Important information for USS members – Dealing with the funding challenges

(1) Introduction

Defined benefit pension schemes across the UK face many challenges. USS is not immune and will have to meet a number of funding pressures in the years ahead. These include continuing improvement in longevity and changing patterns of pay in the HE sector. These pressures could be addressed simply by increasing the employer contribution rate, or alternatively by making judicious changes to the pension benefits that USS members will earn in future years.

The funding challenges that are facing USS, and the identification of solutions, are issues currently being discussed at a USS Joint Review Group (JRG) comprising representatives of the employers on one hand and UCU (representing all USS members) on the other, under the independent chairmanship of Sir Andrew Cubie. It is the stated intention of the employers and UCU to retain USS as a valued and trusted scheme for the sector's current and future employees. At a meeting of representatives of the JRG held on 3 June 2009 Sir Andrew Cubie said "*There are singular challenges for all defined benefit schemes currently. I am encouraged that after some months of intense discussion both sides in the process still remain at the table. There is a shared determination to find ways to ensure viability and sustainability for the scheme in the longer term*".

It is important to recognise that USS, or more specifically the board of directors of the company that runs the pension scheme (known as Universities Superannuation Scheme Limited), cannot effect changes to the scheme's benefits. The company fulfils the role of scheme trustee, and its primary purpose is to deliver the benefits set out in the rules. In USS, it is the scheme's stakeholders, principally the employers and the trade union (the latter representing all scheme members), who must decide on any future benefit changes. As the discussions develop, we anticipate that the stakeholders will consult with institutions and with scheme members and keep them informed of progress. USS believes that it is helpful, through this paper, to brief members on the matters giving rise to the discussions.

Members should be reassured that benefits accrued prior to the date of any changes (and changes are not inevitable) are protected and cannot be affected in any outcome reached by the review group.

(2) Funding pressures

There are funding pressures in the following areas:

(a) Longevity

People are living longer, which means that pensioners will, on average, draw pensions for longer periods of time. Whilst it is of course good news for pensioners, it does lead to higher costs for pension schemes. At the last valuation of the scheme as at 31 March 2008, the USS scheme actuary revised the mortality assumptions used in the valuation based on his analysis of the scheme's own experience which indicated improving longevity of USS pensioners. There is strong evidence to indicate that rates of longevity will *continue to improve* in the coming years, and indeed, the Pensions Regulator has recommended that schemes should use mortality tables which allow for greater improvement in longevity into the future than is currently allowed for in the USS assumptions. It is likely, therefore, that USS will need to increase its longevity assumptions in future, thereby further increasing the cost of the scheme.

(b) Salary increases

The trustee company monitors salary increases in the USS active membership, as salary levels – and in particular the rate at which they increase from year to year – are extremely important in a final salary pension scheme. The trustee company needs to see how salary increases compare with the assumption that has been made. In recent years, salary increases in the sector have been significantly greater than in the past. While the actuary has made some allowance for this increase in calculating the funding level of the scheme at 31 March 2008, he has not yet done so in calculating the required contribution rate for future service, anticipating that the recent experience may be a temporary phenomenon. If the recent experience were to continue, the contribution rate would inevitably need to increase further.

(c) Investment Returns

In the past, the trustee company could be relatively sanguine about fluctuations in the scheme's funding level, as USS is a scheme for the long term. However, the new regulatory regime places more emphasis on the short-term, and volatility in the scheme's funding level is therefore now a greater problem. De-risking the investment strategy would reduce volatility but would also reduce investment returns and thereby increase the cost of the scheme.

(d) Funding deficit

There is a risk that the scheme will not be fully funded on its technical provisions as at the 2011 valuation (ie the value of its liabilities calculated on the new "scheme specific" basis exceeds the value of the assets) which raises the possibility that the employers would need to pay deficit contributions to the scheme over and above the normal contributions.

(3) The way forward

The above funding pressures make it highly likely that, without changes to future benefits, the contribution rate will need to be increased – perhaps substantially – in future years. These pressures have been jointly recognised by the members of the JRG, and the group is pursuing solutions in a purposeful manner, on a confidential basis.

(4) Conclusion

We hope that this briefing note is helpful to you in understanding the context of the discussions between the employers and the trades union on the future of the scheme, and at the same time gives you reassurance that the security of the pension you have already built up is in no way under threat.

We expect that there will be further communications in the coming months to explain how things are progressing, both from USS and from the stakeholders involved in the discussions.