USS Update – AHUA Conference, 19 Sept. 2014

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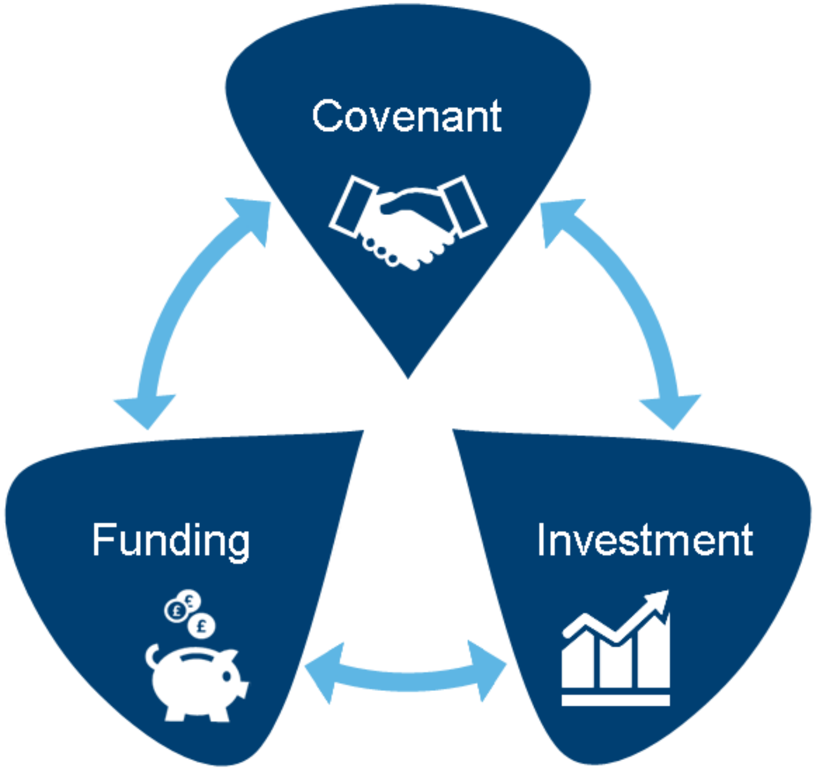
Pensions Regulator – Integrated approach to funding

Covenant, funding and investment decisions interact so that material changes to one affects the other two

Trustees should understand the risks across all of these strands and define acceptable parameters for each

- Potential additional drivers for Trustee consultation:
- Record deficit, coupled with limited willingness from institutions to increase contributions substantially.
- Pensions Regulator is treating USS valuation as one of its 25 "early intervention" cases for 2014.



tPR's Code of Practice on Funding

USS approach – includes benefits

Why are benefits part of the plan?

