USS Investment Builder

A summary of member research

May 2016

Foreword

USS is unique; established by the higher education sector to provide a valuable way for academics and senior staff in related institutions to save for their retirement.

We have been doing that for more than 40 years, and today USS is one of the largest pension schemes in the UK. Our purpose remains the same and our objectives are entirely aligned to the needs of our members and their employers.

In April, we launched the USS Retirement Income Builder, the new core defined benefit (DB), which offers a career revalued pension and tax free cash lump sum for all members.

In October, we shall launch the USS Investment Builder, the new defined contribution (DC) section of the scheme. This new section is available to all active members; for those earning more than £55,000, contributions in respect of salary above that threshold will automatically be made into the USS Investment Builder. With an employer contribution of 12% and a member contribution of 8% this will quickly become a significant part of their overall retirement saving plan. All members, including those earning under the threshold, can choose to make additional contributions to the USS Investment Builder and, in doing so opt for a further 1% matching contribution from their employer. We think, and indeed the evidence shows, that this will be an attractive option for many.

Under the previous arrangements around 15,000 of our members invested further sums in various additional voluntary contributions (AVCs) options. We believe this number will grow, with more people saving more with USS for their retirement. When we surveyed our members almost half (49%) of them said they would likely or certainly take up the match and we would expect that figure to be considerably higher as the USS Investment Builder becomes more established and members realise it is excellent value for money.

We want to continue the long tradition within USS of going that extra mile to meet members' needs. This means ensuring we understand what members want from the new USS Investment Builder, and how we can support them to get the most from this form of retirement saving.

We have undertaken substantial research both directly with members – including the largest ever survey of members' attitudes to risk – and with leading defined contribution schemes, as well as seeking input from senior academics. This research has informed the design of the new USS Investment Builder section. Today we publish the findings of the research and an explanation of how this research has informed the design. On behalf of the USS trustee, I hope you find the information useful and I thank the scheme members, and others, for their valuable contribution.

Bill Galvin

Group Chief Executive Officer

May 2016

03 Acknowledgements

This document aims to provide a comprehensive explanation of the research, analysis and evidence that has supported the design of USS's new USS Investment Builder. In order to produce this summary, USS has worked collaboratively with, and received input from, a number of independent parties.

We are grateful to those who have contributed independent commentary – Chris Curry, director, Pensions Policy Institute, Professor David Blake, director of the pensions institute at Cass Business School and scientific adviser to A2Risk, and Janette Weir, director of Ignition House, the research organisation which carried out focus groups with USS members. We are also grateful to their colleagues Daniela Silcock, head of policy research at the Pensions Policy Institute, Alistair Haig, director at A2Risk, Ed Ripley, director at Ignition House, and Joseph Birch, research manager at Ignition House.

We would like to thank the Universities and Colleges Employers Association (UCEA) for their comments, and particularly Laurence Hopkins, head of research, for the data he has provided on sectoral demographics.

We would also like to thank Dr Paul Cox, an investment adviser at NEST and senior lecturer at the University of Birmingham, for his comments and suggestions, particularly on ethical investment and behavioural finance.

Finally we are grateful to Professor Jane Hutton, from the department of statistics at the University of Warwick and a UCU-nominated director of USS, who provided valuable support as a reviewer.

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The purpose of this report is to summarise the research about Universities Superannuation Scheme (USS) members which has informed the design and investment approach for the new defined contribution (DC) section, which is known as USS Investment Builder. USS is moving to a hybrid defined benefit (DB) and DC structure. Under the new structure members will contribute to a career revalued benefits (CRB) section, known as USS Retirement Income Builder, which provides benefits (in the form of a pension, alongside a lump sum) based on a member's salary for each year of service, up to an initial earnings threshold of £55,000. Pension contributions above that threshold will be directed into USS Investment Builder.

The scheme also allows all members, regardless of salary, the opportunity to contribute an additional 1% of salary into the USS Investment Builder and receive a 1% match from their employers. Members can choose to save more into the USS Investment Builder but contributions above 1% will not be automatically matched.

Defined benefit arrangements are designed, principally, to provide members with predictable benefits in the form of regular, stable, and secure income for life. The employer takes on all the risk and is ultimately responsible for paying the specified benefits to the member, for life, regardless of the performance of the scheme's investments and its liabilities. Defined contribution savings are different, in that the member and the employer put a pre-agreed percentage of a member's salary into the fund and the final amount available at retirement will be determined by how much goes in, and how well the investments perform, net of any costs and charges. The member takes on more of the risk in DC compared to DB as the size of the fund the member has at retirement is influenced by the decisions they make about how much to contribute, any charges, how it is invested, and how the markets behave.

There are advantages to both types of pension. DB arrangements offer the security of an employer's underpin along with a clear definition of the benefits which are earned through membership. DC savings give members flexibility and choice about how they invest, and how they wish to access their funds. The combination of DB and DC in the USS hybrid arrangement aims to provide a balance between freedom and security, between flexibility and predictability.

The pension income provided by the USS Retirement Income Builder can give members reassurance that they can meet their day to day needs in retirement, whilst the USS Investment Builder allows them to benefit from investment growth and access their savings in a way that reflects their individual circumstances in the form of regular pension, or lump sum, or indeed through other flexible access options.

Providing good quality DC pension saving

USS is governed by its trustee board, which has the responsibility for making sure that the scheme is well run – acting in members' best interests – and in recent months it has prepared for the introduction of the USS Investment Builder. This drive to provide the most appropriate DC arrangement and a tailored suite of investment options for the USS active membership is in line with the expectations of the Pensions Regulator (TPR).

In the USS Investment Builder there will be a default strategy (which is a carefully designed and chosen pre-set option for the member) and a range of self-select investment options. Experience from other schemes tells us that the majority of members will invest in the default strategy as they feel that is the approach designed for the mainstream of members, and/or because they may not want or feel equipped to make investment decisions. Equally the decision to go into the default strategy may not be a conscious one, as members may simply not have thought about their pensions savings.

The default strategy must therefore be carefully designed and built, and the DWP and TPR have set out specific guidance around default investment strategies and the requirement to review the default arrangements in DC schemes.

The range of self-select options will also need to reflect the objectives of members who do not think the default is appropriate for them, whether their needs are based on their risk preferences or other motives, for example ethical or religious concerns.

The research supporting the design of the USS Investment Builder has considered the demographics of the USS active membership, and in particular those who will be investing in the USS Investment Builder, and has focussed on members' capacity and appetite for risk, as defined below:

- **Capacity for risk:** This refers to how much risk the member can reasonably take in seeking growth on this part of their retirement savings. Risk capacity will be influenced by factors such as members' earnings and therefore how much they will be contributing into their pensions, how long they have until retirement, their level of financial education, how much debt they have, and the level of their assets outside the USS scheme (for example an inheritance or property);
- **Appetite for risk:** Individuals will be willing to accept varying levels of risk with their pension saving depending on their own perceptions of investment and their individual circumstances. Members' experiences with other forms of savings and investments may affect their propensity to take risk with their pension saving.

Another component which may be relevant is the need for risk, in the sense of the need for members to take some risk to achieve their retirement goals. The level of risk must be appropriate given the member's aims, but the perception of risk need is highly subjective. The trustee has considered the appropriate amount of risk for members to bear by focussing primarily on risk capacity and appetite.

The trustee undertook a substantial programme of research and analysis to inform the design of the USS Investment Builder, as outlined in Section One. The first stage of this involved member cohort analysis to explore how the active membership is dispersed in terms of factors such as age, salary and service, which will be relevant to their pension provision. Analysis of the projected outcomes for eleven representative example members was then carried out, looking at a range of different options for the default strategy.

Education programmes have been found to increase the attractiveness of DC. Members who attended the focus groups were more likely to say that they would take up the match at the end of the session than the beginning. This research suggests that the target group for the USS Investment Builder could expand following a programme of education and communication explaining the benefits of the matching employer contributions and the other options and choices available. Therefore the size of the group wishing to save into the USS Investment Builder could be increased through education – whether this is direct to members or based on the experience of peers.

We gleaned some insights from existing qualitative research and industry practice on DC pensions from sources such as the National Employment Savings Trust (NEST), the Department for Work and Pensions (DWP) and Willis Towers Watson. We then moved on to carry out our own qualitative and quantitative research through focus groups carried out by research organisation Ignition House. We also carried out our USS member survey on the USS Investment Builder, which is, to our knowledge, the largest undertaken by any scheme trustee, supported by work from research organisation A2Risk.

Executive Summary

Key findings on risk capacity

The group which will save into the USS Investment Builder (those earning more than £55,000 per year, those taking up the 1% employer match, and those making additional contributions) has a relatively high capacity for risk. The hybrid structure means that members are protected by the DB underpin which will provide them with (amongst other things) a predictable annual income.

In a DC arrangement the member bears the risks associated with investment, but the introduction of the USS Investment Builder will not affect the entirety of the benefits USS members receive in retirement. The significance of the USS Investment Builder as a proportion of their overall retirement income will depend on a number of factors, including: how close members already are to retirement (and their previous arrangements within USS and in other pension schemes), their salaries throughout their careers, and any additional contributions they choose to make.

Other factors which influence capacity for risk are the other assets outside USS which are available to the member in retirement and the member's expected levels of outstanding debt. In our survey most members did not expect to have significant debt post retirement, and more than half thought they would continue to work in some capacity (thereby potentially bringing in an income – but one which is uncertain and may not be realised).

On balance, the trustee believes that USS members have a greater capacity to bear risk in the USS Investment Builder – relative to those who are members of other DC schemes – given the existence of the USS Retirement Income Builder within the overall USS benefit structure.

Key findings on risk appetite

Despite their relatively high risk capacity, USS members generally expressed a fairly conservative approach to risk. Most members were unfamiliar with DC pensions and with investments, and were therefore uncomfortable making decisions on such matters.

USS members who responded to the survey or participated in focus groups tended to be risk averse. Nearly two thirds of survey respondents said they would look for safer investments even if it meant lower returns.

Some members expressed feelings of fear about investing their money in the stock market, primarily because they did not have much investment experience. Investment risk was seen as the main risk in the USS Investment Builder amongst focus group participants, and many were worried about making the wrong investment choice. Almost half of survey respondents said they did not feel comfortable investing in the stock market, and just over one half said it took them a long time to make up their minds on investment matters.

The group which is expected to be saving into the USS Investment Builder had a slightly higher appetite for risk than the overall active membership, largely because members on higher salaries tended to be willing to take greater risks. Research organisation A2Risk assigned scores representing members' appetite for risk based on their responses to a set of questions about investment risk, loss, and volatility. The higher the score assigned, the greater the members' appetite for risk.

The trustee has taken that risk appetite into account when designing the default strategy. There are different risk preferences throughout the membership, but given that all USS members will benefit from the DB underpin we do not have reason, based on these scores, to be concerned about taking a moderate to high risk approach in the default strategy.

Implications for investment choices

The USS trustee has drawn its conclusions on the most appropriate investment strategy to launch in October 2016 for its members after examining its own and existing research, and considering the experiences of other hybrid and DC schemes in the UK and globally. Insights from behavioural finance about member inertia have taught us that the majority of members are likely to save into the default strategy, and will not make active investment decisions as they move through their careers.

Taking into account the members' demographics, capacity and appetite for risk, and also the hybrid structure of the scheme, suggests an appropriate default strategy would have an emphasis on investments which will seek a high level of return well into members' working lives while controlling exposure to risk as members approach retirement. The default should be accompanied by a tailored range of self-select options for members who wish to choose their own specific investment types (from the range available).

Through the programme of research described above we have found that there are likely to be three ways in which members will manage their DC pension investments: – some will want USS to take care of their investments, some will want some assistance but would like to engage, and some will want to manage their own DC savings. That is why we have segmented the membership into three categories – Do It For Me, Help Me Do It, and I Want to Do It Myself.

Approaches to DC investment

- **Do It For Me:** Default lifestyle strategy – the fund which members will go into either through active choice or by default if they do not wish to make their own investment decisions. It is designed to meet most members' needs and ensure they can get the best returns over the long term, taking into account the appropriate level of risk. The amount of risk in the scheme will reduce over time as the member approaches retirement to make sure their assets are protected from market downturns;
- **Help Me Do It:** Alternative blended risk labelled funds – members will have the option to choose alternative "ready-made" funds if they are willing to accept a higher or lower degree of risk than that offered in the default strategy, or want to invest in an ethical strategy throughout their working life. These funds may also be appropriate for members who wish to adjust their journey plans or destinations;
- **I Want to Do It Myself:** Additional standalone funds that members can select themselves if they want to manage their own investments, or have particular beliefs or retirement objectives. These members can also choose to include risk labelled funds in their portfolios. This approach is appropriate for members who wish to construct their own risk and return profiles, and journey plan.

