



UoB Briefing

6 November 2017

An update on the valuation of the Universities Superannuation Scheme (USS)

Colleagues will be aware from media articles over recent weeks that an actuarial valuation of the Universities Superannuation Scheme (USS) is in progress. Although the valuation is not yet finalised, it is apparent that the result will show a significant ongoing deficit and indicate increased costs if the level of benefits to be earned for future service are maintained at present levels. The provisional results of the valuation will be discussed at the Joint Negotiating Committee (JNC) in December 2017. This body, consisting of employer and union representatives, will consider what actions need to be taken in response to the deficit and increased costs. Any proposals made by the JNC will be subject to consultation in the first quarter of 2018.

The notes below are provided to help you understand the facts in what is a very complex matter, particularly recognising that the valuation requires prudent judgements to be made for a number of assumptions used to value the future liabilities of the scheme, in order to assess its financial position.

What is the USS?

USS is the principal pension scheme for universities and other higher education institutions in the UK. The University of Birmingham is one of around 360 employers who use this scheme. It is the pension scheme for University staff on academic and academic-related scales of pay (Grade 6 and over). USS is the largest private sector scheme of its type in the UK, with assets of approximately £60bn.

What is a valuation?

A valuation is an assessment of the pension scheme's assets (the investments it holds, and the returns it expects to make on those investments, plus the money it receives in contributions from employers and members), and the liabilities (the amount it needs to pay the pensions already earned).

Its purpose is to establish, at a point in time, whether USS can reasonably expect to have enough money to pay the benefits built up prior to the valuation date (March 31st 2017). It also assesses the cost of providing pensions for the future service of employees, yet to be earned.

Why is the USS subject to a valuation?

As a defined benefit pension scheme USS is required by law to carry out a valuation every

three years to determine the scheme's financial position. This enables the trustee, Universities UK (representing all employers in the scheme) and University and College Union (UCU) representatives the opportunity to consider whether the findings indicate that adjustments need to be made to future contribution rates or the scheme's future benefits – or to both.

What happens if there is a deficit?

Where a pension scheme is in deficit, the Pensions Regulator requires the scheme to put in place remedial measures to reduce or eliminate the deficit over time. Typically, this means either paying more money into the scheme, or reducing the benefits paid to members for future service, or a combination of the two. The Pensions Regulator needs to be satisfied that a valuation is prudent and that the interests of the scheme members and the government are sufficiently protected in any recovery plan or scheme changes agreed. The Pensions Regulator can impose a valuation if not satisfied that a valuation is sufficiently prudent.

What is the latest valuation likely to show?

As a result of the last actuarial valuation of USS in 2014, the final salary section of the scheme was closed and its members transferred to the career re-valued benefits (CRB) section. Among other changes, a salary cap of £55,000 was introduced, below which pension contributions were made into the CRB fund; and above into a defined contribution fund. Employer and employee contributions were also increased.

Despite the measures taken in 2014, financial market conditions and their impact on the key valuation assumptions mean that the deficit has not reduced in line with previous expectations and the costs of providing current levels of benefits for future service have increased. The provisional valuation results suggest that the cost of providing scheme benefits has increased from the present 26% of salaries (18% employer and 8% member contributions) to an indicated level of 32.6% – well above the maximum seen as sustainable both for individual members and employers. This means that to provide current benefits into the future the sums that employers and individual scheme members (university sector staff) would have to pay into the scheme would need to rise to potentially unaffordable levels. The scheme must therefore be reviewed to address the deficit and increased costs.

USS is a large fund with a mix of assets. Growth in the value of those assets increases the size of the fund and is an important element of funding future pension payments, in addition to the contributions made by members and employers.

As the largest scheme of its type in the UK USS is subject to close scrutiny and as part of the consultation process for this valuation the Pensions Regulator has indicated that it believes USS should be more prudent in its valuation assumptions than those which have been used in the provisional valuation, and has also suggested that less reliance should be placed upon the financial strength of the sector. It has also challenged the level of risk inherent in the scheme's future investment strategy i.e. it should reduce its portfolio of what might be seen as riskier (but perhaps higher earning) investments in favour of more stable (but perhaps lower earning) investments. If a more prudent overall approach were adopted the resultant deficit and increased cost of USS would be likely to be even greater than those indicated by the provisional valuation.

Not everybody agrees with more prudent approach; in particular, UCU has commissioned a report proposing that the USS valuation and investment strategy should adopt more risk, in particular relying upon higher returns from the asset portfolio. This would in turn place more

emphasis on the future financial strength of universities, in the event that the higher risk investment strategy failed to deliver. Such an approach is at odds with the view of the Pensions Regulator and is extremely unlikely to be accepted by it, given its' views on greater prudence as already expressed through the consultation process.

What stage are we at with the 2017 Valuation?

USS issued a technical discussion document on the methodology and key inputs for the 2017 Valuation in February 2017 seeking views from employers, via Universities UK, on the range of inputs.

On 1 September 2017 the USS Trustee board issued a formal consultation on the technical provisions of the Scheme to Universities UK (see <https://www.uss.co.uk/how-uss-is-run/valuation/2017-valuation-updates/consultation-with-universities-uk-commences>).

The University submitted its views on the consultation via a survey from Universities UK. This feedback, along with the views of other employers participating in USS, has enabled Universities UK to represent the collective view of employers about the valuation approach, funding and benefits in USS given the funding challenges facing the scheme at this valuation. You can read the University of Birmingham's submission to Universities UK here: <https://intranet.birmingham.ac.uk/hr/documents/staff/USS-Consultation-Response.pdf>

The University is one of over 300 employers in USS. Our voice, while significant, will need to be taken into account by Universities UK along with the views of its other members in determining an approach to take in discussions with the UCU on how to respond to the expected increase in the cost of the scheme.

Next steps

Any proposed changes to contributions or benefits will need to be considered within the negotiating structure of USS. Employer and employee representatives (Universities UK and UCU respectively) will each develop a position on their response to the outcome of the valuation, which will then be discussed and negotiated within the JNC. Both the employers and the UCU have an equal voice on the JNC and discussions have not yet started. It is clearly too early to be considering industrial action.

USS has provided details on how decisions are made on future pensions for USS at <https://www.uss.co.uk/how-uss-is-run/views-from-uss/how-decisions-are-made-on-future-pensions-for-uss>

Further information on the valuation and the timetable can be found on the USS website <https://www.uss.co.uk/how-uss-is-run/valuation>

Further reading

The Employers Pension Forum has also provided advice on the 2017 valuation: <http://www.employerspensionsforum.co.uk/he-sector-pension-schemes/universities-superannuation-scheme/2017-uss-valuation>.

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