certain that the Pensions Regulator would step in and take strong action to force scheme changes. Under the current proposals employers would pay additional contributions of around £135 million a year to the scheme in order to help reduce the deficit - but this alone, without benefit reform, is not enough.
Important information about the legal status of this document

This analysis, including any appendices, has been prepared at the date given for illustrative purposes only, using a range of assumptions which are available on request. As such, it should not be used or relied upon by any person for any other purpose and all third parties are hereby notified the report shall not be used as a substitute for any enquiries, procedures or advice which ought to be undertaken or sought by them.

This report was based on data available to us as at the date of the report and takes no account of developments after that date. With respect to data/information on which we have relied in producing our report (including that from third parties), it is not possible for us to confirm the accuracy or completeness of such data/information. The information is based on the face value of information provided to UUK by or on behalf of third party sources and we have not verified the provenance, validity, completeness or accuracy of such information and give no representations or warranties in respect of such matters.

Whilst it is hoped that the current proposals will achieve the desired results highlighted in this document, neither the USS, Universities UK, Employers Pensions Forum for Higher Education or their advisers, or the participating employers, can give any assurances as to the future financial status of the scheme and, as a result, whether any further changes will be required to the scheme at some point in the future.
Example 1: New “fast progression” academic, 20 years’ future service
This example looks at a member who joins USS on the date the new benefit structure comes into effect, and leaves with 20 years of future service in the hybrid scheme. The member joins as a Lecturer (or equivalent) and then receives incremental salary increases and progresses with no delays through to the top of that grade with the maximum contribution points.

Comparison of future service benefits

<table>
<thead>
<tr>
<th></th>
<th>Employers’ proposals: member option (a)</th>
<th>Employers’ proposals: member option (b)</th>
<th>Current scheme projections (CRB section)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total pension</td>
<td>£9,200</td>
<td>£10,100</td>
<td>£9,700</td>
</tr>
<tr>
<td>Total lump sum</td>
<td>£27,600</td>
<td>£34,600</td>
<td>£29,100</td>
</tr>
<tr>
<td>Flexible DC fund</td>
<td>£27,900</td>
<td>£0</td>
<td>£0</td>
</tr>
</tbody>
</table>

Assumptions used in this example
- Past Service: 0 years.
- Future Service: 20 years.
- Employer contributes 12% into DC fund for salary in excess of £50,000 p.a.
- Member contributes 6.5% plus additional 1% of salary and receives 1% matching employer contributions.
- DC fund grows by 5.5% a year.
- Illustrated pension from DC fund provides same level of increases and dependant’s benefits as current USS CRB structure. It is based on long term annuity rates.
- No comparison is made with the current final salary section as the member would never have been eligible to join.

Salary progression
The member in this example joined on spine point 30 (starting salary £31,342), making annual (uninterrupted) future progression to spine point 46 and remaining at that point until retiring with a total of 20 years’ service (salary at retirement £50,200). All values are shown in today’s terms.

Member option (a) shows total future service benefits if the member chooses not to use the flexible DC fund to provide a pension.

Member option (b) shows total future service benefits if the member chooses to use the flexible DC fund of £27,900 shown in option (a) to provide an additional pension of £900 p.a. plus £7,000 cash.
Example 2: New entrant lecturer, 30 years’ future service

This example looks at a member who joins USS on the date the new benefit structure comes into effect, and later leaves with 30 years of future service in the hybrid scheme. The member joins as a Lecturer (or equivalent) higher up the pay scale than in example 1 and achieves six years of immediate incremental progression, remaining at this level for the rest of their career.

