USS Valuation – Questions and Answers (Q&A)

Every three years most pension funds in the UK are legally required to undertake a valuation. Work on the Universities Superannuation Scheme's (USS) triennial valuation as at 31 March 2017 is progressing and the statutory deadline to complete the valuation is 30 June 2018.

This version of the document is for use from 17 November 2017 and UUK will review and add to this information as the negotiations on benefit reform progress through the Joint Negotiating Committee (JNC) with the member representative body, the University and College Union (UCU).

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1. How does the valuation affect my pension?

Every three years USS is required to carry out an actuarial valuation. During a valuation, the USS trustee assesses the fund's assets and liabilities to ensure it has sufficient funds to pay the pensions already earned, and also that contributions into the scheme cover the cost of the planned future service benefits.

The last two USS valuations (in 2011 and 2014) have been challenging. Both valuations revealed a funding deficit and rise in the cost of future service benefits. In 2014, UUK and member representatives (UCU) agreed a package of reform to address these funding challenges. As part of the reform, both members and employers agreed to pay more towards

USS and changes were introduced to benefits from April 2016. USS became a hybrid scheme, offering defined benefits (currently on salary up to £55,550) through the USS Retirement Income Builder and defined contribution-type benefits on salary above the threshold through the USS Investment Builder.

Since the 2014 valuation, economic conditions for defined benefit pensions have worsened. As a result, the position at the 2017 valuation is much more difficult than expected. The greatest challenge at this valuation is the significant rise in the cost of future service benefits, which has risen by over a third since the last valuation. The funding deficit has also increased to approximately £7.5bn (89% funded) on the assumptions adopted by the trustee. The deficit was £5.3bn (89% funded) in 2014 and the plan was to recover that deficit over a 17-year period.

As a result of the increased cost of defined benefit pensions, UUK believes that changes need to be made to future benefits (yet to be earned) to ensure that USS remains sustainable. UUK and member representatives (UCU) are discussing possible options, and no decisions have yet been made. Importantly, it should be noted that benefits already built up in the scheme are protected by law and cannot be changed retrospectively.

2. Why have future service costs increased so much since the last valuation?

Future service costs in USS have increased by more than a third since the last valuation. This is primarily due to the lower interest rate environment, and is associated with a further reduction in expected future investment returns. This is a problem faced by the vast majority of UK funded defined benefit schemes. The increased cost of making new defined benefit promises is one of the main financial challenges at this valuation.

3. Why is the scheme in deficit?

The deficit at the valuation date (31 March 2017) is estimated at £7.5bn and is similarly driven by exceptionally challenging economic conditions.

In 2014, UUK agreed a recovery plan to wipe out the deficit over 17 years through deficit recovery contributions paid by USS employers from 1 April 2016 (and some planned additional investment return). We did not expect the deficit to be fully addressed by March 2017 but the increased deficit is a sign of the higher level of risk involved in funding a much larger pension scheme by asset size than was predicted three years ago.

4. What is the timeline for the valuation process?

The valuation date is 31 March 2017 and the trustee is required to sign off the valuation and submit its report to the Pensions Regulator within 15 months of that date. The process began well before March 2017, with detailed and open dialogue between the trustee, UUK and UCU at all stages.

5. Why are we discussing reform of USS pension benefits again?

The cost of providing the defined benefits (DB) component of the overall USS future service benefits has risen by over a third since the last valuation. This means that to maintain current benefits overall contributions towards USS would have to increase from 26% of salary presently to just over 37% of salaries, an increase of at least 11% of salaries.

USS employers pay 18% of salaries towards USS. This is a high level of employer contribution and reflects a clear and continued commitment to offering high quality retirement benefits. However, employers are not in a position to increase their contribution further, and it is clear that many employees would find an increase beyond the current member contribution of 8% challenging too.

The trustee requires the increased cost in future service benefits to be addressed at this valuation, and the Pensions Regulator and trustee will also need to agree a credible plan to address the deficit. Employers believe that benefit reform is necessary to ensure the scheme is on a stable and sustainable footing for the long-term. It is not in employers' or in members' interests to increase cost or risk to an unsustainable level. Controlling cost and risk is important in order to ensure that accrued benefits are secure and to enable employers to continue to make high contributions towards future pension benefits.

6. Why don't employers just pay more?

USS is designed to meet the retirement needs of the higher education sector, and many USS employers are universities and registered charities operating on a not-for-profit basis. Most universities can't afford to pay more into pensions without diverting money from other central areas, such as teaching or research, reducing universities positive impact in the areas most central to their core mission and purpose. Increasing contributions could damage the high standards that students, research funders and others rightly expect, and could undermine the sustainability of some institutions.

Ultimately, increasing employer contributions to an unsustainable level could threaten the very security of the pension scheme. The USS trustee is able to take a certain level of risk in its investments because it knows that employers have the capacity to support the scheme if those risks do not pay off, although this capacity to take risk has its limits. If the cost of employer contributions exceeds its present level, employers will no longer have the same capacity to shoulder the level of risk being run in the scheme.

