USS

An integrated approach to scheme funding – a summary for members

A formal valuation of the scheme's assets and liabilities will shortly be completed and the trustee anticipates that, as previously stated, it shall report a continuing substantial deficit.

The trustee's role is to ensure that there are sufficient funds available to pay the pensions promised and the trustee has a duty to set out both how it will recover the deficit and what it will do to manage scheme funding in the future.

The trustee has been preparing for this formal valuation for some time. Last year it completed an assessment of the strength of the employer covenant – that is the ability of the employers to support the scheme - which involved taking a substantial, representative selection of institutions and carrying out a detailed examination of the financial health of the employers that stand behind the scheme.

Through this the trustee has been able to update its view of how much support employers could actually provide to USS if pension contributions were prioritised.

The strength of the employer covenant impacts on the amount of risk which can be prudently taken by the trustee. Risk is inherent in the funding of the scheme and in the investment of the scheme's assets and the amount of risk the trustee feels it is prudent to take has an impact on the contribution requirements associated with providing a particular level of benefits.

In broad terms the trustee believes that the amount of risk taken should be proportionate to the amount of support available to the scheme from the employers, and specifically that there should be no increase in the reliance placed on the covenant over time.

Indeed, it is the trustee's view that with the right economic conditions, opportunities should be taken to reduce the amount of risk within the scheme and therefore the reliance on the covenant.

The trustee believes this is the right approach for the scheme as it will ensure that the commitments required from participating employers (and members under the cost sharing arrangements[1]) do not, over time, become overwhelming.

[1] The current cost sharing arrangements are triggered when, following actuarial investigation, the aggregate contribution rate exceeds 23.5%. It falls to the Joint Negotiating Committee (JNC) to determine how the excess over the 23.5% threshold is to be addressed, either by increases to the contribution rate, and or changes in benefits under the scheme. If additional contributions are to be levied then, unless the JNC decides otherwise, they will be shared 35:65 between members and employers respectively.

Three guiding principles have been adopted by the trustee in order to manage scheme funding; these principles draw very clear lines between the support available from participating employers and scheme risk over the horizon of the covenant (and the trustee's view is that it has visibility of the covenant over a period of 20 years).

This is in keeping with the trustee's long-term view of the scheme and its approach to funding and investments.

The guiding principles can be summarised as follows:

- Over the period for which there is visibility of the covenant (estimated to be 20 years) there should be no increase in USS's reliance on the covenant of the sector and, where opportunities arise, the reliance on the covenant should be reduced if possible.
- There should be a high probability that the employer contribution rate will not exceed 18% of salaries over a three year period and there should be a very high probability that the employer contribution rate will not exceed 21% of salaries over the same period. In the longer term the stability of the contribution rate should be increased.
- The balance sheet of the scheme's participating employers should be able to cover the impact which a rare set of adverse circumstances (tail risk) may have on the funding position of the scheme.

The trustee will use these principles to both assess the options put forward by the scheme's stakeholders to respond to the current funding challenges and to manage scheme funding going forward.

Scheme funding within USS will continue to evolve as the trustee deals with the challenges of a constantly changing economic and sectoral environment, and with the need to adopt sensible long term plans for funding the scheme and for setting contribution requirements.

These challenges are certainly not unique to USS; all defined benefit pension schemes are making these adjustments, particularly as the cost of providing a guaranteed income in retirement continues to rise, for example because of increasing longevity (in pensions terms, every two years of extra life adds five per cent to pension liabilities).

Alongside these external factors, USS's trustee has a duty to take account of the particular characteristics of this scheme, of its operating environment and prospects for its participating employers, and of the risks associated with its investment strategy, in updating its long term funding plan for delivery of the benefits.

It is important to remember that specific changes to pensions offered in the future are a matter for the scheme's stakeholders, and discussions are ongoing between representatives of Universities UK and the University and College Union. The trustee welcomes this ongoing engagement and will continue to share information to support the representative bodies as these discussions continue in the coming months. Further updates for members will be posted on the USS website and also included in the Members' Annual Report which will be published for all members in the autumn.