Comparison of future service benefits

<table>
<thead>
<tr>
<th>Employers’ proposals: member option (a)</th>
<th>Employers’ proposals: member option (b)</th>
<th>Current scheme projections (CRB section)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total pension</td>
<td>£14,100</td>
<td>£15,900</td>
</tr>
<tr>
<td>Total lump sum</td>
<td>£42,300</td>
<td>£55,800</td>
</tr>
<tr>
<td>Flexible DC fund</td>
<td>£55,800</td>
<td>£0</td>
</tr>
</tbody>
</table>

**Assumptions used in this example**

- Past service: 0 years.
- Future service: 30 years.
- Employer contributes 12% into DC fund for salary in excess of £50,000 p.a.
- DC fund grows by 5.5% a year.
- Member contributes 6.5% plus an additional 1% of salary and receives 1% matching employer contributions.
- Illustrated pension from DC fund provides same level of increases and dependant’s benefits as current USS CRB structure. It is based on long term annuity rates.
- No comparison is made with the current final salary section as the member would never have been eligible to join.

**Salary progression**

The member in this example joined on spine point 37 (starting salary £38,511) making annual (uninterrupted) future progression to spine point 43 and remaining on that point until retiring with a total of 30 years’ service (salary at £45,954). All values are shown in real terms.

**Member option (a)** shows total future service benefits if the member chooses not to use the flexible DC fund to provide a pension.

**Member option (b)** shows total future service benefits if the member chooses to use the flexible DC fund of £55,800 shown in option (a) to provide an additional pension of £1,800 p.a. plus £13,500 cash.
Example 3: Mid-career “fast progression” academic, 20 years’ past service, 10 years’ future service

This example looks at a member who joined USS as a member of the final salary scheme 20 years before the new benefit structure comes into effect, and then remains in the scheme before leaving with 10 years of service under the new hybrid scheme. The member started their career as a Lecturer and progresses through to the top of that grade with the maximum contribution points. They then spend the rest of their career at this level.

Comparison of total service benefits

<table>
<thead>
<tr>
<th></th>
<th>Employers’ proposals: member option (a)</th>
<th>Employers’ proposals: member option (b)</th>
<th>Current scheme projections (Final salary section)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total pension</td>
<td>£17,300</td>
<td>£17,800</td>
<td>£18,800</td>
</tr>
<tr>
<td>Total lump sum</td>
<td>£51,900</td>
<td>£55,700</td>
<td>£56,500</td>
</tr>
<tr>
<td>Flexible DC fund</td>
<td>£15,200</td>
<td>£0</td>
<td>£0</td>
</tr>
</tbody>
</table>

Assumptions used in this example

- Past Service: 20 years in final salary section (included in examples).
- Future Service: 10 years.
- Employer contributes 12% into DC fund for salary in excess of £50,000 p.a.
- DC fund grows by 5.5% a year.
- Member contributes 6.5% plus an additional 1% of salary and receives 1% matching employer contributions.
- Illustrated pension from DC fund provides same level of increases and dependant’s benefits as current USS CRB structure. It is based on long term annuity rates.

Salary progression

The member in this example has 20 years’ past service at the point at which the proposed scheme is introduced. The member joins on spine point 30 (salary £31,342) and makes annual (uninterrupted) progression to point 46 (salary £50,200), remaining at that level until retiring with a total of 30 years’ service. All values are shown in real terms.

Member option (a) shows total service benefits if the member chooses not to use the flexible DC fund to provide a pension.

Member option (b) shows total service benefits if the member chooses to use the flexible DC fund of £15,200 shown in option (a) to provide an additional pension of £500 p.a. plus £3,800 cash.

Data source: USS

See page 5 for the legal status of this document
Example 4: Mid-career researcher/academic on professorial “fast track”, 20 years’ past service, 10 years’ future service

This example looks at a member who joined USS as a member of the final salary scheme 20 years before the new benefit structure comes into effect, and later leaves with 10 years of future service under the new hybrid scheme. The member joined USS as a Lecturer, incremented and progressed, achieving their first professorial promotion after 17 years and their second after a further four years. They then remain at this level for the rest of their career.

