2014 Formal Valuation: Information for members

Dear member,

There has been much discussion in recent months about scheme funding and potential changes to pension benefits. Whilst the latter is predominantly a matter for the representatives of the stakeholder bodies to the scheme, ie Universities UK and the University and College Union, we would like – as far as we are able – to keep members informed. So, in addition to the regular communications we send to you, we have also developed a scheme funding section on our website and will issue ad hoc updates as appropriate. Below you will find some further information about scheme funding, along with how we believe our planned, updated approach to these issues will support the continued sustainability of the scheme in the interests of employers and members.

Scheme funding is built on some key fundamentals. Our foremost priority, as trustee, is to ensure there is enough money available to pay the pensions earned. USS is not a pay-as-you-go scheme; legally the trustee cannot just use contributions from today's employers and members to pay today's pensioners. We must put money aside now to pay pensions in the future. But we don't need to put aside now all of the money required to meet those future pension payments. Instead we are able to make an allowance for the money we expect to earn from investing the contributions you and your employers have paid, and will in the future pay in, to the scheme.

One of the challenges of funding a defined benefit pension scheme like USS is that the amount of money needed to pay the pensions promised is fixed, but the money we make from investments varies depending on future market conditions. We must acknowledge that at a time when the cost of providing pensions is increasing, we can be less assured about the future returns we can expect from our investments. In other words, the amount of money we expect to make in future is likely to be lower than it has been in the past. This is crucial because the less money we can make from our investments, the more has to be paid into the scheme in contributions to cover the same fixed level of pensions. Any shortfall must be met, and that will typically be through increased contributions.

We have of course considered carefully the ability of the employers to support the scheme. We believe that currently the amount we rely on future investment income to pay pensions, whilst considerable, is proportionate to the strength of our sponsoring employers. We rely on the scheme's sponsors (the employers and members under the cost sharing arrangements) in a number of ways; firstly to provide for the pensions already accrued by making additional contributions to pay off the scheme deficit (currently estimated as £12.3 billion), secondly to provide for any shortfall if the investment income relied upon within our deficit recovery plan fails to materialise and thirdly to provide for any shortfall from the investment income we rely upon to continue to deliver the pensions promised in the longer term. To give an order of magnitude on that final part, even if the scheme were fully funded now we would be relying on almost £7 billion extra in future investment returns just to have enough to pay the pensions already promised. That is not including the additional investment returns required to cover the build up of any future pension benefits that are to be earned. The overall reliance which the scheme places on our sponsoring employers is substantial, and we do not think it should be allowed to get any bigger; this is a view the employers share. Without change to the funding arrangements, the amount of reliance we place on employers will grow. We have therefore set out plans to reduce investment risk and keep the value of the reliance placed on investments, and therefore employers, in proportion to the amount of additional contributions that could be used to make up any shortfall.

This approach means we can manage the increased cost of delivering pensions and have confidence that we will have the funds available to pay your pension when it becomes due. We are supporting the employer and member representatives in their discussions around changes to future benefit arrangements in order to respond to the continuing challenges of delivering good pensions at predictable and affordable cost. Under our scheme rules and under pensions law, any changes made cannot affect the pensions that have been earned to date but could affect the amount of pension benefits you might be able to earn in the future. Changes to future benefits are a matter for the employer and member representatives; the trustee's role is to provide guidance and information about the financial and operational implications of any potential changes being considered and to implement any new benefit structure once formal consultations are complete. These discussions are ongoing and you can be assured that we will provide further updates in the coming months as soon as there is progress to report.