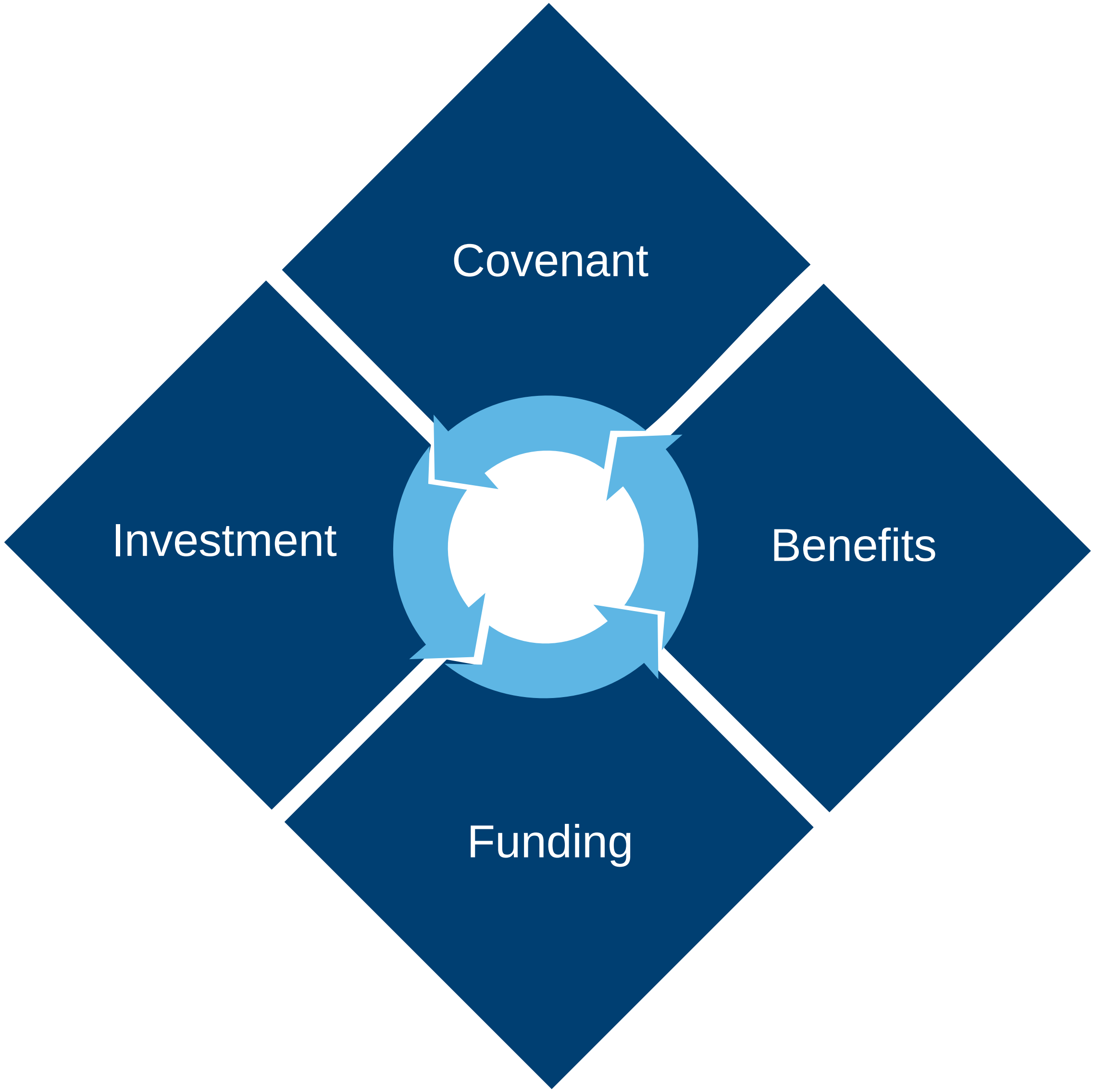
If the conclusions of Trustees' analysis are accepted then deficit is £13.1Bn* and future benefits cost 26.5%* of pay

Required contributions

Employees – 12.3%

Employers – 25.1%

** All figures in this presentation are approximate and based on financial conditions as at 30 September 2013*



USS analysis (December 2013)

USS: Integrated approach to scheme funding (July 2014)

- Three "guiding principles" and accompanying tests to govern their ongoing management of scheme finances.

> *"Tests are a guide and a reference for the trustee and for stakeholders in funding sustainable long-term funding solutions – they are not intended to provide a single and formulaic answer."*

	Test 1	Test 2	Test 3
	Benefit security and additional contribution cover	**Stability of contributions**	**Benefit security and the sector asset base**
Guiding Principle	Over a 20 year period, reliance on sector should not be increased.	A **high** probability that employer contributions will not exceed 18% over a 3 year period, and a **very high** probability that contributions will not exceed 21%.*	Balance sheet should be able to cover: Economic deficit plus allowance for a potential increase in this deficit over a one year period, if an exceptional economic event were to occur.

