

How USS works

Video transcript

I'm going to go through an example of how benefits build up in USS. For this example, I have a member who's working for three years before retiring. Our member has a salary of £45,000 in year 1, £60,000 in year 2 and £75,000 in year 3.

Now, the salaries chosen for this example over this three year period are not meant to be representative of a typical member. They're completely made-up for the purposes of showing you how things work. I wanted to show you how the build-up of benefits in USS works, and when someone's salary goes over the salary threshold, using a wide range of salaries so you can see what's going on.

For our example member, let's look at year 1 first. At the end of year one, our member earned £45,000, so they'll have built up a 75th of £45,000 as a pension block. This gives a pension block a block of annual pension from year 1 of £600 and that would be payable every year in retirement.

Looking at the end of year 2, the block of annual pension from year 1 was earned a year ago, so will receive an increase from the end of year 1 to the end of year 2. And I'm just going to apply an illustrative example of an increase to that pension built up in year 1.

At the end of year 2, our member earned £60,000 over the year, so they will have built up a 75th of £60,000 as a pension block. So we have another block of pension built up from year 2 at £800.

Then moving on to the end of year 3, our banked annual pensions from years 1 and 2 will increase in line with USS annual increases, so we'll apply that in an illustrative increase there. And at the end of year 3, our member earned £75,000 over the year, but that amount earned over the year is greater than the salary threshold.

The Retirement Income Builder formula only uses salary up to the salary threshold, so we can only use £71,484, the current salary threshold, in the calculation of the annual pension for this year of service. Using the formula of the 75th of earnings up to the salary threshold, this gives the member a block of pension from year 3 of £953 a year.

Adding all these blocks of pension built up over that three year period, for this member, gives a total pension of £2,416 a year. So this is the annual pension from the Retirement Income Builder.

In addition to the annual pension, the member's also entitled to a tax-free cash lump sum. A one-off payment, paid at the point of retirement, of three times the annual pension, which in this case amounts to £7,248.

But we've only used the salary threshold in the formula for the Retirement Income Builder calculation for that third year of service. There's also £3,516 worth of salary that the member's paid contributions on in excess of the salary threshold. Now a total of 20% of this element of the member's salary will go into the member's Investment Builder.

In this case £703, 20% of the salary above the salary threshold, has been paid into the Investment Builder pot in the third year because the member exceeded the salary threshold. There may have been some investment gains or losses on the money in the pot as well, but for simplicity I've ignored that for this example.

Putting the Investment Builder part together with the benefits built up from the Retirement Income Builder, we can see the benefits built up for this member for their three years of membership in USS. So overall the member has a pension of £2,416 a year, and that will increase every year in line with the measure currently linked to the Consumer Prices Index, or CPI, measure of inflation, up to certain limits. Plus a one-off tax-free lump sum of £7,248. Plus an Investment Builder pot of around £703, depending on investment returns.

The annual pension and the tax-free cash lump sum shown here is the standard benefit package, and the member would then be offered options on the combinations of cash and pension by USS when they come to retirement. The member will be able to exchange pension for a larger tax-free cash lump sum, or vice versa, or even take more pension with a reduced or no lump sum.

The member might be able to take some, or even all, of their Investment Builder savings as tax-free cash if taken at the same time as the Retirement Income Builder benefits. USS will quote the options available to you when you're approaching your retirement. And you can use USS's Benefit Calculator tool in My USS to see what your benefits might look like at retirement.