Based on the experiences of other pension schemes such as NEST, we would anticipate that most members will invest in the default strategy, either through inertia or active choice, which is why it is particularly important that it has an appropriate risk strategy which will suit the majority of members' needs throughout their careers.

In focus group discussions the majority of members did not want a large range of options because they did not want to be confronted with too much unfamiliar information, be overwhelmed by choice or increase the risk of making the wrong decision. That is why USS will offer a tailored range of funds initially, in addition to the default strategy, for members who want to take more of an active interest in their DC investments.

Choices which will be available outside the default strategy will reflect different attitudes to risk, and other preferences based on ethical and religious beliefs, or different classes of assets and retirement objectives.

A significant proportion of the members who responded to the survey expressed an interest in USS offering at least one ethical investment option, and our research has revealed a positive, albeit limited, appetite for a Sharia-compliant fund.

The trustee will keep the investment options offered within the USS Investment Builder, and their take up by members, under review, and will evolve the options as required as we learn more about member preferences.

Retirement objectives

The new USS Investment Builder is being created in a policy and regulatory landscape which has changed dramatically in recent years. Not all members have the same objectives at retirement, and members now have far more choice and flexibility in how they access their DC funds from age 55 onwards. Working with the stakeholders, the trustee plans to put in place flexibilities which will help members in their retirement choices, taking advantage of the opportunities available under pensions rules whilst maximising the tax effectiveness.

Faced with the uncertainty of a changing landscape, it is important to build flexibility into the design of the default strategy approach, the de-risking glide path and changing retirement objectives, and to support this with an engagement strategy that facilitates member decision-making.

Initially, we would expect most of those retiring to take the savings they have built up in the USS Investment Builder in the form of cash, because the sums of money involved will be small compared to their likely DB benefits (and they can currently draw 25% of those assets in cash form tax free). But we anticipate growing demand for other options as the size of funds within the USS Investment Builder grow – for example options which allow the member to remain invested and draw down their funds as income or cash lump sums as and when required.

Section One – Introduction and methodology

Purpose of this document

The purpose of this report is to summarise the research about Universities Superannuation Scheme (USS) members which has informed the design and investment approach for the new defined contribution (DC) section. USS is moving to a hybrid defined benefit (DB) and DC structure. Under the new structure members will contribute to a career revalued benefits (CRB) section, known as USS Retirement Income Builder, which provides benefits (in the form of a pension, alongside a lump sum) based on a member's salary for each year of service, up to an initial earnings threshold of £55,000. Pension contributions above that threshold will be directed into the new USS Investment Builder.

The switch began on 1 April 2016 with all final salary members and existing career revalued benefits members moving into the career revalued benefits section. The USS Investment Builder will go live on 1 October 2016. This will be immediately relevant to those members earning £55,000 or more. However, all USS members will also have access, regardless of salary, to a 1% matching contribution from their employers if they contribute an additional 1% themselves. Members can choose to save more into the USS Investment Builder but contributions above 1% will not be automatically matched. The USS Investment Builder is therefore potentially relevant to all active members, regardless of salary.

USS's target member group for the purposes of this document is made up of the section of the active membership who will be affected by the introduction of the USS Investment Builder from 1 October 2016. These members are:

- those who are, or are expected to be, earning £55,000 or above, and;
- those who are considering paying the 1% matching contribution, or making additional contributions above 1%.

Members in the USS Investment Builder will have different needs to members of other DC schemes because they will have a DB underpin covering a portion of their salaries. The interactions between DB and DC have been explicitly taken into consideration when designing the USS Investment Builder.

USS is building this scheme against a regulatory landscape which has changed radically since the Chancellor's 2014 Budget. The freedom and choice agenda[1] which came into force on 6 April 2015 has introduced much greater flexibility at retirement for those in a DC scheme, and has removed the virtual requirement for retirees to buy an annuity. Savers now also have the option to take cash from their pension pots from age 55, with the first 25% tax free. USS has designed the USS Investment Builder bearing this policy background in mind and acknowledging that not all savers will be heading towards the same objectives at retirement.

Following a consultation on the treatment of pensions tax relief[2], the government has opted to maintain the current regime. We are designing the scheme bearing in mind the existing landscape, but with an awareness that it could change again in the future.

The Pensions Regulator's DC Code[3] states that schemes must provide appropriate investment options for their membership, and in order to achieve that they must understand the needs of those members.

[1] Freedom and Choice in Pensions: The government response to the consultation, HM Treasury, July 2014 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332714/pensions_response_online.pdf

[2] Strengthening the incentive to save: A consultation on pensions tax relief, HM Treasury, July 2015 https://www.gov.uk/government/consultations/strengthening-the-incentive-to-save-a-consultation-on-pensions-tax-relief

[3] Governance and administration of occupational defined contribution trust-based schemes, code of practice 13 https://www.thepensionsregulator.gov.uk/codes/code-governance-administration-occupational-dc-trust-based-schemes.aspx

The Pensions Regulator DC quality features

In a quality scheme, trustees will:

- Ensure that investment objectives for each investment option are identified and documented in order for them to be regularly monitored;
- Ensure that the funds and risk profile of the investment options offered reflects the needs of the membership;
- Ensure that a default strategy is provided which is suitable for the needs of the membership;
- Act in the best interests of all beneficiaries.

In designing the USS Investment Builder in the best interests of members it is essential to understand the following:

- The risk capacity of the target group, and how that compares to other pension savers in DC schemes, and the wider USS active membership;
- The risk the active membership needs to take to achieve the desired outcomes;
- The diversity of risk preferences and loss aversion within the target group;
- Other preferences and beliefs which could influence members' investment decisions.

When developing the default strategy and self-select options we have taken into account members' risk capacity and risk appetite, along with personal investment preferences and beliefs, for example for ethical and Sharia-compliant funds, and lessons learnt from the experiences of other DC pension plans.

Methodology

This research summary assimilates analysis and evidence from a number of different sources to inform the design of the new USS Investment Builder. The sources and methods we have used include:

Comparative studies: Comparing the experiences of other UK and international pension schemes to see how examples of best practice could inform the design of the USS Investment Builder. The research summary looks at specific case studies such as NEST and the Australian UniSuper.

These studies have been informative but have been applied to the design of the USS Investment Builder with caution. They relate to different member demographics and in some cases different policy and regulatory environments. These studies have been considered alongside detailed analysis of the active USS membership to determine where parallels can be drawn with the USS context.

Sector insights and demographics: Analysis of statistics from the Higher Education Statistics Agency (HESA) and Universities and Colleges Employers Association (UCEA), and Office for National Statistics (ONS), along with research from the Chartered Institute of Personnel and Development (CIPD), Pensions and Lifetime Savings Association (PLSA), Pensions Policy Institute (PPI), State Street Global Advisors (SSGA), and Willis Towers Watson.

The above research gives context, in terms of the higher education employment landscape and workforce dynamics, and recent developments in the DC pensions landscape in the UK. The sample sizes and coverage of this research varies, and where this factor may have introduced bias or may not be representative it has been noted. The HESA statistics cover the whole of the higher education sector, rather than specifically the portion covered by USS participating employers and USS members, so they are intended to give an impression of wider sector trends rather than to state the specific situations of USS members.

These statistics all refer to a point in time and the sector is dynamic so will change over time. The date of each study has been given where it is mentioned.

Wider qualitative research and behavioural insights: We have reviewed academic research looking at trends in higher education careers and behavioural finance. This analysis has included published research from various sources in the UK and overseas and supports our views on how the USS membership is likely to behave.

These studies also relate to different member demographics and in some cases different policy and regulatory environments. This research has therefore been considered alongside detailed analysis of the active USS membership to determine where parallels can be drawn with the USS context.

USS population analysis: Data about the current active membership (as at 31 March 2015) relating to age, gender, salary and length of service. These figures have helped us understand today's active membership and identify the characteristics of members we expect to save into the USS Investment Builder automatically because they earn £55,000 or over, and the members who we might expect to opt-in to the USS Investment Builder through the employer match and those members who may cross the salary threshold over time. This data has been used to segment the membership and identify patterns and trends which may be relevant to their pensions needs – for example service histories and legacy DB entitlement for different cohorts.

Member outcome analysis: Stochastic modelling to show the likely outcomes of different members at retirement based on different illustrative investment strategies was used to inform the focus group discussions. This analysis was also used to assess the likely adequacy of outcomes for members at retirement from USS and inform the view of members' risk capacity and the likely size and role of their DC funds at retirement.

These are projected figures based on a set of assumptions and parameters which may not be realised.

USS member survey: USS sent out an anonymised survey to participating employers to distribute to around 150,000 active members in September 2015. It was completed by around 9,700 members and asked a series of questions relating to personal characteristics, capacity for and attitudes to risk, likelihood to take up the 1% match, retirement expectations and preferences and beliefs relating to ethical and Sharia-compliant investment. This is the largest survey of pension scheme members we are aware of that has explored attitudes to investment risk and used psychometric methodology to score attitudes to risk.

We recognise that members who took the time to complete the survey are likely to be those who are most engaged with USS, or with pensions and investment issues.

These results were also self-reported and there may be a discrepancy between how people say they will act and what they do in practice. For example, members may say they are likely to take up the matching contribution when in practice the opt-in approach may mean they do not take immediate action and defer decision making.

Focus groups: USS worked with independent research organisation Ignition House to run focus groups at seven institutions, involving more than 100 participants. The participants were representatives of the universities of Birmingham, Glasgow, Manchester, Oxford, Leeds, the London Business School and the London School of Economics. This sample is in line with the level of robustness expected of qualitative work undertaken for organisations under public scrutiny.

The focus groups started with an introductory session explaining the scheme changes and a Question and Answer session from USS. Ignition House asked members about their perception of the changes to the scheme, their understanding of pensions, and their attitudes to investment risk and their options and choices within the revised scheme. They collected individual written answer booklets and members were asked to fill in before and after questions on their views around the scheme changes and whether they would be likely to take up the employer matching contribution.

Men were over-represented in the focus groups, and so were older members and those earning higher salaries. This potential source of bias was taken into account when considering the applicability of the conclusions from the focus groups and the suitability of the DC investment design for the breadth of the USS active membership.

> “USS worked with independent research organisation Ignition House to run focus groups involving more than 100 participants”

Section Two – Understanding the sector

Sectoral demographics

USS was set up to be the main pension scheme for academic and professional staff in UK universities and other higher education and research institutions.

Understanding the demographics of the sector in which USS members are employed provides useful context as it may influence their engagement, choices and priorities. There may be considerations which are specific to the higher education sector workforce which are relevant to their pensions needs throughout their careers.

Employment

USS primarily caters for academic and professional services staff in UK higher education institutions. The scheme currently covers almost 400 participating employers. More than half (59%) of members who responded to the USS DC survey identified themselves as academic, or academic-related staff, and 36% said they worked in professional services. USS eligibility is broadly defined, but employers can choose to interpret that definition in their own way.

To be considered as a participating employer an institution must be resident in the UK, and must be either:

- a university, or university college, or a higher education institution;
- any other body which is established for the purpose of higher education and research or not for profit;
- a body which is majority owned, owned, or governed by one or more existing USS institutions and which in the opinion of USS supports the primary objects of those institutions, whether or not the activities of the body constitute a trade or other commercial or investment activity.

USS must tailor its pension provision to suit the career paths of its members. The needs of full-time staff who work within higher education institutions for their whole careers will be different to those on part-time or fixed term contracts, in terms of their reliance on USS to provide for their retirement, and the split between their DB and DC benefits. In 2014, two thirds of staff in higher education institutions were employed on full-time contracts, and one third on part-time[4].

The trustee was interested to find out the split for the UK between research and teaching staff, and those who combined both in their roles. Half of the full-time staff in the sector have both teaching and research responsibilities, with 39.3% doing research only and just 9.4% teaching only[5]. Part-time staff were more likely to undertake teaching only (63.6%) than research only (19.2%), and just 16.4% combined both job functions, reflecting the time commitment involved. Part-time teaching is very common, and also includes industry professionals and postgraduate students undertaking teaching, along with people who teach during term time, delivering specialist training such as language tuition.

[4] Higher Education Statistics Agency (HESA) statistics 2013-14 https://www.hesa.ac.uk/index.php?option=com_content&view=article&id=1898&Itemid=634 Table 1 (Staff by HE Provider)

[5] Pre-92 institutions, Higher Education Statistics Agency (HESA) statistics 2013-14

Section Two – Understanding the sector

Flexible working is common in higher education because of the nature of the work. Demand for teaching in specialist subjects is likely to fluctuate depending on student appetite, and specialists may take on multiple roles because their expertise is relevant in different environments[6]. As a result, a number of staff at higher education institutions are employed on fixed term contracts. In 2014, 36% of all academic staff were employed on fixed term contracts[7]. The proportion of fixed term contracts was higher amongst those who were part time workers than for those employed full time – 56% of those employed part-time were on fixed term contracts, compared to a quarter of full-time employees. Many of the staff employed on fixed term contracts are research staff whose contracts are associated with fixed term grant funding.