** Setting these contribution rates at lower levels would have implications for the amount of de-risking required*

UUK response to USS (March 2014)

Covenant	• 21% is not credible for many institutions. • 16-18% is the maximum employer contribution rate without causing material strain. • Widespread discomfort with the EY comments that Capex plans could be reduced or deferred.
Investment	• Case for investment de-risking not yet proven. • Continue to engage in a constructive dialogue. • There are few contingent assets available.
Funding	• Some support for a longer recovery plan than at present (i.e. 10 years) – probably in the range of 15-20 years.

Benefits	• Benefit package should include re-defining the salary linkage for past service final salary benefits.
	• Majority of institutions would prefer to focus primarily on extending CRB for all
	    • Leave potentially more radical changes for a later date.
	    • A significant minority favour more radical action sooner.

The Triangle of Compromise

Investment De-risking

From nil to full Trustees' proposals?

Contributions

Up to 18%
Don't forget the ~2-2.5% NI

Benefit Changes

Redefine final salary a "given"?
CRB for all, or more radical solution?

Potential packages considered

- **Package 1: CRB for all**
  - Likely to draw most support from institutions.
  - Would not produce sufficiently material reduction in risk.
  - Reasonable likelihood of further benefit change at next valuation.
- **Package 2: Hybrid CRB with DC contributions above a threshold**
  - Provides a more sustainable solution.
  - Better placed to compromise requirements of employers, Trustees and Regulator.
  - DB is targeted on scheme members with lower incomes.
  - Higher paid members can cope better with DC.
  - New Budget flexibilities.
  - Contribution flexibility?
- **Package 3: Target CRB (a "defined ambition" scheme)**
  - New concept – legislation still to be passed.
  - Less attractive than Package 2 partly following Budget.
- **Package 4: 12% DC**
  - Strong message from majority to maintain a core element of defined benefit.
  - Significant minority supported DC.