7. Why can't the scheme just carry on as it is until the next valuation and see what happens with interest rates, bond yields and investment returns?

The trustee is required to sign off the valuation and submit its report to the Pensions Regulator within 15 months of the valuation date (i.e. by 30 June 2018). The valuation report must include how the trustee plans to tackle any deficit, and must also set the contribution rate for future benefits. The trustee is responsible for setting the contributions required for the current benefits and has concluded the cost must rise. The option to simply carry on as now does not exist. Even if it was allowed, this approach would also constitute a multi-billion-pound gamble on the progress of the global economy over the next three years which could be catastrophic for the scheme and the university sector if assumptions were not borne out in practice, and appropriate measures had not been taken sooner.

8. How might benefits be reformed at this valuation?

Any potential changes to member benefits or contributions are negotiated within the Joint Negotiating Committee (JNC), and once decided upon in the JNC any proposed changes will be subject to a full consultation with all affected employees. The JNC is made up of equal numbers of representatives from the employer representative body (UUK) and from the member representative body (UCU), together with an independent chair.

UUK submitted a proposal on behalf of USS employers to the JNC on 13 November. The proposal is for the full flexibility of the current hybrid scheme to be used: modifying the salary threshold in order to offer market-leading defined contribution saving (through the USS Investment Builder) to all employees, on all salary. This is seen as the most effective way of managing USS risk, whilst simultaneously offering high quality benefits to employees and maximising options for the future should the funding position materially change.

9. What happens to the benefits I have already built up?

Benefits for past service are protected by law and cannot be changed retrospectively.

10. Are employers proposing paying less towards pensions?

No, the overall amount employers have committed to pay towards USS benefits is 18% of salaries. This is unchanged.

11. What is the Pensions Regulator's role in the valuation process?

The Pensions Regulator is the public body that protects workplace pensions in the UK. The Regulator's powers are outlined in the 2004 Pensions Act. The Regulator must evaluate valuations once they have been concluded by the scheme trustees, and it therefore will need to find acceptable any outcome to the 2017 USS valuation. The USS trustee and UUK are engaged in dialogue with the Regulator to ensure it is aware of the progress on the valuation, and so that any concerns it has can be identified early on in the valuation process.

A sustainable solution to the funding challenges facing USS needs to be found. This has been clearly emphasised by the Pensions Regulator, who wrote to USS trustees and its stakeholders in September 2017 expressing concerns.

12. Have other schemes within the higher education sector also been affected?

Until relatively recently the higher education sector offered final salary pension benefits to the vast majority of employees. However recent reforms have seen increasing divergence in the pension schemes offered in the higher education sector. Most have been reformed in one way or another, though the scale and shape of that reform would have depended on the specific circumstances and status of the different schemes.

Comparisons have been drawn between USS (predominantly for pre-92 institutions) and the Teachers Pensions Scheme (TPS) (for post-92 institutions, amongst others). However, this comparison is misleading, without recognising that the TPS is underwritten by the Government.

TPS is a statutory, unfunded scheme backed by the UK tax payer. In contrast, USS is a private sector (non-statutory) scheme directly backed by higher education institutions with a fund set aside (from employer and member contributions, plus investment return) to pay benefits. USS employers bear the risk that the fund is insufficient to deliver the promised benefits. An unfunded scheme is not reliant on investment performance (as is the case within USS) and greater risk can be taken as benefits are ultimately underwritten by the Government. TPS also has different valuation requirements and is not subject to the approach that the USS trustee must follow. Any comparison must reflect those significant differences in structure and regulatory requirements.

13. Can I pay more to continue my current benefits?

Member contributions only meet a proportion of the cost of current benefits. If the current level of defined benefits continued to be available this would constitute an additional cost of at least 11% of salaries (in addition to the current 8%). UUK does not see a way in which employers or employees could afford that level of increase in cost, particularly as some members are indicating that they have affordability concerns at the current contribution rates. In addition, even if members could afford higher contributions to provide defined benefits, the benefits that are provided are still ultimately underwritten by employers and the risk exposure at the moment is too high.

14. Is the scheme going to collapse?

No. USS is supported on a collective basis by over 350 employers that are committed to the scheme. The scheme is designed so that the risk being run by the USS trustee does not exceed the risk capacity of the sponsoring employers.

However, it is clear that the risk the USS trustee is running in the current economic environment is very high and that action must be taken to put scheme funding back onto a sustainable footing. This is why employers are proposing a reform of benefits in order to ensure the scheme is secure and sustainably funded, and to not put at risk the wish to provide excellent pension provision for employees for the long term. Universities can't afford to pay more into pensions without diverting money from other areas, such as teaching or research.

15. How can I give my view on the valuation?

The JNC is responsible for deciding on changes to benefits and employee contributions to the scheme. If the JNC proposes benefit reform or changes to employee contributions there will be a statutory consultation between employers and affected staff. If indeed the JNC decides on the form of any proposed reforms within the planned timeline, a consultation is expected to take place indicatively in Spring 2018, which will provide the opportunity for affected employees to comment on the proposals.

Further information is also available on the USS website.