There is also a section of the higher education workforce known as atypical workers – again this is largely driven by fluctuations in demand for specialist expertise. In 2014, HESA recorded 75,040 atypical staff in UK higher education institutions. Examples of atypical workers would generally be: guest lecturers, stand-by lecturers, and external examiners. An atypical contract will meet one or more of the following conditions, according to HESA guidance:

- Are for under four consecutive weeks, so no statement of terms and conditions needs to be issued;
- Are for one-off or short term tasks;
- Involve work away from the supervision of the normal work provider;
- Involve a high degree of flexibility – often in a contract to work as-and-when required.

However, it is unlikely that these staff would be in USS, and many would not constitute eligible jobholders for the purposes of automatic enrolment.

The widespread use of fixed term and atypical contracts has pensions implications because staff may undertake a high number of fixed term contracts throughout their careers, and build up a relatively small pension entitlement with each. This is less of a problem in the higher education sector than in many other sectors, since, as outlined below, academic staff typically move from one higher education institution to another and therefore remain within USS.

International staff can influence the shape of the higher education workforce and USS membership - 11.4% of the academic workforce was made up of non-EU workers, and 15% of EU workers outside the UK, during the 2013-14 period. These staff may take a job in the UK with varying expectations about how long they will remain in the UK, but they have a pivotal role to play in maintaining the competitiveness of the UK higher education sector.

There are communications implications because a USS member undertaking multiple fixed term contracts could feasibly have a salary that crosses the £55,000 threshold at some points in their career, but not others, so their saving into the USS Investment Builder may be sporadic. USS will need to make sure that appropriate options are available to members with comparatively small DC funds at retirement.

[6] Fairfoul and Hopkins, Employer perspectives on zero hours contracts in UK higher education, April 2014

[7] HESA Staff introduction 2013/14 Table L https://www.hesa.ac.uk/component/content/article?id=3497&Itemld=278?

Level of education

Academics at higher education institutions are typically more highly educated than the general population – a high level of education is generally a prerequisite given the nature of the work.

Half of the academic staff at all UK institutions have a doctorate, and a further 20% have another higher degree. Those who did any study beyond a first degree are more likely to have a doctorate than any other postgraduate qualification. Just 10% completed their education with a first degree and 2% have another undergraduate qualification.

Higher levels of education have been found to be associated with higher risk tolerance[8], which suggests that USS members may have a higher capacity and appetite for risk than the wider population. This has potential implications for the design of the default strategy and range of funds available, particularly when the DB underpin is taken into account.

In the UK as a whole just under a third (27.2%) of adults report having a degree level qualification or above as their highest educational qualification, whilst 12.3% completed their formal education with A levels or equivalent level qualifications[9].

Ethnicity

Three quarters of staff at Russell Group institutions are white, and this figure rises to 77.3% when all pre-92 universities are taken into account. Amongst pre-92 universities, which make up the majority of USS employers, 8.8% of employees are Asian, and 1.1% are black. The proportion of staff whose ethnicity is unknown is 9.3% amongst pre-92 institutions and 11.1% at Russell Group universities.

Some of the variation in ethnicity can be explained by the proportion of staff who come from overseas – 11.4% of the workforce are from outside the EU, and a further 15% are from the EU outside the UK.

Ethnicity may be relevant to scheme design because amongst the general population minority ethnic groups are more likely to be low earners. However this is less likely to apply to the USS population who earn more and have higher education levels, on average, than the UK population. It may also be relevant because there is a significant overlap between some religious groups and some minority ethnic groups – specifically some Muslim members may prefer to invest in a Sharia-compliant fund if one is made available.

Disability

The vast majority of staff in higher education institutions have no known disability on a self-declaring basis – just 3.4% of staff in pre-92 universities are known to be disabled, although given the size of the sector this does constitute thousands of people.

The presence of a disability can be relevant to scheme design because disabled people are generally more likely to have broken work histories than non-disabled people and this may be matched by a disrupted history of contributing to a pension or building savings. It may also be relevant because, depending on the type of disability, the members in question may have different communications needs. They may, for example, have difficulty accessing the website so will need alternative forms of information to understand the choices and options available to them. At present USS provides large text or braille versions of communications on request.

[8] Joo and Grable, 2004; Van Rooij, Lusardi, and Alessie, 2012; Yao, Hanna, and Lindamood, 2004

[9] Office for National Statistics data from 2011 Census

Turnover and flows in and out of sector

When designing the USS Investment Builder it was important to understand the role the USS Investment Builder might play within the higher education sector, and over members' working lives. Understanding the paths members' careers are likely to take is an important part of that process on both an individual and collective level. Knowing what turnover levels are, and what is driving flows into and out of higher education institutions gives us a better impression of the shape of the membership and how that will change.

Academics typically stay within the higher education sector even if they move between institutions, which will usually mean they stay within USS if they joined USS as their first pension scheme in the sector (although they may, for example, spend a period with an overseas institution).

Retention is reportedly less of a problem for employers than recruitment – the majority of respondents to the University & Colleges Employers Association (UCEA) Higher Education Workforce Survey 2015 said they had no retention difficulties at all[10]. Overall turnover rates are close to the national median of 13.6%[11], and the overall turnover in 2014 was 11.1%.

Academic staff are likely to stay with an institution once they have been recruited, and those who move on from their existing institutions typically move within the higher education sector, so if they begin their career in a USS institution they are likely to stay within USS. The median length of service amongst the full-time USS active membership is six years, but this takes into account significant expansion in recent years – we would expect members' length of service to be significantly higher over time but the current median has been lowered by a large number of new joiners. In the years 2013-14 almost half (49%) of all those in academic leadership positions, and 43% of professors[12], moved to another higher education institution, with the majority of the rest leaving to retire. Just 2% of academic leaders, professors, and senior lecturers respectively left to join the private sector[13].

Likewise, the majority of academic staff joined their current roles from another higher education institution. This was the most common pathway for those taking on professorships (74.2%), academic leadership positions (66.8%), and senior lecturer roles (65.2%). Owing to the nature of the job functions, just 3.4% of new professors came from private sector backgrounds, along with 6.3% of senior lecturers, and 7.8% of those in academic leadership roles. An only slightly more common option was for these professionals to come from the public sector, as 9% of the academic leadership, 6.6% of professors, and 10% of senior lecturers did. Anecdotally, those coming from outside the public sector were more likely to have previous experience of DC provision, rather than pure DB.

The highest redundancy rate in 2013-14 was amongst full-time research assistants, at 3.6%, and the lowest amongst professors (0.5%). Among part-time staff those in caring and leisure roles had the highest redundancy levels, at 2%, and administrative staff had the lowest at 0.1%. The UK average is 0.42%[14].

[10] Universities & Colleges Employers Association (UCEA) Higher Education Workforce Survey 2015

[11] Chartered Institute of Personnel and Development (CIPD) Resourcing and Talent Planning Survey Report 2015

[12] Percentages across both full-time and part-time staff

[13] Universities & Colleges Employers Association (UCEA) Higher Education Workforce Survey 2015

[14] ONS NSA: Redundancies levels and rates 11 November 2015

This research supports the belief that most members who join USS will stay in the scheme for an extended period. The median past service for members in USS was six years. Just over a third of the respondents to our DC survey had been in the scheme for at least fifteen years.

With such high proportions of staff remaining eligible for the USS scheme it is critical that USS can offer a pension arrangement which is appropriate at every stage of a long term career. We are aware that the workforce is likely to change and will closely monitor these changes to make sure the scheme remains appropriate. This is required by The Pensions Regulator under the DC code, which states that: "Trustees should take time to monitor and review the appropriateness of the default strategy"[15].

DC code

"When reviewing and monitoring the default strategy, trustees should consider its suitability taking into account innovations in DC investment products, changes in regulatory requirements, the demographics of the scheme membership and innovations in the decumulation market. The review should take into account the needs of both active and deferred members. Investment and risk monitoring may help trustees to identify other potential risks. This analysis, coupled with demographic reports, helps trustees to decide whether the risk and maturity profile of the scheme membership is adequately addressed by the default strategy."

The Pensions Regulator DC Code s 117

Workforce from overseas

The UK academic sector is reliant on an international workforce - 11.4% of the academic workforce was made up of non-EU workers, and 15% of EU workers outside the UK, during the 2013-14 period[16]. The proportion of non-EU workers was higher in the fields of science, technology, engineering and maths (STEM), reaching 20.1% of the engineering and technology workforce, and 14.1% in biological, mathematical and physical sciences. The latter two groups make up 27.1% of the total academic workforce.

In the fields of humanities, language based studies, archaeology, and social studies, the proportion of non-EU staff is 12%[17].

Non-EU research students studying in the UK make up 29.5% of all postgraduate research students, and retaining this group is an important part of the UK's academic recruitment strategy.

[15] The Pensions Regulator DC Code s 115

[16] Universities & Colleges Employers Association (UCEA) Higher Education Workforce Survey 2015

[17] Higher Education Statistic Agency (HESA) 2013-14

Section Three – Understanding USS members

USS member demographics

Understanding the demographics of the scheme membership is critical to designing a scheme which will meet their needs. The factors which are likely to be of most interest in terms of pension provision are the members' ages, genders, salaries, and prior experience of pensions saving (either through service with employers participating in USS, or in another pension arrangement)[18].

More than half (52%) of the USS active membership is aged under 45. A further 28% are aged between 45 and 54, whilst 11% are 55-59 and 9% are aged 60 or above.

The gender split of the USS population is fairly even, with a slightly higher proportion of men (at 53%) than women (47%). Men were slightly overrepresented in the survey and focus groups compared to the USS member active population.

The vast majority (83%) of members earn below £55,000, which is especially significant in the DC context because this is the earnings threshold beyond which members' pension contributions will go into the USS Investment Builder. Of the 17% who currently exceed that threshold, 11% earn £55-75,000, and 6% earn £75,000 or more.

The median salary of an active USS member working full-time is £38,300, compared with £42,860 amongst full-time staff at Russell Group institutions, and a £26,500 average for the wider United Kingdom, suggesting USS members are typically more affluent than the general population.

More than half (57%) of USS members work at Russell Group institutions. More than half (55%) of clinical academics choose to join the NHS pension scheme whereas 35.4% of the clinical academic workforce is in USS.

Clinical academics typically earn significantly more than other parts of the academic workforce, so having a lower proportion of clinical academics in USS than in the wider Russell Group population may partly explain the lower median salary.

The Pensions Policy Institute (PPI) has reviewed this research document independently and drawn some comparisons between USS and other schemes. The PPI is an educational charity which provides non-political, independent comment and analysis on public policy on pensions and the provision of retirement income in the UK.

[18] Figures correct at 31 March 2015

How does USS compare to wider pension scheme membership?

The USS scheme is evolving, as is the rest of the pensions sector in the UK. For any employer or group of employers considering the pension arrangements that they put in place, it is important that the arrangements are suitable for the employees that will become scheme members. This is particularly important where an element of DC is offered where members bear more of the risk. How do the members of the USS scheme compare to members of other pension schemes?

There are a number of very important differences between the membership of USS and more typical pension scheme members. Some of these relate to the type of pension scheme they belong to, some relate to labour market position, and some are individual characteristics.

One of the most important differences is that USS members belong to a DB pension scheme. Across most of the private sector the vast majority of pension scheme members belong to a DC scheme. Even after allowing for the public sector, including the Local Government Pension Scheme (LGPS), Teachers' Pension Scheme (TPS) and National Health Service (NHS) schemes, there are now more members of DC than DB schemes in the UK. And it is worth remembering that there are almost as many people in work who currently are not members of any pension scheme at all as there are pension scheme members. Once automatic enrolment has been rolled out across all employers, pension scheme membership will be more common, but it will be even more predominantly DC in nature.

USS members are also more likely to be highly educated than other pension scheme members. As well as showing that individuals with higher education levels tend to be more financially capable and confident, research also shows that members of DB schemes tend to have above average levels of financial capability. So despite feeling unsure about how DC pensions might affect them, USS members are probably better prepared to cope with DC decision making than other pension scheme members.

Perhaps as a result of higher educational qualifications, the average salary level of USS members is also higher than the national average and length of service within the scheme is higher than the population average. Debt levels, or at least expectation of debt in retirement, are also low. And the proportions of USS members expecting to continue to work past state pension age – and even into their seventies – is relatively high. All of these factors point to a workforce well equipped and well prepared for retirement, in stark contrast to many individuals in the wider population.

In particular, the fact that USS members are likely to have a secure DB pension as the basis of their retirement income, alongside the New State Pension from April 2016, means that any DC pension that USS members build up could be used more flexibly than might be possible for other pension scheme members. Of course some USS members might still want to use DC pension saving to provide a retirement income – especially if they have not been USS members throughout their career.