UUK proposal in more detail

Past service

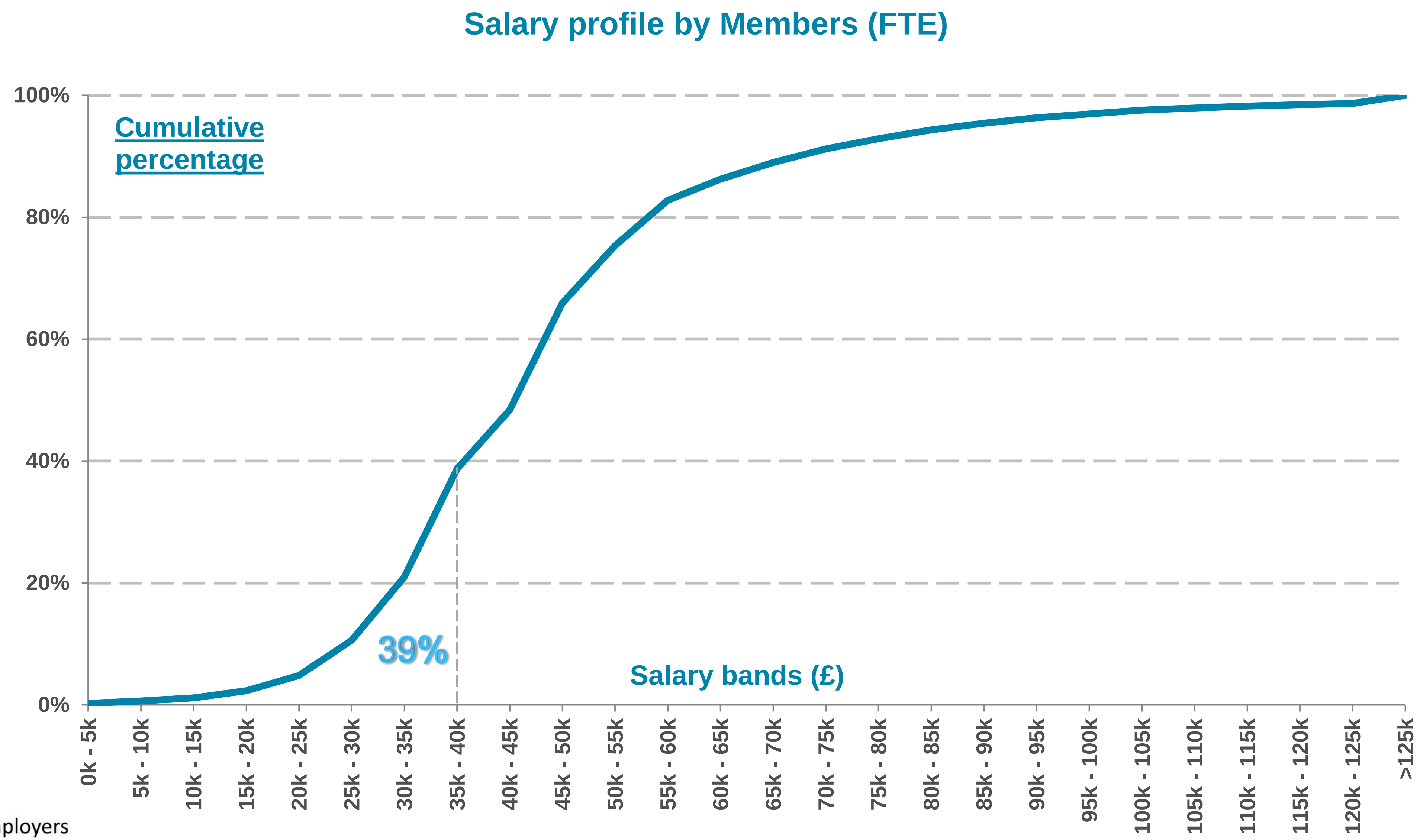
- Salary link replaced with CPI*

Future service

- Core CRB* benefits up to a Salary Threshold
- Salary Threshold of no less than £40,000*
- Member contributions of 6.5%*
- Additional flexible DC pot
  - Additional matching employer contributions of up to 2%* on salary up to threshold.
- DC benefits above threshold
  - 12%* of pay (part to fund death in service and ill health benefits)

** Variations possible on these parameters, and have been found elsewhere, but note the significant differences between those changes that add to DB liabilities and those that do not, in terms of their potential impact on trustees' de-risking plans*

