Agenda

- Pensions today
- USS in context
- The current position
- Timeline
- Questions

Pensions Today

- Changes in:
  - state pension age
  - framework for state pensions
  - the annuity market
  - the introduction of auto enrolment
  - increases in longevity
  - market norms for investment returns
  - defined contribution pension pots from April 2015
  - public sector pension schemes

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The Pensions landscape has seen more change in the last few years then in the previous 50

Changes in state pension age and the framework for state pensions, the impact of the economy on the annuity market, the introduction of auto enrolment, increases in longevity and the disappearance of what was considered market norms for investment returns – are but a few of the changes.

We are also seeing a radical new approach to defined contribution pension pots from April 2015

And then there are the changes to public sector pension schemes

Pensions Today : Defined benefit

- Main types of pension schemes

  Defined benefit:

  - final salary, career average (80ths)
  - pension calculated with reference to earnings and service
  - risk to fund/employer

There are two main types of pension schemes – defined benefit and defined contribution and a range of derivatives thereof

Defined benefit, sometimes referred to as final salary, sees employees and employers pay in to a trust based fund which invests in a range of investment vehicles. Risk is born by the fund and the trust deed governs how that risk is shared, with the responsibility often resting with the employer.

The Fund provides the pension on a prescribed basis linked to years of service and salary or earnings on a structured basis

Pensions Today : defined contribution

Defined contribution/money purchase:

- contributions to fund
- fund achieves return on investments
- retirement lump sum purchases annuity
- annuity provides pension
- risk to employee

Defined contribution, sometimes referred to as money purchase, sees employees and employers pay in to a trust or contract based fund which invests in a range of investment vehicles. Risk is born by the employee as each employee has their own pension pot within the fund.

At retirement the employee uses the fund to structure a pension in retirement often through the purchase of an annuity that provides a series of income payments over time. Recent legislation that comes in to force in April 2015 provides more flexibility for individuals both before and at retirement.

USS in context

Defined benefits scheme with two sections:

- Joiners up to October 2011: final salary scheme
- Joiners from October 2011 onwards: career revalued benefits (career average) scheme

Governance:

- Trustee Board
- Joint Negotiating Committee

USS is a defined benefits scheme which provides benefits as laid down in the scheme's Trust Deed. USS currently provides benefits through two different mechanisms with individuals membership linking to one of those mechanisms dependent upon when they joined the scheme.

Up to October 2011 joiners were entered in to a final salary scheme where one's pension was determined by pensionable earnings in defined periods, normally the last 12 months of employment, before retirement.

From October 2011 onwards joiners benefits are calculated on an annual basis linked to earnings each year revalued for inflation – a career revalued benefits system

Governance

The USS Board of Trustees has between 3 and 5 independent trustees, 4 employer representatives (from UUK), and 3 UCU representatives, or which at least one must be a member of USS.

The Board receives recommendations from the JNC, the membership of which is 5 UUK representatives, 5 UCU representatives and an independent chair.

USS in context : what's the problem?

- Maxwell scandal
- Pensions Regulator
- Actuarial valuations
- Scheme/employer plan to make good any deficit

In the 1990s, Robert Maxwell, owner of Mirror Group Newspapers, raided the firm's pension scheme to keep the business afloat. The business went bust, as did the pension scheme. Maxwell committed suicide and the members of the pension scheme were left high and dry. The government stepped in to provide them with a pension.

In order to avoid a repeat of the Maxwell scandal, in 2004, the government established the Office of the Pensions Regulator with powers to establish a pension protection scheme through a levy on final salary schemes and to ensure that pension schemes are adequately funded to meet their obligations.

Final salary pension schemes are required by the Regulator to undertake full valuations every three years to ensure they have sufficient funds to meet the pensions promise they have made to members. If there is a deficit, the regulator requires that a plan be put in place to bridge the gap

The valuation looks at the value of the assets and liabilities using a set of assumptions agreed between the trustees and the employers.

USS is unusual as it is a multi employer scheme and thus its employers are represented by UUK and its members are represented by UCU

USS in context: The valuation process

- Process prescribed by Regulator
- Assets
  - Contributions
  - Income from investments
- Liabilities – future pension payments
- Actuarial assumptions (eg longevity)
- Funding surplus or deficit
- The current USS valuation will show a substantial deficit

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The valuation looks in a prescribed manner at the assets and liabilities of the scheme

Assets – tangible investments plus cash flows

Contributions

Income from assets

Liabilities – future pension payments

Both cash flows and liabilities are linked to actuarial assumptions and results are discounted to present day values

Difference is a funding surplus or deficit

The current valuation will show a substantial deficit

USS in context: Why is there a deficit?

- Longevity
- Economic factors
- Risk

Longevity – people are living longer and thus receiving pensions for longer. Schemes assume that people will live for a certain number of years on average and aim to have sufficient funds to pay the pensions that each member accumulates.

Economic factors – pension scheme liabilities are assessed using gilt returns (interest on government securities) which are at an all time low thus increasing the liability measure.

