UUUK’s proposed changes to USS

What the proposals mean for you

November 2014
Introduction and aims for today

Provide support for affected employees and help you understand...

• Why changes are being proposed and who is proposing them
• What the consultation process involves
• The latest proposals and the potential impact on your benefits
• Other relevant changes
• Where you can obtain additional information and support

...and an opportunity to ask questions
Areas covered

1. Background (general)
2. Background (USS)
3. Consultation process
4. Latest proposals
5. Other issues
6. Role of the University
7. What next
1. Background - general

- Life expectancy
- Markets and the wider economy
- Tax limits and changes in Government policy
- Differences between private and public sector pension provision
Life expectancy at 65 is increasing by 1 year every 10 years.

Current (and 1982) life expectancies at 65:
- Males = 21.4 (14)
- Female = 24.1 (18)

(For UK population as a whole)

USS population has longer life expectancy than UK average due to socioeconomic group.

Pensions are paid out over increasing periods, which has led to a significant increase in outgo and liabilities. Impact on future accrual reduced by link to SPA.
Markets and the economy

- Asset performance relative to liabilities is key.
- Liabilities are measured by reference to gilt prices (as are insurers’ annuity prices).
- Assets have not kept up with liabilities.
- The UK and global economic recovery is fragile.
- Interest rates may remain well below historic ‘norms’ for the foreseeable future, keeping liabilities high.

Asset returns low and volatile relative to liabilities. Environment remains challenging and DB costs remain volatile and high.
Taxation of pensions and Government policy

HMRC – tax limits

- Fixed limits apply to annual and total lifetime savings
- These limits were reduced again in April 2014 following previous reductions (and further reductions may follow in the future)
- Pension savings above these limits will be subject to penal tax changes

Wider policy

- Major changes to DC pensions from April 2015
  - No requirement to buy an annuity
  - At retirement guidance
  - Removal of 55% tax on lump sum death benefits

An increasing proportion of USS members will be affected by the lower tax limits

‘New’ DC will be more attractive than old DC. The increased flexibility will also lead to an increase in transfers from DB to DC
**Private Sector vs. Public Sector**

**Private Sector pensions**
- Underwritten by the employer
- Must be funded
- Are subject to Regulator’s funding requirements:
  - Prudent valuation
  - Provide security and stop schemes falling into the Government’s lifeboat scheme (‘the PPF’)
  - Contribution notices can be imposed

**Public Sector pensions**
- Guaranteed by the Government
- Different (less rigorous) regulations apply
- Many are unfunded (i.e. NHS, TPS, Civil Service) and operate on a pay as you go basis

*Public and Private sector schemes are subject to very different requirements.*
2. Background to proposed changes - USS

<table>
<thead>
<tr>
<th>2014 valuation</th>
<th>Regulator requirements</th>
<th>Last man standing</th>
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<tbody>
<tr>
<td>• Increased deficit</td>
<td>• Prudent funding</td>
<td>• Over 300 institutions</td>
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<td>• Increased contributions</td>
<td>• Long term plan required</td>
<td>• A small number of institutions provide the major part of this guarantee</td>
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<td>• Affordability and risk</td>
<td>• Reduction in risk</td>
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Funding deficit of £12.3bn if scheme left as is leading to member cons of 11.5% and employer cons of 23.6%

- USS Trustees required to value liabilities prudently
- USS Trustees required to put in place a holistic long term plan to restore funding and reduce reliance on employer covenant
- Solution must be affordable in terms of cost and risk
### 3. The consultation process

<table>
<thead>
<tr>
<th>STAGES</th>
<th>Possible timings</th>
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<tr>
<td><strong>1. Pre consultation communications</strong></td>
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<tr>
<td>- consultation between USS/UUK and employers</td>
<td>July 2014 to Nov 2014</td>
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<tr>
<td>- initial funding information</td>
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<tr>
<td>- initial and updated benefit proposal from UUK</td>
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<td>- JNC agreement on proposal to be put forward</td>
<td>Jan 2015?</td>
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<td><strong>2. Formal (legal) consultation process</strong></td>
<td>Early 2015</td>
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<td>- formal consultation with employees and unions</td>
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<td>- feedback gathered</td>
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<td><strong>3. Post consultation</strong></td>
<td>Mid 2015</td>
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<td>- feedback must be considered</td>
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<td>- proposals may be changed</td>
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<td>- JNC agreement on final proposal</td>
<td>Summer 2015</td>
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<td><strong>4. Implementation</strong></td>
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4. The latest proposals

1. Reminder of existing benefits
   - *Final salary members*
   - *CRB members*

2. Overview of latest proposals

3. Key elements of UUK’s proposals
   - *benefits you’ve already built up*
   - *benefits you will earn in the future*
Existing benefits – final salary members

Pension built up over full period of membership with pension earned each year equal to:

\[
\frac{1}{80} \times \text{Final Salary} = \text{Final Salary Pension}
\]

\[
3 \times \text{Final Salary Pension} = \text{Final Salary Cash Lump Sum}
\]

\[
7.5\% \times \text{Salary} = \text{Your contribution}
\]
Existing benefits – CRB members