And this perhaps highlights one of the ways in which USS scheme members are similar to other pension scheme members. They are not uniform, they have different characteristics, lives and preferences, will be in different circumstances and will all have different needs in retirement. Scheme design needs to be able to cope with, and respond to, these differences, and to enable individuals to make the best of their retirement.

Chris Curry, director,
Pensions Policy Institute

Research into the active membership

Target group

Of the existing USS active membership, 17% are automatically affected by the USS Investment Builder because they earn £55,000 or more. We relied on quantitative and qualitative research to estimate the proportion of members who would be likely to take up the match, which will be available on an opt-in basis.

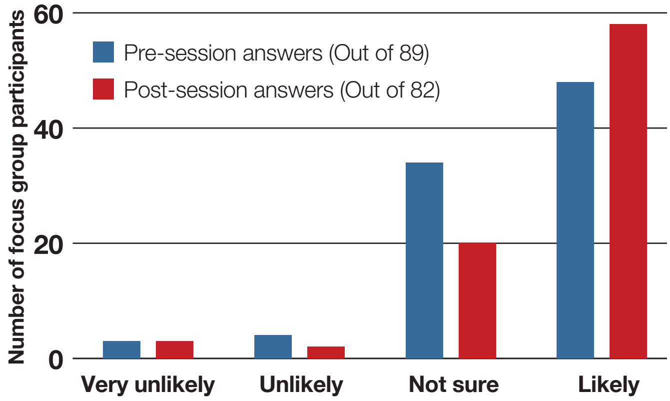
Amongst those who responded to the DC survey, 30% fell into the target group by virtue of earning £55,000 or more, although the membership will change over time and around two thirds of current active members may find themselves earning above the threshold as they progress through their careers, if they remain within the scheme[19]. In addition, members were explicitly asked if they thought they would take up the match. Amongst those who earned below the £55,000 salary threshold, 16% said they would definitely match, and 29% were likely to, whilst a further 46% were undecided.

Of those who participated in the focus groups almost half (47%) fell within the target group because they earned more than £55,000. This was a self-selecting group so it is unsurprising that this percentage is higher than the overall percentage of the USS population who are expected to be above the salary threshold initially.

Members who attended the focus groups were more likely to say that they would take up the 1% match at the end of the session than the beginning. Initially, 48 of 89 members asked said they were likely to take up the match, and 34 of 89 were undecided. By the end of the sessions the proportion who were likely to match increased – 58 (of 82) said that they were likely to match and just 20 were undecided. The number of focus group participants who were unlikely to contribute fell from seven to four during the course of the session.

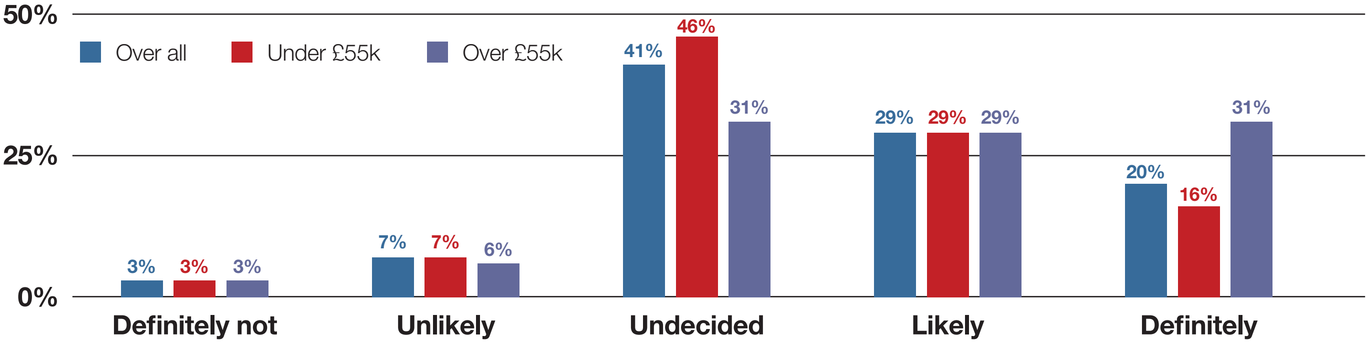
This research suggests that the target group for the USS Investment Builder could expand following a programme of education and communication explaining the benefits of the matching employer contributions and the other options and choices available.

How likely are you to take the matching contribution in USS Investment Builder?



Source: Member focus groups, Ignition House.

Member responses on take up of the 1% matching contribution from employers



Source: DC member survey.

[19] The threshold is expected to be revalued in line with consumer price index (CPI) inflation, whilst salaries are projected to revalue at RPI + 1%, plus an allowance for a promotional scale.

Demographics

		USS membership	Survey respondents	Focus groups*
Overall	Under £55,000 salary	83%	71%	53%
	Over £55,000 salary	17%	29%	47%
Overall	Under 45	52%	44%	27%
	45 to 54	28%	34%	39%
	55 and above	20%	23%	34%
Under £55,000 salary	Under 45	63%	53%	37%
	45 to 54	23%	30%	41%
	55 and above	14%	17%	22%
Over £55,000 salary	Under 45	22%	21%	11%
	45 to 54	43%	44%	39%
	55 and above	35%	35%	50%
Overall	Male	53%	55%	58%
	Female	47%	45%	42%
Under £55,000 salary	Male	48%	48%	unknown
	Female	52%	52%	
Over £55,000 salary	Male	71%	73%	unknown
	Female	29%	27%	

* if available
Figures are subject to rounding.

More than half (52%) of the overall USS population is under 45, whilst 28% are aged 45-54, 11% are aged 55-59, and 9% are aged 60 and over. Given the earnings threshold is £55,000 initially, the target group who will automatically be covered by the USS Investment Builder is relatively older than the overall active membership because older members are more likely to have progressed further in their careers and therefore have higher salaries. When compared to the overall age demographics for USS active members, older members were over represented in the survey and the focus groups.

In the group earning £55,000 and above who responded to the survey, the majority (67%) were between the ages of 45 and 59, with just under a quarter between 50 and 54. This group is slightly older than the overall survey respondents – just under half of the total group were between 45 and 59, and 29% were under 40, compared with just 8% of the higher earning group falling into the youngest age bracket.

The group who said they would definitely take up the 1% employer match were again most commonly between the ages of 45 and 59. Younger members aged 55 and under were more likely to say that they were likely to match, but the combined totals for those likely and certain to take up the match were 54% for those aged 45-55, and 52% for those aged 55-59, compared with 46% of those aged below 45 and 44% of those aged 60 and over. Other members could be encouraged to take up the match through a programme of education and communications.

The members who participated in the focus groups also tended to be older than the overall USS population – 34% were aged 55 or over, whilst 39% were aged 45 to 54 and 27% were under 45[20].

Gender profile

The gender split of the USS population is fairly even, without taking age or salary factors into account. Overall, there is just a slightly higher proportion of men than women as 53% are men and 47% are women.

Survey respondents earning £55,000 and above were over represented by men at 73%. The overall gender split of survey respondents from the active membership was much more even at 55% male and 45% female, broadly reflecting the overall USS membership split. Russell Group universities in general are again slightly more male dominated, at 59% male compared to 41% female. More than half (57%) of the USS active membership is made up of staff at Russell Group universities. Amongst all pre-92 universities the population is 58% male and 42% female.

Men were more likely than women to want to take up the 1% match. Of the survey respondents, 14% of women said they were certain to match and 29% said this was likely. The same proportion of male respondents said they were likely to match, whilst 25% definitely intended to match. Women were more likely to be undecided – 48% of women gave this response compared to 36% of men.

The member's gender may influence what communications resonate best with them – for example, women are more likely than men to work part-time or take a career break to raise children, so their pensions concerns will be different. TIAA-CREF has conducted research into the best ways to communicate with different groups of members. They found that women spend on average eleven years out of the workforce, look for trusted partners in making investment decisions, value information from their peers, and appreciate the opportunity to get information in interactive settings. The trustee will seek to develop a segmented approach to engagement as it learns more about member behaviour and preferences.

The focus group participants were slightly more weighted towards men than the overall USS population – 58% were men, and 42% were women.

Earnings

Those earning £55,000 or more will be automatically affected by the introduction of the USS Investment Builder in October 2016. This represents 17% of the USS active membership.

The group who earn at least £55,000 were more highly represented in the research we carried out, and made up 29% of those who responded to the member survey, and 47% of those who attended focus groups.

[20] These figures do not add up to 100% because we did not have age data for all participants

Section Four – Lessons from other DC schemes

We looked at examples of best practice in other DC schemes to help inform our decisions and benchmark the potential USS investment offering against other high-profile hybrid and DC schemes. The National Employment Savings Trust (NEST) has served as a useful example as they have also been tasked with providing a high quality DC offering for a large, multi-employer membership. Although the demographics are likely to be very different to those of USS some of the principles and the rigour with which decisions around the investment design have been made are similar. We learned from the member research brief which NEST produced[21], which explained how they assessed their members' attitudes to risk, and their approach to choosing a self-select fund range, for example including an ethical and a Sharia-compliant option.

The Pensions Trust, a multi-employer trust based pension scheme predominantly targeting charities and the voluntary sector, surveyed its members in 2010 and it became apparent that ethical and responsible investing were important to the membership, so the trustees introduced a new ethical fund to its range of investment options. It is particularly important to ask the membership what they actually want when member preferences that depend on personal belief systems are involved. The USS trustee asked members to give views on approaches to ethical investment as part of the DC survey, including any specific areas they would want to exclude from their DC investments, such as arms, fossil fuels, and tobacco.

International experiences

Whilst designing the USS Investment Builder for USS we have learned valuable lessons from overseas schemes. Many of them have gone through similar processes when trying to understand their membership and construct the most appropriate scheme for them. Three relevant pension schemes are: TIAA-CREF in the United States, and UniSuper and QSuper in Australia.

[21] NEST Member Research Brief https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/member-research-brief,PDF.pdf

TIAA-CREF https://www.tiaa-cref.org/public/index.html

The Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF) provides pensions for people who work in academia and research in the US, and is responsible for managing $834 bn. TIAA-CREF offers members Lifecycle funds with investment strategies designed to target dates when they are likely to retire – for example there would be a Lifecycle 2045 fund for a member who was likely to retire in 2045. TIAA-CREF manages these funds and allocates members to the strategies deemed most age appropriate.

TIAA-CREF provides deferred annuities, which allows employers to supplement their pensions offering by giving members access to a predictable income. The Investment Horizon annuity provided by TIAA-CREF allows members to lock in their interest rates for a fixed period of time whilst building and investing their savings. When that period finishes the member has the option to take an income from the annuity or to keep their funds invested at another set interest rate. When the member decides it is an appropriate time to start drawing on their income for retirement they have three options – to take the money as a lump sum, as income for a specific period, or as a fixed income guaranteed for life. This structure builds in the option for members to take a secure income at a point in the future, providing them with the security offered by the DB benefits in a hybrid scheme such as those provided by USS Retirement Income Builder..

TIAA-CREF has also done extensive research into its membership to inform its strategy and decide the most relevant ways of segmenting members. TIAA-CREF acknowledges the need to understand the membership, and advocates looking at different members according to their life stages, and any other characteristics which could influence their savings needs – for example, women may be more likely to take time out of their careers to care for children. USS likewise appreciates the importance of understanding the people who make up the membership.

Section Four – Lessons from other DC schemes

UniSuper https://www.unisuper.com.au/

UniSuper is the Australian equivalent of USS in the sense that it is responsible for providing pensions for the higher education and research sectors, and manages AUD $49.2 bn. As academia is an international profession, there are many similarities between the UniSuper and USS memberships in terms of their demographics and aspirations.

UniSuper also offers a hybrid scheme made up of DB and DC components. Like USS they carried out research to find out what their members want and designed the Flexi Choice structure. Members have the choice of how they split their contributions between the DB (termed “formula-linked”) and DC (“market-linked”) sections, and they can change that split over time. Their DB benefits are calculated with reference to the length of their service and level of contributions into the formula-linked section.

UniSuper acknowledged the importance of keeping the DB section open as members see it as a valuable benefit, but found that members would also appreciate the added flexibility and possibility of enhanced returns offered by the DC section.

QSuper https://qsuper.qld.gov.au/

QSuper is another one of Australia’s superannuation funds, which manages AUD $50bn in retirement funds for Queensland Government employees. QSuper offers its members a defined contribution “Accumulation” account.

The QSuper default strategy is known as the Lifetime fund, and members in that fund are automatically allocated to an investment strategy according to their age and level of savings in QSuper. As members progress throughout their careers they are automatically reallocated to the strategy that is deemed most suitable, according to their capacity for risk – younger members are put in higher risk funds targeting higher returns and older members are put in lower risk funds with lower returns as they approach retirement.