Membership distribution



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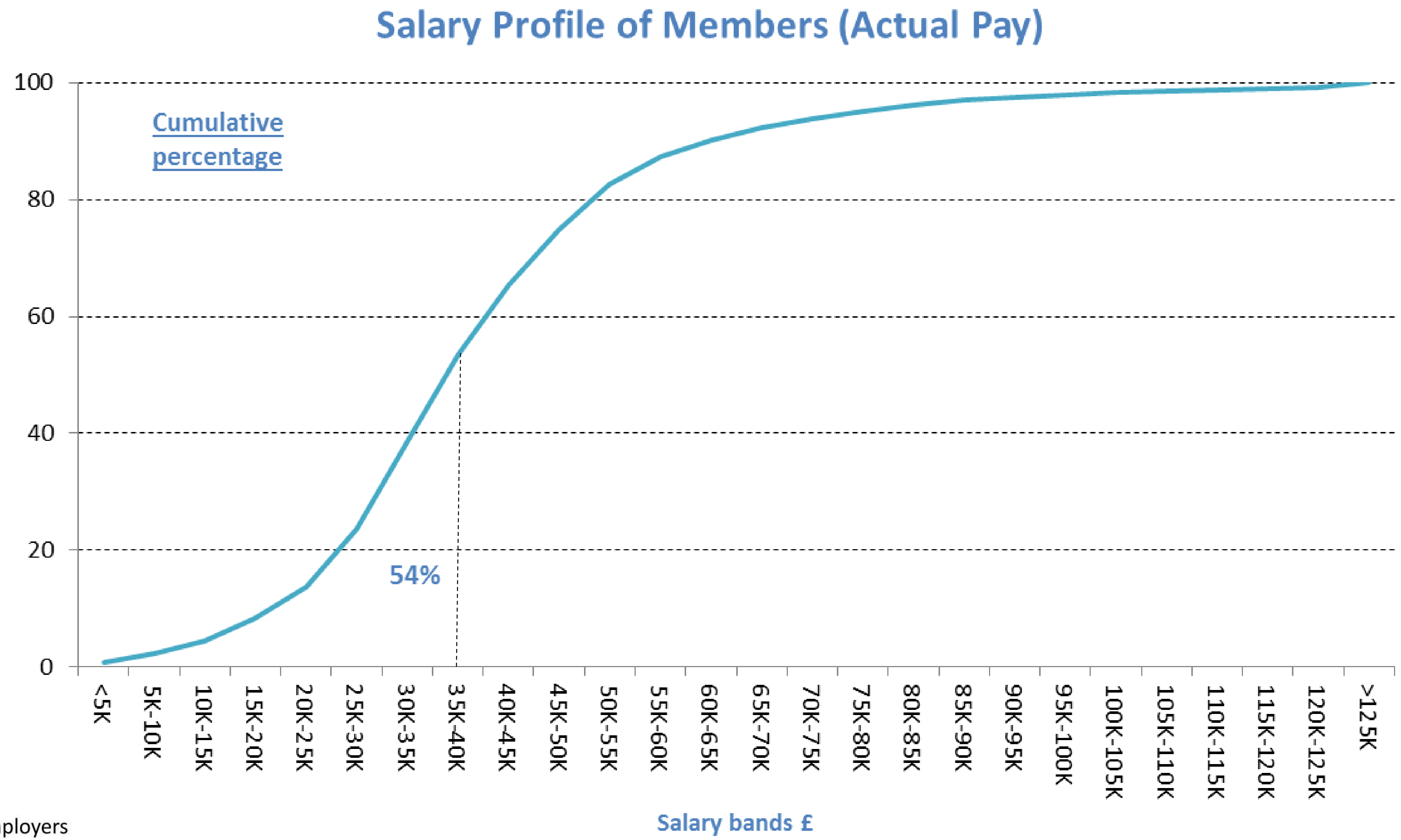
Membership distribution



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Issues for consultation

Durability

- Employers should aim for a long term solution which significantly reduces the risk of further employer contribution increases above the 16-18% range (while preserving an attractive and flexible benefit package).

- **De-risking**
- Benefit flexibility should be adopted so that Trustees can, in line with their risk parameters, undertake less investment de-risking than originally proposed. To achieve a sustainable solution, benefit reform is likely to involve a hybrid career average option which incorporates DC.

- **Salary Threshold**
- The Salary Threshold should be set so that as many members as possible are below this, while still retaining an affordable model.

Note: *Extension of consultation period to 22 September to consider modelling*

Analysis of future service benefits

The matrix below gives a breakdown of **the future service benefits** which would be payable under the proposed hybrid arrangement for a member who is (illustratively) 15 years away from retirement, showing benefits which would accrue under the DB and DC sections over those 15 years. For illustration, the benefits which would be payable from the USS CRB section and the USS final salary section are also shown.

Salary at start	Proposed hybrid scheme benefits				CRB section	FS section
	DB pension / DB lump sum	DC Fund	Annuity / Cash	Total pension / Total lump sum	Pension / Lump sum	Pension / Lump sum
£30,000	£8,000	£33,300	£1,200	£9,200	£8,000	£8,400
	£24,000		£8,300	£32,300	£24,000	£25,200
£40,000	**£9,900**	**£53,700**	**£1,800**	**£11,700**	**£10,600**	**£11,200**
	£29,700		**£13,400**	**£43,100**	**£31,800**	**£33,600**
£50,000	£9,900	£102,300	£3,300	£13,200	£13,300	£14,000
	£29,700		£25,600	£55,300	£39,900	£42,000
£60,000	£9,900	£150,800	£4,900	£14,800	£15,900	£16,800
	£29,700		£37,700	£67,400	£47,700	£50,400
£100,000	£9,900	£345,100	£11,300	£21,200	£26,500	£28,000
	£29,700		£86,300	£116,000	£79,500	£84,000