Pension built up each year

\[
\frac{1}{80} \times \text{Salary} = \text{CRB Pension earned in year}
\]

\[
3 \times \text{CRB Pension} = \text{CRB Lump Sum earned in year}
\]

\[
6.5\% \times \text{Salary} = \text{Your contribution}
\]
• Normal Retirement Age
  • Linked to State Pension Age for benefits earned on/after 1 October 2011 (some members have guarantees)
  • 65 for benefits earned before 1 October 2011

• Pension Increases and revaluation
  • Linked to Consumer Price Inflation (CPI)

• Contributions – cost-sharing principle
  • Overall contributions above 23.5% are shared between the employer (65%) and members (35%)
Overview of latest proposals

Past service (Final Salary members only)

• Final salary benefits already earned will be frozen based on final pensionable salary at the implementation date
• The frozen final salary benefits will be increased each year in line with CPI inflation

Future service (Final Salary and CRB members)

• CRB benefits will be provided for ALL members on salary up to a threshold of £50,000. The threshold will be increased each year in line with CPI
• A contribution of 18.5% (12% employer, 6.5% member) of any salary above £50,000 will be paid into an individual fund within a new DC section
• For members who pay an additional contribution of at least 1% of ALL salary, the employer will pay a matching contribution of 1% with these contributions being paid into an individual fund within the DC section.
Past Service benefits (Final Salary members only)

Example – Age 55, 20 years service, £40,000 final salary at change date
Frozen pension = 20/80 x 40,000 = £10,000, increasing in line with CPI

- There will be losers and winners
- Those with future salary growth above CPI will receive a lower benefit
- Those with future salary growth below CPI will receive a higher benefit
Future Service under CRB – for salary up to £50,000

Example – member with initial salary of £40,000
Illustration of how benefits built up each year

- Block of pension earned each year
- Based on salary in that year
- Once earned, blocks are revalued in line with CPI every year
- Same principle for losers and winners vs. final salary
Defined Contribution – key points

• **Members build up a fund based on**
  • Contributions paid in
  • Period of investment and the return achieved
  • There will be a range of fund choices, including a default fund

• **Benefits**
  • 25% of the fund can be taken as tax free cash
  • Remainder can also be taken as cash (subject to marginal rate of tax), or left invested or used to buy an annuity

• **Risk**
  • Investment and annuity risk are carried by the members
How the hybrid structure would work
Future service under DC – for salary over £50,000

Example – member with salary of £80,000
Illustration of how benefits build up

Member contribution is 6.5% of total salary (£5,200)

£30,000
Pensioned on a ‘DC’ basis

18.5% of £30,000 (£5,550) paid into member’s DC fund

£50,000
Pensioned on a CRB basis

Member earns a CRB pension of 1/80th of £50,000 (£625) plus a lump sum of £1,875
Future service under DC – optional matching contribution (full salary)

Example – member with salary of £40,000
Illustration of how benefits build up

Here, member contribution is 7.5% of salary (£3,000)

Member earns a CRB pension of 1/80th of £40,000 (£500) plus a lump sum of £1,500

2% of £40,000 paid into member’s DC fund under matching facility (1% paid by employer)
Illustrations

A number of sources exist...

• UCU
• TES
• UUK and USS

Key points

• Ensure right benefit structure is used (latest proposals)
• Ensure like for like comparison
• Remember DC fund is variable – not guaranteed
• Consider form of benefits shown
  *(standard form is pension plus 3 x lump sum)*
• Is matching contribution allowed for?
5. Other issues

Options and flexibility in USS

- Flexible retirement – benefits can be taken in tranches
- Lump sum – standard defined benefit lump sum can be increased or reduced

Changes to the State Pension

- From April 2016 the new Single State Pension commences
- Members will cease to be contracted out of the State Second Pension
- Members will start to earn an additional State Pension
- Members and the Employer will pay extra National Insurance Contributions
6. Role of the University

Responding to USS/UUK consultations

• The University has given its view on the initial proposals
• The University has given its initial view on the funding plan
• Influence is limited as one of hundreds of employers

Provide funding and security

• The University will pay future service and deficit contributions to ensure benefits are properly funded
• The University forms a key part of the overall employer covenant under the last man standing guarantee

Support for employees

• Transparency on consultations with UUK and USS
• Seminars for affected employees
• Raising your questions with USS and UUK
7. What happens next?

1. **JNC to agree proposals for formal consultation**

2. **Formal consultation process**
   - University consults with employees based on proposals agreed by JNC
   - USS provides supporting materials
   - Employees provide feedback

3. **Consideration of feedback and (possible) amendments to proposals**
   - Employee feedback considered and results of feedback shared
   - Further changes may be considered

4. **Final agreement and implementation**
   - JNC agreement on final proposals
   - Implementation
QUESTIONS

Any further questions?

Information will be added to the following web address as it becomes available

http://www.pensions.admin.cam.ac.uk/uss/uss-news-publications