Capacity for risk lies at the heart of the QSuper pension arrangement, and it is a factor which we have taken very seriously in designing the USS Investment Builder. The next section will explore what we have discovered about our members’ ability and willingness to take risk in their pension savings.

Section Five – Understanding USS members' capacity and appetite for risk

Risk preferences

Managing risk is a core part of providing a pension, and different levels of risk will be appropriate for different individuals at various stages of their career. This is particularly relevant in the DC context because the member, rather than the employer, bears the risk. When constructing the DC default strategy and range of self-select fund options we had to determine what levels of risk would be appropriate for the membership. There are two elements to this risk assessment:

1. Capacity for risk: How much risk the member can take without jeopardising the security of their retirement income. Risk capacity will be influenced by factors such as how long they have until retirement, their level of financial education, how much debt they have, and the level of their assets outside the USS scheme (for example an inheritance or property).
2. Appetite for risk: Individuals will be willing to accept varying levels of risk with their investments depending on their own perceptions of the stock market and their own circumstances. Members' experiences may affect how amenable they are to taking risk with their pension arrangements.

Capacity for risk is easier to measure than appetite for risk as it is influenced by more objective measures, whereas appetite for risk is more personal and emotion driven. We have addressed appetite to risk by engaging with individual members through focus groups and questions in the DC survey. Perception of risk is also likely to be influenced by members' preconceived ideas about pensions and DC in particular, so we carried out some research to find out what USS members currently think about pensions.

Attitudes to pensions

The USS membership is an unusually highly educated group, but that does not necessarily mean they are well versed in pensions or comfortable with making investment decisions. We wanted to gauge the level of understanding members had about pensions and savings in general as well as the benefits they are entitled to receive from USS specifically.

The focus groups run by Ignition House provided a useful way of getting spontaneous and specific feedback on the areas of pensions and USS which members found confusing, and also of raising awareness about the new scheme structure and the differences between DB and DC pensions in general.

Ignition House is an independent research consultancy which specialises in pensions and financial services. USS worked with Ignition House to conduct qualitative research into the USS membership through focus groups.

Section Five – Understanding USS members' capacity and appetite for risk

Focus groups with USS members

Ignition House conducted a comprehensive qualitative research programme with USS members to inform the design of the new USS Investment Builder. We used a deliberative research methodology to explore what members thought and felt after being exposed to information about the scheme changes and different investment and retirement options.

More than 110 self-selecting members from seven institutions took part in 16 three hour sessions. There was a good mix of respondents by age, gender and earnings, which enables insights across different subgroups of the USS membership. This sample is line with the level of robustness expected of qualitative work undertaken for organisations under public scrutiny.

A significant proportion of members had only ever been a member of the USS scheme. This is very different to the wider population of Great Britain,, who typically have a myriad of DB and DC pension arrangements in place from many different employments. There was also a higher proportion of members whose partners are also members of DB schemes, resulting in less exposure to DC at the household level. Consequently, there was a lot of uncertainty about how DC schemes work in both the accumulation and decumulation phase, which will require a significant amount of member communication.

Members' personal savings appear to be more concentrated in savings accounts and cash ISAs than in the general population, which means they have had very limited exposure to investment risk to date. Members see investment risk as the main risk in the USS Investment Builder, and many were worried that their lack of knowledge and experience could result in them making poor choices.

Members were more capable than the general population at assimilating information on risk. Members were able to make reasonable assessments of risk levels from a range of portfolios. They identified a common set of factors affecting appetite for risk, ranking the importance of the DC pot to financial well-being and the size of the pot as their most important factors.

The vast majority of members were willing to take some investment risk with their DC pot, and many were willing to take more risk than with their personal investments. Several reasons were given: the value of the DC pot will be small or a very minor part of overall provision, so they see their DC assets as nice to have, rather than a necessity.

Their USS Retirement Income Builder entitlement provides a safety net enabling them to take more risk with their DC pot, and younger respondents can take risk as there is enough time to make up any falls. Showing members illustrative income projections from their DB and DC savings helped to bring this to life, with some increasing their appetite for risk considerably once they understood the impact of the DB underpin.

Members felt there should be a default in place for those that do not want to make any active choices, but that this one size fits all approach is not sufficient. Most members wanted a small range of funds, ideally no more than six. Results from a number of exercises confirmed that the majority of members are likely to choose a low to moderate risk investment portfolio. Most felt that there should be an ethical fund made available in these options, but a small minority strongly voiced support for an ethical default. Despite a low awareness of lifestyling, members felt that it was important to vary the level of risk in any default strategy with age.

Members did not think that they could sensibly engage with decisions about how they would want to access their DC savings until around five years before retirement. Low engagement with DC pensions to date means that member education will be needed to explain the options, in particular around the tax implications of how they access their DC savings.

Janette Weir, Director, Ignition House

Section Five – Understanding USS members' capacity and appetite for risk

Knowledge of DC pensions

Members' understanding of the new USS Investment Builder will be influenced by their prior knowledge and experience of DC pensions. USS members who have only been members of the USS pension scheme and those who have come from public sector organisations are unlikely to have personal experience of DC pensions, whereas those who have moved into USS from the private sector are likely to have saved into DC pension schemes previously. USS will take into consideration the relative lack of familiarity with DC amongst the active membership when communicating the revised scheme.

Policy belief:

While many USS members do not currently have any experience of DC saving, and are not confident in making investment choices, a substantial number would feel empowered to engage in decisions if they were provided with the right information and materials by the trustee and their employers.

“If I had enough information, I could then make a decision on what type of investment I'd like my personal pots to be put in. And that's fine – I'm comfortable with that”

Birmingham respondent

“Some people might enjoy working out how to maximise their investments, but that's not me. I don't know how to do it. I would much rather keep it at arms-length and have someone else do it”

Manchester respondent

Members did have some understanding of the benefits of saving into a DC scheme. They typically knew that a DC scheme could allow them to access their money before their normal retirement age and they could take money out tax free. They also understood that they would have the flexibility to make their own investment choices, and there was the potential for their money to continue to grow if the markets performed well – unlike in a DB scheme.

Some members were very well informed about DC investment and wanted to have access to detailed information about the charges associated with the funds available.

Policy belief:

For the small minority of members expected to be very actively engaged more detailed information should be readily available where possible, including specific information around the investment options, underlying fund managers, and the charging structure within the USS Investment Builder, provided this does not compromise the trustee's ability to make improvements and respond to changing circumstances.

“We would need to know very clearly what the annual charges would be”

Leeds respondent

Section Five – Understanding USS members' capacity and appetite for risk

Some members did not understand the benefits of saving into the USS Investment Builder rather than a SIPP or ISA in the form of employer contributions and lower costs and charges.

Members were understandably confused about the tax implications of DC, including the benefits of tax relief on contributions and what could and could not be taken as tax-free cash. Some did not understand the difference in tax treatment between a transfer out to another approved pension and taking money out directly from USS or another scheme by crystallising the benefits. Members were afraid of making decisions that would result in paying too much tax, and were concerned that the tax regime could change and remove advantages.

Policy belief:

The communication materials and engagement strategy for the new hybrid scheme in the early years of the USS Investment Builder should address members' key concerns and uncertainties around the new scheme structure and how it affects them personally, and should highlight their options around making additional contributions, active investment choices, and retirement options (including tax implications) within the scheme. Members already close to retirement should be made aware of the choices that will be available to them from the outset and the potential tax implications of different options.

Understanding and awareness of the revised scheme structure

We wanted to know how much members already know and understand about the revised scheme structure, to help us decide where there was a need for more targeted communications. The focus groups were particularly useful as they provided an opportunity for open discussion with members about their perceptions, and allowed them to ask questions.

As a self-selected group the focus group participants are likely to have been particularly interested in, or concerned about, their pension provision – but there were still clear misperceptions and gaps in understanding which were raised during the sessions.

There was some confusion about how the DB and DC schemes would work together in a hybrid arrangement, and some participants expressed concern that the new scheme rules could be too complicated and potentially put off younger members.

Some members were unaware that the final salary scheme would be closing for everyone. There was also some confusion about the earnings cap and some members did not initially realise that the USS Investment Builder would only apply to earnings above £55,000.

We asked members to define how they felt about the scheme changes at the beginning and end of each focus group. Participants' initial reactions were often negative, with many selecting words like cautious, uneasy, wary, and doubtful. More than half had the perception that they would be a little or a lot worse off under the new structure. By the end of the session there were more positive responses coming through, with more members saying the changes were rational and sensible, and some saying they now felt more prepared and optimistic.

Answers to an open request for feedback on the changes produced a mixed response at the focus groups. Some members said the changes were a measured and well thought out response to a difficult situation, and one felt they would protect lower earners. Others were more negative and felt let down or that there was no need for the changes. Some mistakenly believed that the reason for the DB deficit was poor investment performance, which provided the opportunity to explain that the deficit is to a large extent driven by increasing longevity, liabilities, and market conditions.

Section Five – Understanding USS members' capacity and appetite for risk

Capacity for risk

Members' capacity for risk was a very important consideration when designing the default strategy as the trustee should ensure that the investment options are designed to expose members to the appropriate level of risk and return to meet their needs in retirement. The potential hazards of misjudging risk capacity are twofold – set the risk level too low and members may not get the level of returns they need to get the retirement income they want. On the other hand, setting the risk level too high could expose members to more loss than they can afford and again reduce their potential retirement income.

Capacity for risk is not precisely defined but is generally assessed according to the members' income, level of savings and debt, level of financial education and experience, and the time horizon they have before they plan to retire. Well informed members with high earnings, high savings, low debt, and a long time horizon have the greatest capacity for risk. Those who have saved less and have higher levels of debt can afford to take less risk, particularly as they get closer to retirement.

Policy belief:

USS members in the USS Investment Builder will generally have greater risk capacity than members in pure DC arrangements and could target a relatively high rate of investment return within a growth phase, and beyond, because of the DB underpin within the scheme. The relative role of the USS Retirement Income Builder will be kept under review as the hybrid arrangement overall, and the USS Investment Builder specifically, evolves.

As USS members have a DB underpin they have predictable underlying savings, meaning that their capacity for risk is likely to be higher than for members of another DC scheme. However, for higher earners with salaries significantly above £55,000, who are at a relatively early stage in their careers, the USS Investment Builder could make up a material proportion of their USS benefits. We are aware that many members will not be included within the USS Investment Builder until they are part way through their careers, so will need to monitor the scheme's demographics and provision to ensure it remains relevant.

Members of DB schemes have been found to have a better understanding of pensions than members of DC schemes, according to research carried out by the Pensions Policy Institute. All USS members belong to a DB scheme, so according to this research they are likely to understand pensions better than members of pure DC schemes and therefore their capacity for risk may be higher[22].

Policy belief:

Generating investment returns will particularly impact the levels of retirement benefits for members for whom the USS Investment Builder will make up a significant part of their overall retirement savings provision from USS.

[22] Transitions to Retirement, Pensions Policy Institute, November 2014
http://www.pensionspolicyinstitute.org.uk/publications/reports/transitions-to-retirement---'how-complex-are-the-decisions-that-pension-savers-need-to-make-at-retirement

Section Five – Understanding USS members' capacity and appetite for risk

We asked survey respondents when they expected to retire and what assets they thought they would have to support them in retirement.
This information is key when measuring capacity for risk. We realise that many members will not start saving into the USS Investment Builder until later in their career, so this is another USS specific consideration to take into account.

Policy belief:

Many members will not make significant contributions into the USS Investment Builder until part way through their working life. Maintaining the potential to generate strong investment returns through a member's mid and late career will therefore be important in order for the USS Investment Builder to offer an attractive investment return and retirement outcome to those members.

The most common expected retirement age was 65 (35%), but 20% expected to retire at 67 and 10% at 70 or over. Those who expected to retire late were split between those currently aged under 45 (15%) and those aged 60 or over (16%).
A possible explanation at the younger end would be that members have seen the state pension age increasing steadily, and at the higher end members may have a more realistic idea of the number of years they want to, or feel they have to, continue working in academia.

Policy belief:

Younger members within USS are expected to have a higher capacity for risk than older members given their longer horizon until retirement and, associated with that, their ability to recover from investment losses.

Looking at a longer time horizon would increase members' capacity for risk as they can take more investment risk in the early years because they need to build up their returns and have time to recover from any losses. Most members will not automatically be saving into the USS Investment Builder at the start of their careers because of the salary threshold, but may have chosen to take up the 1% match, and may well enter the USS Investment Builder in the middle of their careers, which would still give them time for longer term investment. The default strategy will include what is known as lifestyling – this is where members are automatically moved into lower risk funds as they approach retirement and their capacity for risk decreases.