Comparison of total service benefits

<table>
<thead>
<tr>
<th>Total pension</th>
<th>Employers’ proposals: member option (a)</th>
<th>Employers’ proposals: member option (b)</th>
<th>Current scheme projections (Final salary section)</th>
</tr>
</thead>
<tbody>
<tr>
<td>£19,600</td>
<td>£58,800</td>
<td>£71,800</td>
<td>£74,400</td>
</tr>
<tr>
<td>£21,300</td>
<td>£52,100</td>
<td>£71,800</td>
<td>£74,400</td>
</tr>
<tr>
<td>£24,800</td>
<td>£52,100</td>
<td>£71,800</td>
<td>£74,400</td>
</tr>
</tbody>
</table>

Member option (a) shows total service benefits if the member chooses not to use the flexible DC fund to provide a pension.

Member option (b) shows total service benefits if the member chooses to use the flexible DC fund of £52,100 shown in option (a) to provide an additional pension of £1,700 p.a. plus £13,000 cash.

Assumptions used in this example

- Past service: 20 years in the final salary section (included in examples).
- Future service: 10 years.
- Employer contributes 12% into DC fund for salary in excess of £50,000 p.a.
- DC fund grows by 5.5% a year.
- Member contributes 6.5% plus an additional 1% of salary and receives 1% matching employer contributions.
- Illustrated pension from DC fund provides same level of increases and dependant’s benefits as current USS CRB structure. It is based on long term annuity rates.

Salary progression

The member in this example has 20 years’ past service at the point at which the proposed scheme is introduced. The member joins on spine point 37 (salary £38,511) and makes annual (uninterrupted) progression up to point 48. At 17 years of service the member is promoted to fixed point service, remaining at band C until retiring with 30 years’ service (salary at retirement £66,172). All values are shown in real terms.
Example 5: Mid-career late starter professional, 10 years’ past service, 10 years’ future service

This example looks at a member who joined USS as a member of the final salary scheme 10 years before the new benefit structure comes into effect, and then leaves with 10 years of future service under the new hybrid scheme. The member started in higher education administration later in their career as Assistant Registrar then received incremental rises until promotion to Faculty Manager, continuing to rise to the top of the range in this role and remaining there for the rest of their career.

### Comparison of total service benefits

<table>
<thead>
<tr>
<th></th>
<th>Employers’ proposals: member option (a)</th>
<th>Employers’ proposals: member option (b)</th>
<th>Current scheme projections (Final salary section)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total pension</strong></td>
<td>£10,200</td>
<td>£10,600</td>
<td>£12,600</td>
</tr>
<tr>
<td><strong>Total lump sum</strong></td>
<td>£30,600</td>
<td>£33,900</td>
<td>£37,700</td>
</tr>
<tr>
<td><strong>Flexible DC fund</strong></td>
<td>£13,100</td>
<td>£0</td>
<td>£0</td>
</tr>
</tbody>
</table>

**Member option (a)** shows total service benefits if the member chooses not to use the flexible DC fund to provide a pension.  
**Member option (b)** shows total service benefits if the member chooses to use the flexible DC fund of £13,100 shown in option (a) to provide an additional pension of £400 p.a. plus £3,300 cash.

### Assumptions used in this example

- Past service: 10 years in the final salary section (included in examples).
- Future service: 10 years.
- Employer contributes 12% into DC fund for salary in excess of £50,000 p.a.
- DC fund grows by 5.5% a year.
- Member contributes 6.5% plus an additional 1% of salary and receives 1% matching employer contributions.
- Illustrated pension from DC fund provides same level of increases and dependant’s benefits as current USS CRB structure. It is based on long term annuity rates.

### Salary progression

The member in this example has 10 years’ past service at the point at which the proposed scheme is introduced. The member joins on spine point 30 (salary £31,342) and makes annual (uninterrupted) progression up to spine point 46, remaining at point 46 until retiring with 20 years’ service (salary at retirement £50,200). All values are shown in real terms.