USS believes that its current investment strategy is too risky and is looking to take a more cautious approach in the coming years – this will impact on its cash flows

USS in context: How to tackle a deficit

- Raise contribution levels
- Reducing benefits
- Take greater risks
- Combination

Raise contribution levels

Reducing benefits

Take greater risks

The latter is dependent upon the employer agreeing to the additional risk being taken and to their being a strong covenant from the employer to meet the consequences of the additional risk not producing the required return.

Market volatility is another factor to be taken in to account in determining investment strategy

USS in context: Recovery Plan

- Recovery Plan
- Schedule of Contributions
- Role of the Pensions Regulator

Schemes such as USS are required to agree a Recovery Plan and Schedule of Contributions as actuarial valuation outcomes. These identify how the scheme and its participating employers will meet any deficit.

The Pensions Regulator will receive these documents and signal acceptance or otherwise of the plan and schedule.

USS is of particular concern to the Regulator because of its size and the Regulator has been an observer in the valuation process of USS.

USS is considering the length of its recovery plan as this will have a material impact on the approach to the deficit

The current position

- Substantial deficit - several £bn – expected
- Long recovery plan 15 years or more
- Increased contributions:
  - Employer potentially 25% plus
  - Employees potentially in the order of 12%
- Additional cost of de-risking

Initial figures would suggest that the USS scheme as at 31st March 2014 is in excess of £12.3bn.

The Trustee of USS is responsible for determining the approach taken to meeting the deficit but the employer has to meet the cost of any additional contributions.

Absent any other steps being taken the potential contributions required, assuming a 15 year recovery plan to meet the above deficit, would be 25.7% from the employer and 12.7% (final salary) and 11.7% (CRB) from the employee.

De-risking the investment strategy could have a £6bn impact

The current position: UUK proposals

- Final salary section to close April 2016
- All members would become part of the CRB section
- CRB section earnings cap (£50k)
- CRB employee contributions at 6.5%
- Additional/optional DC (money purchase pot)
- Employer contributions at 18%

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As of 01/04/2016 the final salary section would cease to accrue benefits for existing members – benefits to date would be deferred and increased in line with inflation (CPI)

All members would become part of the CRB section of USS with benefits earned each year uprated for inflation

The CRB section would operate an earnings cap which is likely to be no less than £50k.

CRB member contributions would be at 6.5% but staff could pay more in to a DC (money purchase pot). The first 1% would be matched by additional employer contributions.

For pay over the earnings cap there would be a DC arrangement with members paying 6.5% with an employer contribution of 12% from a total employer contribution of 18% with the balance above the 12% providing Death In Service and Critical Illness cover

An increase from 16% to 18% will cost this University £3.3m a year.

The current position: UCU proposals

- CRB scheme (70ths)
- Employer contributions 22.4% for a 15 year recovery plan and 20.9% for a 20 year recovery plan.
- Scope for negotiations:
  - No DC element in the scheme
  - Final salary link to be replaced by another index
  - Movement in employee contributions
- Potential for an absolute cap on pensionable salary at 85th percentile of members earnings

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UCU disagree with the approach taken by UUK and feel there are alternative means of tackling the problems facing USS

UCU would wish to see a different basis used for valuing liabilities linked to actual asset returns rather than using government bond returns. They would wish to apply the same approach to the de-risking strategy.

The UCU approach would reduce the deficit and enable a different benefit structure to that proposed by UUK.

UCU propose a CRB scheme on a 70th's basis with a 3x lump sum at retirement and CPI revaluation.

They estimate that employer contributions, including deficit contributions, would need to be 22.4% for a 15 year recovery plan and 20.9% for a 20 year recovery plan.

In order to fund these changes, UCU are willing to enter negotiations around:

a) No DC element in the scheme

b) Final salary link to be replaced by another index

c) Movement in employee contributions, possibly on a 2:1 ratio (i.e. 18%:9%)

Money intended by employers for the DC element to be used to enhance DB pensions for the maximum number of members

The potential for an absolute cap on pensionable salary

Cap on the pensionable salary to be revalued according to the 85th percentile of members earnings, so that for 85% of members all salary would be pensionable in the DB scheme

Timeline: the process from here

- Negotiations in USS Joint Negotiating Committee until January 2015
- JNC recommendation to USS Board
- Employee consultation starts Feb/March?
- USS Board to consider results of employee consultation Summer 2015
- April 2016: implementation of Recovery Plan begins

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UUK and UCU proposals will be considered by the JNC with the intention of agreeing a joint proposal by the 15th January 2015 to be put to USS.

Consultation with members is likely to run at some time between February and April 2015

The formal consultation with members will be led by individual institutions on behalf of USS with co-ordinated feedback being provided to USS. This will require consistent communication materials being prepared by USS for the institutions to utilise.

Once the consultation is complete and the USS board has agreed the changes to be implemented the USS back office system will need a major rewrite; as will all USS scheme documents and all training and communications materials.

Scheme changes are likely to be from 01/04/2016

Payroll software may well need to be amended based on the new benefit and contribution structure.

Institutions are facing legislative changes in April 2016. the removal of the NI rebate will cost this institution £3.7m from April 2016

An increase in employer contributions to 18% for USS will increase the cost of USS contributions by £3.3m.

March/April 2016 also sees the three year anniversary of auto

enrolment for the University and the need to reassess scheme membership. This is a major administrative task.

Questions ?

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