> "I think you should be switching people into a much lower risk investment post retirement because they no longer have the contributions coming in and they no longer have the luxury of the time to recover from investment decisions"
>
> **Oxford respondent**

Most (80%) of those who strongly agreed that their USS pension would be their main source of income were aged 55 or over, and were therefore likely to have a better idea of what their financial position and assets would be at retirement. Likewise, 8% of those who were 60 or over strongly disagreed that the USS pension would be their main source of income, compared to 2% of those under 45, and 3% of those aged 44-55. Older people can take stronger views on this point because they have a better idea of their circumstances.

Section Five – Understanding USS members' capacity and appetite for risk

Men were more likely than women to be dependent on their USS pension as their main source of income in retirement – 74% of men either agreed or strongly agreed that that was the case, compared with 63% of women. Women may be more reliant on pension provision from a partner if they have taken time out of the workplace (and therefore out of pension saving) to raise children, although most will also receive the state pension which could potentially be a source of income.

Higher earners were more likely to be the breadwinners for their families so they were more likely to disagree or strongly disagree that a spouse or family member would support them through retirement. This reflects the responses given by 41% of those earning £55-75,000 and 49% of those earning £75,000.

Following the same trend, 61% of respondents disagreed or strongly disagreed that they expected income other than their USS pension would cover most of their spending needs in retirement. The USS pension will form the core of most members' pension provision, rather than any other assets, for example those belonging to another family member or invested in property, or the state pension or other private pension savings.

Demographics were relevant to the likelihood of having other sources of income. A third of those aged 60 or over thought that their spending needs would be met by other sources of income, including working beyond retirement age, compared with 23% of those under 45. Again, those aged 60 or more are more likely to know what assets they will have access to when they reach retirement.

Those on higher salaries were less likely to have other sources of income to fund their retirement – 72% of those earning £55-75,000, and 71% of those earning £75,000 or more disagreed or strongly disagreed that this would be an option. Those who had reached the career positions which attract higher salaries would traditionally have worked their way up through the hierarchy of higher education institutions, and therefore will likely have been in USS for a substantial period rather than accruing benefits elsewhere. These members will likely be expecting to receive a relatively high level of pension, so will be less likely to need to supplement their pension through other sources of income.

Another source of income members may have in retirement could come from any work they may take on post-retirement. More than half (55%) of the survey respondents expected to do a little paid work post-retirement, but only 4% said they would do a substantial amount, and a substantial 41% expected to do none. Having an ongoing income in retirement would give members more scope to take risk.

Even those who plan to work for a long time and have significant savings could have a lower capacity for risk if they also have high levels of debt. The majority (88%) of survey respondents expected that they would not have significant outstanding debts when they retired. Those who were older were more confident that they would not be in debt, and so were those on lower salaries.

USS members' collective capacity for risk in the USS Investment Builder is slightly higher than average – they have a predictable income from the USS Retirement Income Builder for the first £55,000 of their earnings, many expect to do some work in retirement, and few expect to have significant debt by the time they reach retirement. However, most USS members are dependent on their USS pension for their retirement income so it is important to make sure that they are not exposed to an inappropriately high level of risk.

Section Five – Understanding USS members' capacity and appetite for risk

Attitudes to risk

Regardless of a member's objective capacity for risk they may have different ideas about the risk they feel comfortable taking. We have measured attitudes and understanding of risk using survey analysis and focus group based research. We had support from the research organisation A2Risk, which has developed a metric for representing members' attitudes to risk where higher numbers represent greater appetite for risk.

A2Risk is a specialist research company which has used profiling tools to help USS identify its members' attitudes to risk. A2Risk analysed questions on risk capacity and appetite as part of the USS member survey on the USS Investment Builder and assigned Attitude to Risk scores to various cohorts of members to allow for comparisons, as described on the following pages.

“Regardless of a member's objective capacity for risk they may have different ideas about the risk they feel comfortable taking”

Section Five – Understanding USS members' capacity and appetite for risk

The A2Risk (Attitude to Risk) approach

Our methodology

A2Risk use ATRQ, a set of 12 plain English statements, and respondents state the extent to which they agree or disagree with each statement. No specialist investment knowledge or numerical ability is required. The questions cover a number of factors related to attitude to risk, including:

- Investment knowledge – more knowledgeable individuals tend to be more risk tolerant;
- Overall comfort with risk – some individuals are simply more comfortable with risk in general;
- Investment preferences – individuals' perceptions on the risk of particular kinds of investments;
- Regret – individuals prone to regret tend to be less risk tolerant.

The response scale (known as a Likert Scale) allows five responses ranging from strongly agree to strongly disagree. Individuals' responses are converted into an ATRQ score using a proprietary calculation developed in A2Risk's research. The score is mapped to an ATR Category, which has a description of the typical characteristics of individuals in that category.

It is important to bear in mind that the ATRQ score and categories are relative rather than absolute.

The individual's ATRQ score is mapped to five ATRQ categories. Each category covers a range of scores and has a written description of the typical characteristics of individuals in that category. The ATRQ was developed based on five categories, reflecting a balance between differentiating between different levels of risk tolerance, while acknowledging that a questionnaire can only capture broad aspects of personality.

The categories include cautious investors; moderately cautious investors; balanced investors; moderately adventurous investors and adventurous investors (see Appendix A for full descriptions).

The USS survey of members is the largest survey we are aware of that has explored attitudes to investment risk and used psychometric methodology to score ATR.

Findings for USS members responding to the survey

Around 9,700 responses were received to the survey sent to USS members via the employers. Given the higher average earnings of USS members (the average of UK salaried workers is just over £26,000 compared to £38,000 for USS members) the benchmark group used for comparison purposes was a sample of GB adults earning over £30,000 or more. Over 90% of the survey respondents reported an annual income of over £30,000.

Overall, the USS membership was found to be slightly less adventurous than the benchmark group used (with an average A2risk score of 19 compared to 21), but slightly more adventurous than the GB sample overall. A larger proportion of USS members are found to be cautious compared to the GB population who earn £30,000 or more.

When honing in on the group of USS members most likely to be contributing to the USS Investment Builder (those earning over £55,000 and those who say they are likely to or will definitely match) the average A2Risk score is found to be very similar to that for the benchmark group, with a score of 21.

Male respondents in the USS survey tended, on average, to be more adventurous than female respondents, and this finding is consistent with the GB population when controlled for age and salary.

Section Five – Understanding USS members' capacity and appetite for risk

For members earning less than £55,000 and intending to match 1% contributions, ATRQ averages 20 compared to 17 for those intending not to. This difference holds across salary and gender bands and is economically and statistically significant.

USS has used the A2Risk ATRQ System to inform the design of the default strategy and a range of self-select fund options. Crucially, this assessment of psychological willingness to take risk has been combined with a broader assessment of individuals' capacity for risk.

USS members completing the survey were asked to consider their capacity for loss in the context of the new USS Investment Builder. Since they will be building up DB rights for salaries up to £55,000 in the USS Retirement Income Builder, members will have greater capacity for loss than would typically be the case compared to the population at large and those saving exclusively in DC. This is because a fall in the value of the DC fund would not affect the DB underpin and individuals are protected against downside risk.

Professor David Blake, director of the Pensions Institute at Cass Business School, and scientific adviser to A2Risk

Despite their relatively high capacity for risk, USS members who responded to the survey or participated in focus groups tended to be risk averse. Most (63%) would look for safer investments even if it meant lower returns, although this is unlikely to be an appropriate strategy for younger members, for example, given their long time horizon and higher capacity for risk.

Members on higher salaries were typically more willing to take risk than their lower paid peers. The average ATR score amongst members earning less than £35,000 was 17, and that figure increased to 20 for those earning £35,000-54,999, 21 for those earning £55,000-74,999, and jumped to 23 for those earning £75,000 or more.

The average ATRQ for members who would fall within the DC target group was 21 (higher than the overall average for USS of 19), which in isolation would indicate that a moderate risk strategy would be appropriate, according to the measures used by A2Risk.

Policy belief:

The appetite for risk of USS members expected to be saving into the USS Investment Builder (those members earning £55,000 and who say they are likely to take up the 1% employer matching contribution) is relatively high when benchmarked against the GB population.

ATRQ scores[23] for sections of the USS membership compared to the GB population

	GB adults average	GB population earning £30,000 +	All USS	up to £34,999	£35,000-£54,999	£55,000-£74,999	£75,000 or more	USS DC Target member group
min	0	1	0	0	0	0	0	0
25th percentile	13	15	13	12	13	16	16	14
median	18	20	18	16	18	23	23	19
mean	17	21	19	17	20	21	23	21
75th percentile	22	25	24	21	24	29	29	25
max	46	46	48	46	46	46	46	46

[23] Maximum score is 48 based on a maximum score of 4 for each of the 12 questions.

Section Five – Understanding USS members' capacity and appetite for risk

Members in the USS Investment Builder had a higher appetite for risk than the general USS population. Overall, just 12% of USS members strongly agreed they were not prepared to take any risk within their DC pension fund, and 25% agreed. Just 13% strongly agreed that people who knew them would describe them as cautious, although 49% agreed. Women were slightly more likely than men to be described as "cautious", with 65% of women saying they agreed or strongly agreed they would be described that way, and 61% of men saying the same. Those on lower salaries (up to £55,000) were more likely to say they were cautious than those earning £75,000 and above – 69% of those at the lower paid end of the spectrum said they agreed or strongly agreed, compared with 51% of those on higher salaries.

There was also a link to salary on the question of whether risk was perceived as opportunity – 29% of those who earned up to £55,000 agreed or strongly agreed that they associated risk with opportunity, but this rose to 44% amongst those who earned £75,000 or more. Meanwhile, members on lower salaries were slightly more likely to agree that they felt anxious – the figures were 31% for those earning up to £55,000, 26% for those on £55-75,000, and 22% for those on £75,000 or more.

Policy belief:

The attitudes to risk of USS members are diverse: salary and gender are more important drivers of USS members' risk appetite than their age, with higher earners and men generally having higher risk appetites than lower earners and women, and with younger and older members generally having similar levels of risk appetite, once salary and other factors have been taken into account.

Some members expressed feelings of fear about investing their money in the stock market, primarily because they did not have much investment experience. Investment risk was seen as the main risk in the USS Investment Builder amongst focus group participants, and many were worried about making the wrong choice. Almost half (41%) of survey respondents said they did not feel comfortable investing in the stock market, and most (54%) said it took them a long time to make up their minds on investment matters.

Members would typically prefer to increase the amount they are saving than go into higher risk investments – two thirds gave that response, and age had little impact on the spread of their opinions.

The focus groups provided a forum for members to discuss their views on risk and get a sense of their emotional reactions. A number of focus group respondents had never had any exposure to DC or other financial investments, which may have led the respondents to express a lower appetite for risk than they may have capacity for, taking into account the ongoing DB underpin in the new hybrid scheme.

Policy belief:

Understanding the role of the USS Retirement Income Builder relative to USS Investment Builder can be an important driver of appetite for investment risk, with members appearing more relaxed about investment risk in their DC investments once they understand the relative role of their DB pension and DC savings in delivering retirement income.

Section Five – Understanding USS members' capacity and appetite for risk

There was higher appetite for risk amongst members who realised that the USS Investment Builder was a relatively small part of their overall pension provision thanks to the DB underpin. Several focus group participants noted that the value of the pot would be comparatively small, so they were happier to take more risk in the knowledge that they had the safety net of their USS Retirement Income Builder. Older members earning more than £55,000 were particularly aware that they would only have a limited time to build up a DC pot in the USS Investment Builder, so the entitlement they have already built up was by far the more important benefit.

Policy belief:

Members already close to retirement (within 5-10 years from retirement) generally identify the USS Investment Builder as a "top up" on their existing retirement savings within USS. Within this group there is a diverse range of views – with a small minority of members having either a very strong appetite for capital protection or a very strong appetite for taking lots of investment risk.

"I know in the back of my mind I also have my DB pension so I was willing to take the extra risk"

Leeds respondent

Understanding reactions to volatility and loss

USS members are concerned about stock market volatility – two thirds agreed that this was the case, and the age of the member had little impact on their attitude. Higher earners were less likely to be concerned about stock market volatility – 14% of those earning £55-75,000 said they were not concerned, along with 22% of members earning £75,000 or more.

Members responding to the DC survey were not generally comfortable with seeing the value of their investments fall. We asked how much their investments' value would have to drop before they would begin to feel very uncomfortable. More than a quarter (27%) said they could not tolerate any fall, 17% would feel uncomfortable with a 5% drop, and 27% drew the line at 10%. At the higher end of the risk appetite spectrum 21% said they could handle a fall of 20% or more.

Those with higher salaries were more willing to accept greater falls in the value of their investments – 37% of those earning £55,000 and above would only start feeling very uncomfortable when their investments dropped 20% or more.

Members who participated in focus groups were broadly pessimistic about their ability to recover from a fall – just 20% thought an investment loss in the early years could be easily recovered in future years. These members also felt that they were at risk of losing some of their initial contributions, as just 7% thought that falls in the market would usually only affect past gains.