Key assumption:

DC fund growth rate	5.5%

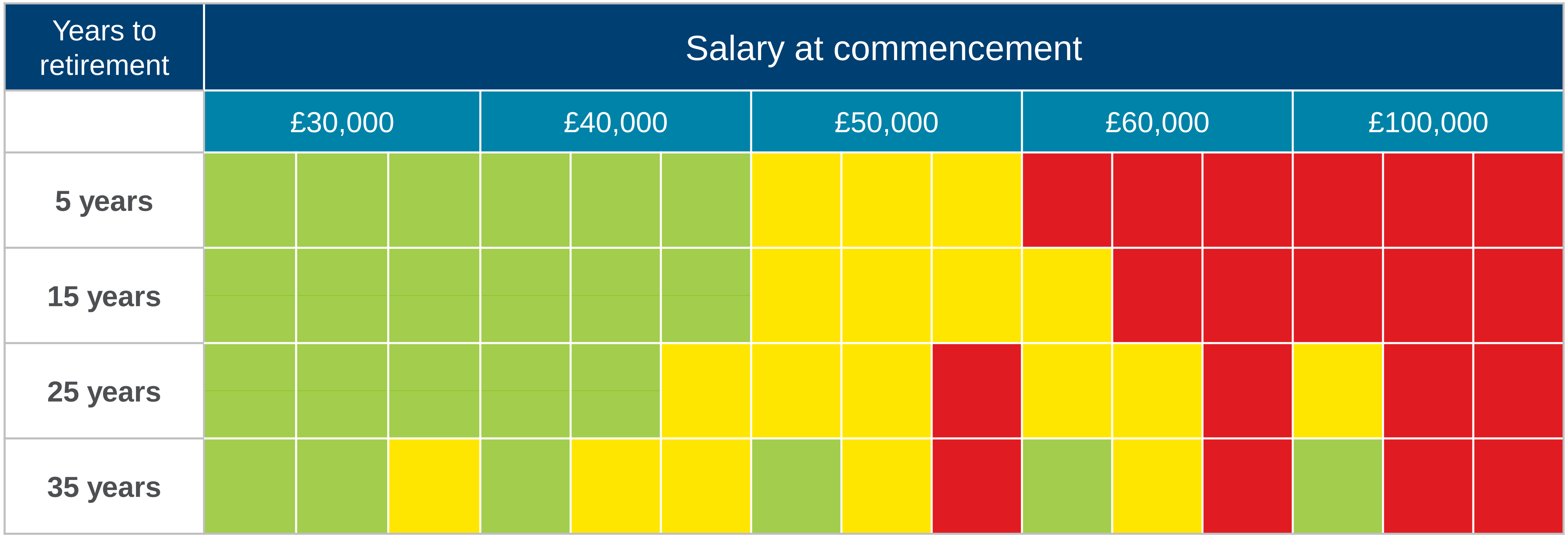
Note:

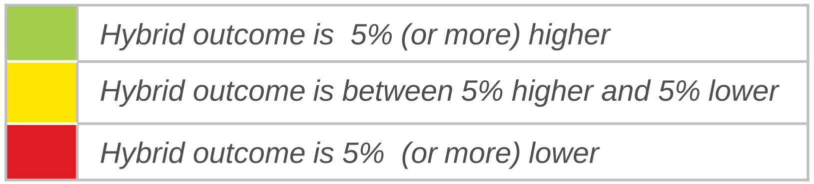
The figures in this matrix are rounded. To make fair comparisons, the fund (less the 25% taken as cash) is converted to pension using the joint life annuity until the pension figure is equal to the CRB section pension. Any remaining funds are converted on a single life basis.