USS trustee board

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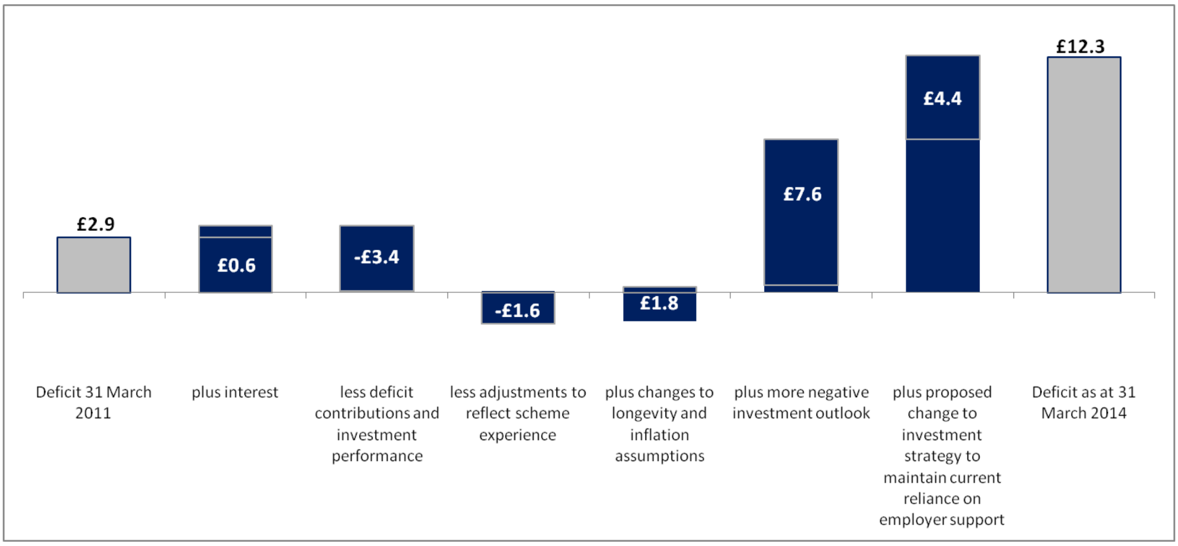
Why does USS have a deficit?

Since 2011, the scheme has experienced a widening of the gap between the amount of money it has already put aside, along with the amount it expects to make from its investments, and the amount it needs to pay the pensions already promised. This gap has increased because changes to member demographics, longevity and inflation mean the amount needed to pay the pensions promised continues to grow. At the same time, having received appropriate analysis and advice, it is the trustee's view that it should be less optimistic in its assumptions of future earnings from investments.

What has happened to the deficit since the 2011 valuation?*



*Based on current benefit arrangements and the trustee's proposed 2014 valuation assumptions. Amounts shown in £billions

The trustee's approach to scheme funding

The cost of providing pensions is increasing. Our analysis shows that, in the three years since the previous valuation, improvements to life expectancy mean that a 65 year old USS member retiring today can expect to live four months longer than a 65 year old retiring just three years ago. These improvements in longevity, whilst welcomed of course, add a further £900 million to the value of the deficit. It is also true that the additional contributions new members bring are not enough to pay for the pensions currently promised. Investment growth is also needed, however, the trustee believes that investment growth will be harder to come by in future. This has two major implications for the scheme. Firstly, more money is needed from the employers to pay for the pensions already promised because the allowance made for earnings from investments is smaller. This has contributed to the increased deficit. Secondly, going forward, the amount needed to pay pensions yet to be earned is also higher. This is the context for the current discussions between the employer and member representatives around changes to future benefits.

Reducing investment risk

The trustee is able to take a substantial amount of investment risk because it is confident in the employers' ability to make up any shortfall. But as the gap between the amount we have and the amount we potentially need widens there is a risk that it becomes too big for the employers to support. The trustee believes it that it should maintain the *current* value of the reliance upon the sponsoring employers, over time, to have continued confidence in its ability to provide future pensions and not place an ever-increasing burden upon employers.

What's happening now?

The trustee has set out, in a consultation document for the employer representatives, the increased cost of providing benefits if the current arrangements were to continue. Both the employer and member representatives have proposed changes to future benefits and these will be discussed and negotiated by those representatives over the coming months. Once a decision has been taken, the benefit proposal will be considered by the trustee board. Affected employees will have an opportunity to share their views as part of the statutory employer consultation – this can only take place once a decision has been taken in the Joint Negotiating Committee on the nature of proposed changes to benefits. Currently we anticipate this consultation will take place in the spring of 2015.

How to stay informed

You will continue to receive regular communication updates from USS, there is also additional information on the scheme funding pages of the USS website at www.uss.co.uk.

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USS

Timeline

- Trustee considers ability of employers to support the scheme now and in future
- Trustee & scheme actuary value the assets and liabilities based on current arrangements
- Trustee advises employers how much it will cost to provide benefits in future, cost of deficit contributions and how much investment risk employers can afford to take
- **Now** – Universities UK & UCU discuss how to make future benefits attractive, affordable and sustainable
- Universities UK & UCU decide upon future benefit arrangements in the Joint Negotiating Committee
- Decision considered by the trustee
- **Spring 2015 (tbc)** – Employer consultation with affected employees (minimum 60 days)
- Employers provide employee feedback to the trustee board
- JNC to make any final amendments to proposed benefit changes
- **June 2015** – Valuation submitted to Pensions Regulator
- Scheme changes implemented – **April 2016 (earliest)**