Those with higher salaries expressed greater tolerance for loss. They are the members who will be put in the USS Investment Builder automatically, but there will also be members with a variety of salaries and risk appetites saving into the USS Investment Builder because they have taken up the 1% match or choose to make contributions of more than 1%.

Section Six – Implications for investment option and choices

Investment choices

The research into the USS membership's attitude to and capacity for risk has informed the design of the investment strategy in the USS Investment Builder – both for the default strategy and the range of self-select options which we make available.

Inertia and defaults

All default strategies must be well designed because members are put into them without specifically being asked. In the case of USS all members are expected to be saving into the USS Investment Builder once they start earning more than £55,000 as contributions above that level will automatically go into the USS Investment Builder.

Research suggests that most DC members will go into the default strategy and will remain there. Research by Madrian and Shea (2001) and Choi et al (2001) has shown that members are strongly biased towards the default when it comes to both contribution rates and investment strategies. The Pensions Regulator has reported that in the year 2014-15 there were 2,771,000 members in default strategies, whilst just 464,000 had chosen their own funds[24].

NEST has also experienced this preference for the default. The overwhelming majority (99%) of its members invest in the default. Research from the Pensions and Lifetime Savings Association (PLSA) has found that 90% of active scheme members invest in the default strategy[25]. This phenomenon is known as inertia, and it has become prolific in UK pension saving since the introduction of automatic enrolment – the law requiring all companies to enrol staff into a qualifying pension scheme.

> “I feel that the majority of people will end up in the default because people don't think about pensions and don't understand what their choices are”
>
> **Oxford respondent**

Not all members who invest into the default strategy end up there through inertia, though. Some members consider their options and make an active decision to go into the default strategy because they believe it is the right choice for them. Research from State Street Global Advisors found that more than two thirds of members were saving into a default strategy, but 49% had made an active decision to do so, rather than being put into the default by the scheme administrator. Members who responded to the State Street survey said they had chosen to be in the default strategy because it was convenient, contained attractive investment choices, or came with a perceived recommendation from their employer or provider[26]. It is therefore important that employers are satisfied the default fund is appropriate for their USS staff.

Default strategies are extremely influential as they typically affect the retirement outcomes of the majority of a pension scheme's membership. That is why it is so important for the trustee to maintain an up to date understanding of the shape of the membership, their preferences, and their capacity for risk.

[24] The Pensions Regulator DC Trust: A presentation of scheme return data 2014-15 http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-a-presentation-of-scheme-return-data-2015.aspx#s16647

[25] Pensions and Lifetime Savings Association (PLSA) Annual Survey 2015

[26] State Street Global Advisors 2013 Member Survey

Section Six – Implications for investment option and choices

Inertia and fund choice

The USS Investment Builder will feature a default strategy, which we would anticipate the majority of members investing in, but we will also offer a range of options. Research has shown that it is important to be careful about the fund choices which are made available (see the behavioural study to the right). Members can be overwhelmed by too much investment choice and make disadvantageous decisions. There is a body of research which suggests that the "tyranny of choice" can lead to poor or no decision-making. Focus group participants expressed a preference for a limited range of options – suggesting that up to six would be appropriate. There is also a risk that if members are given a range of funds they will allocate a proportion to each, which will lead to inefficient portfolio construction and poor outcomes.

> "If I was confronted with a choice of twenty funds I wouldn't know what to do. It needs to be simplified into low risk, medium and high and I can choose and mix and match between them"
>
> **Leeds respondent**

Behavioural study – Choice and investment

Cronqvist and Thaler (2004) carried out a study into the investment choices made by members of the Swedish national occupational pension scheme, which covers all adult Swedes born after 1938 – a diverse population who were typically unused to making investment decisions. When the scheme was set up in 2000 there were 456 funds to select from, and following an intensive publicity campaign two thirds of those who were enrolled into the scheme chose to select their own portfolios.

Three years after the scheme launched just 8.4% of the members being newly enrolled into the scheme were making active investment decisions, suggesting that members will not make such decisions without the influence of communications campaigns, and inertia will prevail.

Those who made active investment decisions typically chose higher levels of equity exposure than the default, and as a result chose funds with higher fees of around 77 basis points higher than the default strategy.

Investors did not amend their asset allocation as they accrued their benefits, which meant that many were hit by the end of the dotcom boom. This study showed that encouraging inexperienced investors to make choices and giving them a large range of options can have significant negative effects. At USS we have chosen to offer a tailored range of investment funds alongside the default strategy. Trust based schemes typically offer a focussed range of funds of around five to fifteen, according to research from Willis Towers Watson[27]. The median number of fund choices found by the Pensions and Lifetime Savings Association in its latest DC survey, including contract-based arrangements, was also fifteen.

[27] Towers Watson FTSE 350 Defined contribution pension scheme survey 2014

Section Six – Implications for investment option and choices

Other fund choices

Although it is designed to suit the needs of the majority, not every USS member will want to go into the default strategy. Some will have strong views about the level of risk they are willing to accept, or will have ethical or religious reasons for wanting to go outside the default strategy. Most members said they did not want to be confronted with a large range of investment fund choices, which they might find overwhelming, so we used our research to develop views on which specific funds would be the most appropriate for our membership.

We have identified three broad attitudes to investment – those members who want to manage their own portfolios, those who would like to make some decisions but need help to do so, and those who do not wish to make any investment decisions. For the latter group a strong default strategy is required, but there will also be a range of funds, and some blended funds for members who have a higher or lower appetite for risk, but who do not have the investment experience to build their own portfolios.

Giving the option of blended funds reduces the risk that inexperienced members will make poor decisions when trying to construct their own portfolios. There are two risks which are mitigated through blended funds – the risk of naïve diversification, where members allocate equally across all available funds, which makes for an inefficient portfolio, and the risk that members will not revisit their portfolio construction so what was originally an appropriate allocation may become unsuitable over time. Trustees have a fiduciary duty to be aware of the potential for these poor outcomes, and should help mitigate them by offering constructed funds for members with different attitudes to risk.

Given the breadth and diversity of the USS active membership, there was a reasonable presumption from stakeholders that we should be providing ethical and Sharia-compliant funds, and this has been backed up by our research findings. The proportion of schemes offering ethical funds has increased from 37% in 2010 to 60% in 2014, and the proportion offering Sharia-compliant funds has increased from 22% to 29%[28].

Policy belief:

Across the USS membership there is a significant minority of members who have expressed the wish to take an active approach to ethical investment, and who are expected to find fund options that screen out certain issues attractive. Examples of these issues include arms manufacture, environmental issues, tobacco, fossil fuels, worker exploitation and child labour. In addition, there is a smaller minority of members with a positive interest in Sharia-compliant investment options in the USS Investment Builder.

[28] Towers Watson FTSE 350 Defined contribution pension scheme survey 2014

Section Six – Implications for investment option and choices

Ethical investment

Many USS members feel that the nature of their work means there should at least be the option of an ethical investment fund, although some think all the funds USS invest in should be ethical. Almost half (49%) of those surveyed expressed a strong interest in ethical investment in USS Investment Builder. "Being in higher education, we might want an ethical option," said one member who participated in the Manchester focus group. A commonly held view amongst members is that the higher education sector has a role to play in creating a better or more sustainable society. One member who attended the Oxford focus group said: "USS, particularly, should not have just one ethical fund but a range because the higher education sector has a higher proportion of people who are actually thinking ethically about their money".

One feature of DC that was attractive to many focus group participants was the option to choose where their money was invested, and a number of members mentioned ethical and socially responsible investments unprompted. Most respondents felt that ethical funds should be optional, although there were a few very vocal members who said they should also be included in the default strategy, although there was not always consistency on what should be included in, or excluded from, an ethical fund.

We delved down into attitudes towards ethical investment in more detail through the DC member survey. Members responding to the survey expressed a high level of interest in ethical investment, even in situations where an ethical investment fund could potentially incur higher charges or produce lower returns. Younger members and those on salaries up to £75,000 were more interested and more likely to opt for an ethical investment fund than older members and those earning above £75,000. Those earning £55-75,000 were the most likely to consider ethical investment even if it meant higher charges or lower investment returns – half of the respondents in that salary bracket said they would. These members are very likely to be saving into the USS Investment Builder over the next few years as they have breached the £55,000 salary threshold.

Very few respondents would rule out investing in an ethical fund completely. Even though 11% of respondents said they were not at all interested in ethical investment, just 7% said they would certainly not opt for an ethical investment fund.

Negative screening and divestment was the most popular approach for a DC ethical investment option – 47% of members gave a score of seven to nine where nine meant they would very much like USS to adopt the approach.

Members identified more than 100 issues which they would like to see removed through negative screening, the most common of which were: arms, environmental factors (especially fossil fuels), tobacco, companies which exploited those in developing countries (for example through the use of child labour), and companies which did not respect workers' rights (for example by not paying a living wage or not recognising trade unions).

An ethical investment fund is not available in DB because including an ethical fund could increase the risk and costs in the scheme, which would affect all members and not just those who have opted in. There are also difficulties associated with determining which ethical standards to use as this measure is subjective.

Section Six – Implications for investment option and choices

Sharia-compliant option

As a large pension scheme covering around 150,000 active members, and multiple employers, we thought it was likely there would be interest in a Sharia-compliant fund amongst the USS membership. Some Muslims feel they would be interested in an investment fund which complies with Sharia rules.

Sharia-compliant funds can be riskier than non Sharia-compliant funds because they invest in equities rather than debt, because interest is not allowed under Sharia law as it is unearned. One of the advantages of the USS Investment Builder is that the member is bearing the risk and as such can invest individually rather than collectively (as they do in USS Retirement Income Builder). The USS Investment Builder will give members the option to apply Sharia beliefs to their pension investment, although this is not available in DB because including a Sharia fund would increase the risk and costs in the scheme, which would affect all members and not just those who have opted in.

When we put the question to the active membership through the DC survey there was a positive, though limited, interest – 2% (representing around 150 members) said they would be interested in this option.

The question of a Sharia-compliant fund was not raised spontaneously at the focus groups, but when prompted participants thought some of their colleagues could be interested. There are other schemes in this sector which offer a Sharia-compliant fund, and members may move between different schemes as their careers develop.

NEST is another multi-employer scheme which offers a Sharia-compliant fund as part of its self-select range. The master trust chose to offer the HSBC Life Amanah fund, and in its member research brief stated that there was an expectation from the market that a Sharia-compliant fund would be available given the scale and diversity of members NEST covers. NEST's research also found that the scheme's target group includes a higher proportion of black and minority ethnic groups than many other pension schemes, so therefore there could be higher demand for a Sharia-compliant fund.

USS will therefore look into including a Sharia-compliant option in the self-select fund, taking into account the level of risk and cost associated with such an investment strategy.

Section Seven – Retirement objectives

In the new pensions landscape of freedom and choice not all USS members will be working towards the same retirement objectives. We have taken this consideration into account when designing the pre-retirement investment paths and thinking about how to support members in making decisions at retirement.

The potential retirement options relating to the USS Investment Builder are:

- Take the entire DC pot as a cash lump sum;
- Go into drawdown, taking regular amounts out of the DC pot;
- Convert the DC pot into a guaranteed income stream, for example by buying an annuity;
- Continue to invest beyond retirement.

We know that most of the first members to retire from the hybrid scheme will not have a significant proportion of their pension assets in the USS Investment Builder. Their USS Retirement Income Builder benefits will make up the core of their retirement provision so they are likely to take their comparatively small DC benefits as tax-free cash.

Policy belief:

The majority of USS members reaching retirement in the early years of the USS Investment Builder will be withdrawing their DC fund as a tax-free cash lump sum (under current tax rules).

A small number of members may choose to keep their funds invested when they reach retirement, to take advantage of possible returns from the market or the ability to pass on their savings as an inheritance. Likewise they may choose to access drawdown arrangements, particularly in the future when members are retiring with more substantial DC savings. USS will monitor the decisions members actually make when they reach retirement to check they are in line with our policy beliefs and the investment offering is still fit for purpose.

The Pensions Policy Institute (PPI) worked with Ignition House to interview pension scheme members, and found that they realised pre-retirement funds targeting annuities may not be appropriate in the light of the new freedoms, and were very supportive of the idea of being offered default strategies that would run to and through retirement[29]. Taking into account the hybrid structure of the scheme, USS will continue to monitor the suitability of the pre-, at-, and post-retirement options offered, and judge whether there is a need to introduce more options as the hybrid scheme matures.

Policy belief:

The retirement objectives of members are expected to evolve as the USS Investment Builder matures and as DC fund sizes grow – the design of the USS Investment Builder including the glide path within the default strategy and pre- and post-retirement options for members will be actively governed to maximise the likelihood of achieving good member outcomes at retirement.

