

Proposed Changes to USS – Myths, Misconceptions and Misunderstandings

Many of the comments and claims that have been made against the case for necessary reform are based on misunderstanding or misinterpretation of the facts. Here we address some of the more common myths, misconceptions and misunderstandings (Ms).

M1: Benefits will not apply above £40,000

Members will continue to build up pension benefits on all of their pay.

Under the employers' proposals for reform, all members of USS will continue to receive defined benefits on salary up to a threshold. The employer representatives currently propose to set this salary threshold at £50,000, which would mean that around two thirds of current members would receive Career Revalued Benefits (CRB) on their whole salary. The vast majority of current members will receive a high proportion of their pension from the CRB section.

Benefits on earnings above the proposed salary threshold of £50,000 will be provided in a new Defined Contribution (DC) section. The contribution rate proposed for the USS DC section is generous compared to the UK average with a total of 18.5% of earnings above the salary threshold going directly into each member's pension pot (12% from the employer and 6.5% from the member). In addition members will have the option to contribute an additional 1% which will be matched by their employer. The average total contribution to private sector UK DC schemes is just 9%* (6.1% employer and 2.9% member).

A salary threshold of £50,000 is subject to the USS Trustees (and the Pensions Regulator) agreeing to an extension of the period over which the current deficit is to be repaid.

M2: Everyone will get lower benefits

Existing members of the CRB section of the USS will see no difference in their benefits unless their pay rises above the proposed salary threshold of £50,000 (currently fewer than a third of members would be affected by a salary threshold at this level). In fact, members who take advantage of the option to pay 1% of their salary into the new DC section would accrue additional benefits with this contribution matched by the employer.

For members currently in the final salary section of USS (who will change to CRB for future benefits), the impact of the proposed changes will very much depend on their individual circumstances. All members with salary above the proposed threshold will build up additional benefits in the DC section of the USS. The changes announced in the March 2014 Budget mean that such members may benefit from being able to take more of their pension as cash and will have significantly greater flexibility as to how and when they take this portion of their benefits.

M3: Employers will pay less under the proposed reforms

The employers will actually pay more under the proposed reforms.

The employers are prepared to increase their overall contribution to USS from 16% to 18% of total salary to help ensure the USS remains sustainable and benefits remain attractive. This additional investment is approximately £135m a year and follows an increase in employer contributions from 14% to 16% in 2009.

The overall contribution is made up of contributions to the CRB section, 12% contributions plus the optional 1% matching contribution to the DC section and deficit reduction payments.

M4: The pre-92 universities are doing well and can afford to pay more than 18% in to the USS

The proposed changes are designed to create a structure for USS which is sustainable and affordable over the long term – for both employers and members. The increase in the employers' contribution from 16% to 18% is a very significant cost to the sector, approximately £135m a year.

The consultation with employers made it clear that contributions above 18% were unaffordable as this could impact on other investments in staff, student facilities and research.

A key objective is to address the USS's sizeable and volatile funding deficit and to achieve this it is essential to move to a position where the rate at which the liabilities grow is more predictable. Simply paying more money into the USS without bringing the defined benefit liabilities under control will fail to address either the deficit or the risk that contributions for USS members and employers alike, may otherwise rise to unsustainable levels.

M5: USS enjoys positive cash flow so the reforms are unnecessary

While it is true that in the last financial year the USS's income – contributions and investment returns – exceeded its outgoings it is not enough for a pension scheme simply to cover its outgoings on a year by year basis. Rather, like all funded UK pension schemes, USS is required to meet its 'statutory funding objective', that is, to have sufficient assets to meet its liability to pay benefits already built up in the scheme. For some years now, the USS has had a sizeable and persistent, yet

volatile, deficit on this basis. Not only is it desirable to take steps to eliminate this deficit, the trustees are required by law to put in place a plan to do so and their plan must meet the requirements of the Pensions Regulator.

The USS is becoming increasingly 'mature'; pensioners are living longer and the ratio of pensioners to active members is increasing. So, while the USS may be cash flow positive at the moment that will not always be the case. The most significant and fastest increasing liabilities are associated with the final salary section of the USS which is why it is necessary to close this section to bring costs under control. In March 2013, the USS was in deficit by £11.5 billion.

M6: The proposed changes are politically motivated to prepare the HE sector for privatisation

The proposed reforms are not politically motivated. They are designed to address the continuing funding deficit while providing attractive benefits that are sustainable and affordable over the long term. The employers recognise that a good pension scheme helps to attract and retain the calibre of staff needed to maintain the UK HE sector's global reputation for excellence. Unfortunately, the current level of USS benefits is unaffordable over the long term and to continue to support it unreformed would result in funds being diverted away from core university activities and probable staffing cuts.

M7: The assumptions used to value the fund have been chosen to artificially create a large deficit

Valuing a pension scheme is an inexact science, as it is necessary to make predictions about future events, such as salary increases, life expectancy and investment returns. This is the job of the USS Trustees and, with the help of their professional advisors, they have modelled a wide range of possible outcomes, always bearing in mind that they are required to act prudently. While the Trustees changing the assumptions in this instant could affect the size of the deficit, it cannot change a deficit into a surplus. The deficit is sizeable and persistent and benefit reform is unavoidable, and expected by the Pensions Regulator.

M8: The changes will lead to a two-tier pension system at UK universities

The two main schemes for academic staff - USS and the Teacher's Pension Scheme (TPS) – have always offered different benefit scales and already have different employee contribution levels. Like USS, the TPS final salary structure has become unaffordable; to bring costs under control the TPS is moving to a CRB structure for all members with effect from next April.

But there are more differences than similarities between the schemes. Unlike the USS, the TPS is unfunded and operates on a pay-as-you-go basis, whereby pensions are paid from current contribution income. Being a public sector scheme, TPS is backed by the Government so any difference between the contributions

coming in and the pensions going out can be picked up by HM Treasury and ultimately, the taxpayer.

In addition, TPS members pay more towards their pension; the average employee contribution is 9.6%, but contributions are tiered based on the member's salary and range from 6.4% to 12.4%. The proposed member contribution to the reformed USS is 6.5% for all members.

The current USS scheme costs 23.4% of salaries and, without reform, this will continue to increase. Moving to a TPS equivalent scheme would require an overall contribution level of 43.9% which would be unaffordable for employers and employees.

* Source: The ONS Occupational Pension Schemes Survey 2013

<http://www.ons.gov.uk/ons/rel/fi/occupational-pension-schemes-survey/2013/index.html>

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