[29] Pensions Policy Institute, Transitions to Retirement – Supporting DC members with defaults and choices up to, into, and through retirement http://www.pensionspolicyinstitute.org.uk/publications/reports/transition-to-retirement-defaults

We would not expect members to annuitise given that they have a predictable DB underpin and are more likely to look to the USS Investment Builder for flexibility. The recent experience of a similar hybrid scheme was that just two retirees chose to annuitise their DC pots at retirement. Annuity sales have fallen dramatically since the 2014 Budget in which George Osborne announced that there would be greater flexibility in savers' at-retirement options. Figures from Legal & General, traditionally one of the UK's largest annuity providers, suggested that sales in annuities fell by 60% between the beginning of 2014 and the beginning of 2015.

Annuities were the least valued service USS could offer at retirement, according to the focus group participants, who ranked it bottom of a list of potential services including a tax calculator and income drawdown calculator (which were the most popular two options). One respondent who attended the Leeds focus group commented: "Most of my pension is going to be from DB, I'm not even thinking about buying an annuity. The DC bit provides me with the flexibility".

Policy belief:

A minority of USS members may have an appetite to keep their DC fund invested or access a drawdown product at retirement; very few members are expected to annuitise given the secure, guaranteed income provided by their DB pension already accrued.

Section Eight – Summary of conclusions

1 **Expected Membership in the USS Investment Builder**
Currently 17% of active members are above the salary threshold with earnings of £55,000 or more and so will automatically be members in the USS Investment Builder. Of those earning below the £55,000 threshold who responded to the member survey, 16% said they would definitely take up the employer match, and 29% said it was likely they would. A further 46% were undecided.
In addition, around two thirds of the current active membership are expected to be earning above the salary threshold at some point during their careers if they remain a member of USS, based on a set of assumptions on revaluation of the threshold and salary increases.

2 **Expected take up of the 1% matching contribution**
Respondents to the member survey were more likely than not to take up the additional 1% employer matching contribution – 29% said they were likely to match, and 20% said they definitely would. 41% were undecided, 7% were unlikely to match, and 3% said they definitely would not match.

3 **Expected take up of the 1% matching contribution by age and salary**
Members aged between 45 and 59 were most likely to say they would definitely match (24% in each age range). As salary increased members were more likely to say they would definitely match – 16% of those earning up to £55,000 gave this answer, and this figure rose to 29% for those earning £55-75,000 and 35% for those earning £75,000 and above. Men were more likely to say they would definitely match than women – 25% compared to 14%. It will be important to ensure that all members understand the benefits of taking up the 1% match.

4 **Capacity for risk**
The group which is expected to save into the USS Investment Builder (those earning more than £55,000, those taking up the 1% employer match, and those making additional contributions) has a relatively high capacity for risk. The hybrid structure means that members are protected by the DB underpin which will provide them a predictable annual income and the risk introduced through the USS Investment Builder will not affect the entirety of the benefits members receive in retirement. The significance of the USS Investment Builder as a proportion of their overall retirement income will depend on a number of factors, including: how close members already are to retirement (and their previous arrangements within USS and in other pensions schemes), their salaries throughout their careers, and any additional contributions they choose to make.

5 **Appetite for risk**
The group which is expected to save into the USS Investment Builder is expected to have a slightly higher appetite for risk than the overall active membership, as assessed in the focus groups and from the analysis of the member survey results. This is driven by differences in appetite for risk between members of different earnings levels and different levels of interest in the 1% match and making additional contributions.

6 **Implications for the default strategy**
Taking into account the members demographics, our assessment of their capacity and appetite for risk, and the hybrid structure of the scheme, points to a need for a moderately risky default strategy that provides the opportunity for strong real returns well into members' working lives, accompanied by a tailored range of self-select options.

Section Eight – Summary of conclusions

7 Approaches to member engagement and fund choice

Through the programme of research described above we have found that there are likely to be three ways in which members will manage their DC pension investments – some members will want USS to take care of their investments, some will want some assistance but would like to engage, and some will want to manage their own DC savings. That is why we have identified three broad categories for the investment options available to members:

- Do It For Me: Default lifestyle strategy –the fund which members will go into either through active choice or by default if they do not wish to make their own investment decisions. It is designed to meet most members' needs and ensure they can get the best returns over the long term, taking into account the appropriate level of risk. The amount of risk in the scheme will reduce over time as the member approaches retirement to make sure their assets are protected from market downturns;
- Help Me Do It: Alternative blended risk labelled funds and an ethical lifestyle strategy – members will have the option to choose alternative "ready-made" funds if they are willing to accept a higher or lower degree of risk than that offered in the default strategy, or want to invest in an ethical strategy throughout their working life. These funds may also be appropriate for members who wish to adjust their journey plans or destinations;
- I Want to Do It Myself: Additional standalone funds that members can select themselves if they want to manage their own investments, or have particular beliefs or retirement objectives. These members can also choose to include risk labelled funds in their portfolios. This approach is appropriate for members who wish to construct their own risk and return profiles, and journey plan.

8 Approaches to member options at retirement

Initially, the trustee would expect most of those retiring imminently to take their DC pots as cash, because the sums of money involved will be small compared to their likely DB benefits. But we anticipate growing demand for other options including drawdown and accessing cash lump sums over time. We would expect very few members to annuitise their DC benefits given that they already have a predictable annual income provided by the USS Retirement Income Builder. We will monitor the situation and acknowledge that the shape of members' retirement benefits will change as more members reach retirement with more substantial DC pots.

9 Future developments

The trustee will keep the investment options offered within the USS Investment Builder, and their take up by members, under review, and will evolve the options as required as we learn more about member preferences. Not all members will have the same objectives at retirement, and members have far more choice and flexibility in how they access their DC funds from age 55 onwards, and so the trustee will build in flexibilities to help all members take advantage of the opportunities available whilst maximising the available tax benefits.

Appendix A: Methodologies

The research we have used to design the USS Investment Builder has included both quantitative and qualitative approaches. The quantitative research took the form of a DC survey sent out to USS' active members, which allowed us to gauge the views of a sample of the active membership, and the qualitative research was carried out using focus groups, which allowed us to add nuances about how members felt about the scheme changes and the direction USS is heading. Qualitative research also allowed us to pick up themes which we had not yet considered.

Quantitative research

This research asks questions designed to give an impression of what is happening and learn the views of most members. The output is a numerical representation of the relevant population's behaviour and attitudes i.e. the percentage of people who hold certain beliefs or behave in a particular way.

This is large scale research designed to give results which are representative of the population being researched within certain confidence limits. The DC survey was distributed to all employers which participate in USS for them to share with their members, and it was completed by around 9,700. The statistics show there was a good spread across institutions. Just over half (52%) of responses came from the twenty employers with the most active members, whilst the remaining 48% came from the other institutions.

As well as the DC survey we have drawn on numerical analysis carried out by A2Risk, which assigned an ATR score to each population of members to represent their risk tolerance, taking into account their attitude to risk and capacity for loss. We included A2Risk's Attitude to Risk Questionnaire (ATRQ) in the DC survey in the section looking at members' attitude to risk.

The ATRQ consists of 12 (proprietary) questions[30] designed to assess respondents' investment knowledge, comfort with risk, investment preferences and propensity for regret. The statements which respondents are asked to react to are:

1. People who know me would describe me as a cautious person
2. I feel comfortable about investing in the stock market
3. I generally look for safer investments, even if that means lower returns
4. Usually it takes me a long time to make up my mind on investment matters
5. I associate the word "risk" with the idea of "opportunity"
6. I generally prefer bank deposits to riskier investments
7. I find investment matters easy to understand
8. I'm willing to take substantial investment risk to earn substantial returns
9. I've little experience of investing in stocks and shares
10. I tend to be anxious about the investment decisions I've made
11. I'd rather take my chances with higher risk investments than increase the amount I'm saving
12. I'm concerned by the volatility of stock market investments

[30] The copyright attached to these questions belongs to A2Risk

A2Risk then analyses the member's responses and turns them into an ATR score using a calculator they have developed through their research. Higher scores indicate greater willingness to take risk. The score is then mapped to an ATR Category which covers a range of scores. The categories are: very cautious and cautious investors; moderately cautious investors; balanced investors; moderately adventurous investors; adventurous investors, and very adventurous investors.

Description for Cautious Investors

Cautious Investors tend to regard themselves as cautious people and view risk negatively rather than as a source of opportunity. They typically have little or no experience of investment and do not find investment matters easy to understand. They can take a long time to make investment decisions and tend to be anxious about any investment decisions they have made. They typically look for safer investments rather than seeking higher returns. They are not comfortable about investing in the stock market and typically prefer bank deposits to riskier investments.

Description for Modestly Cautious Investors

Moderately Cautious Investors tend to regard themselves as quite cautious people and are inclined to view risk negatively rather than as a source of opportunity. They typically have limited experience of investment and do not find investment matters particularly easy to understand. They can take a fairly long time to make investment decisions and can be somewhat anxious about investment decisions they have made. They are inclined to look for safer investments rather than seeking higher returns. They are not particularly comfortable about investing in the stock market and tend to prefer bank deposits to riskier investments. They may be willing to take some risk, once the relationship between risk and higher returns has been explained to them.

Description for Balanced Investors

Balanced Investors do not particularly regard themselves as cautious people and have no strong positive or negative associations with the notion of taking risk. They will typically have some experience of investment and a degree of understanding of investment matters. They will usually make investment decisions reasonably quickly and don't tend to be particularly anxious about investment decisions they have made. They can be inclined to look for safer investments rather than higher returns, but understand that investment risk may be required to meet their investment goals. While they will take investment risk, they are still not particularly comfortable with investing in the stock market and get more comfort from bank deposits than riskier investments.

Description for Moderately Adventurous Investors

Moderately Adventurous Investors do not typically regard themselves as cautious people and are inclined to view risk as a source of opportunity rather than as a threat. They generally have significant experience of investment and find investment matters fairly easy to understand. They tend to make investment decisions relatively quickly and are not usually particularly anxious about the investment decisions they have made. They typically look for higher returns rather than safer investments. They are reasonably comfortable about investing in the stock market and typically prefer riskier, but higher returning, investments to keeping money in bank deposits.

Appendix A: Methodologies

Description for Adventurous Investors

Adventurous Investors do not typically regard themselves as cautious people and usually view risk as a source of opportunity rather than as a threat. They generally have substantial experience of investment and find investment matters easy to understand. They tend to make investment decisions quite quickly and are not generally anxious about the investment decisions they have made. They typically look for higher returns rather than safer investments. They are comfortable investing in the stock market and prefer riskier, but higher returning, investments to keeping money in bank deposits.

We also used other sources of numerical information including the Universities & Colleges Employers Association (UCEA) Higher Education Workforce Survey 2015, and data from the Office for National Statistics and the Higher Education Statistics Agency (HESA).

Stochastic modelling

Stochastic modelling was carried out to project the size of DC funds a set of 11 example USS members would have available at retirement under a set of certain assumptions. The Hymans Robertson DC Model provides projections of retirement income for a variety of contribution and investment strategies. Stochastic projections are provided for asset returns and economic factors such as inflation for each year of participation in the modelled USS Investment Builder. These projections were generated by HRAM, Hymans Robertson's (proprietary) stochastic asset model.

In the modelling each member's salary and accrued DC fund is projected forward using stochastic projections of asset returns and economic factors such as inflation. It is assumed that the member continues to contribute to their chosen investment funds at their current contribution rate until they reach their selected retirement age.

Hymans Robertson modelled a range of illustrative investment strategies to compare the use of a lifestyling investment strategy (where members' funds are automatically moved to less risky investments as they approach retirement) with high-risk and low-risk strategies without any lifestyling. They also modelled investment strategies, based on an illustrative default asset allocation, but with different lifestyling periods – 20 years, 10 years, 5 years and no lifestyling. The modelling outputs were used to inform discussions on the appropriate range of outcomes members might experience under different scenarios.

Qualitative research

This research is more detailed, and is designed to explain **why** the circumstances identified exist, for example why members exhibit certain behaviours or hold specific views. Qualitative research is **exploratory** in that the researcher is seeking to acquire knowledge they do not currently have, **investigative** as it asks how and why questions about people's attitudes and behaviour patterns, and **explanatory** as it seeks to explain why people have certain attitudes or behave in certain ways.

Qualitative research is smaller scale than quantitative research and consists of in-depth group discussions – in our case the focus groups held with seven institutions, which involved just over 100 members.

We used deliberative research in the focus groups to see what members thought and felt after being exposed to information about the scheme and different investment scenarios. This sort of research is helpful where there are misperceptions amongst the relevant population, or where understanding is low. This sort of research provides participants with more information than normal and involves comparatively long discussion groups and workshops.

We used hypothetical situations to explain risk and diversification in investment portfolios and see how members would react to help assess their attitude to risk.

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