Heat Map

Hybrid compared with Final salary

In this matrix we compare **the future service hybrid benefits** with the benefits that would be payable from the USS final salary section. The results shown in red represent outcomes which would be more than 5% lower under the proposed hybrid arrangements, whilst green representing outcomes which would be more than 5% higher under the proposed hybrid arrangements (and shown in amber those results which fall in between).





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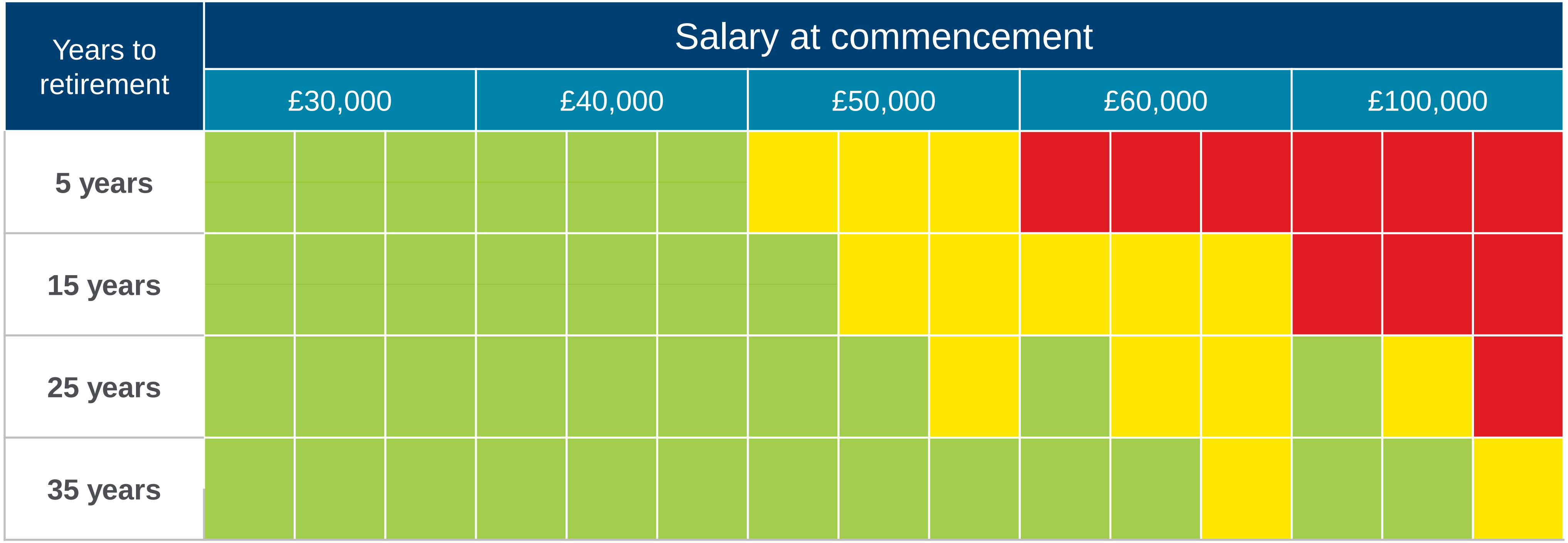
Heat Map

Hybrid compared with USS CRB

In this matrix we compare **the future service hybrid benefits** with the benefits that would be payable from the USS CRB section. The results shown in red represent outcomes which would be more than 5% lower under the proposed hybrid arrangements, whilst green representing outcomes which would be more than 5% higher under the proposed hybrid arrangements (and shown in amber those results which fall in between).



Hybrid outcome is 5% (or more) higher

Hybrid outcome is between 5% higher and 5% lower

Hybrid outcome is 5% (or more) lower

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Discussions with UCU

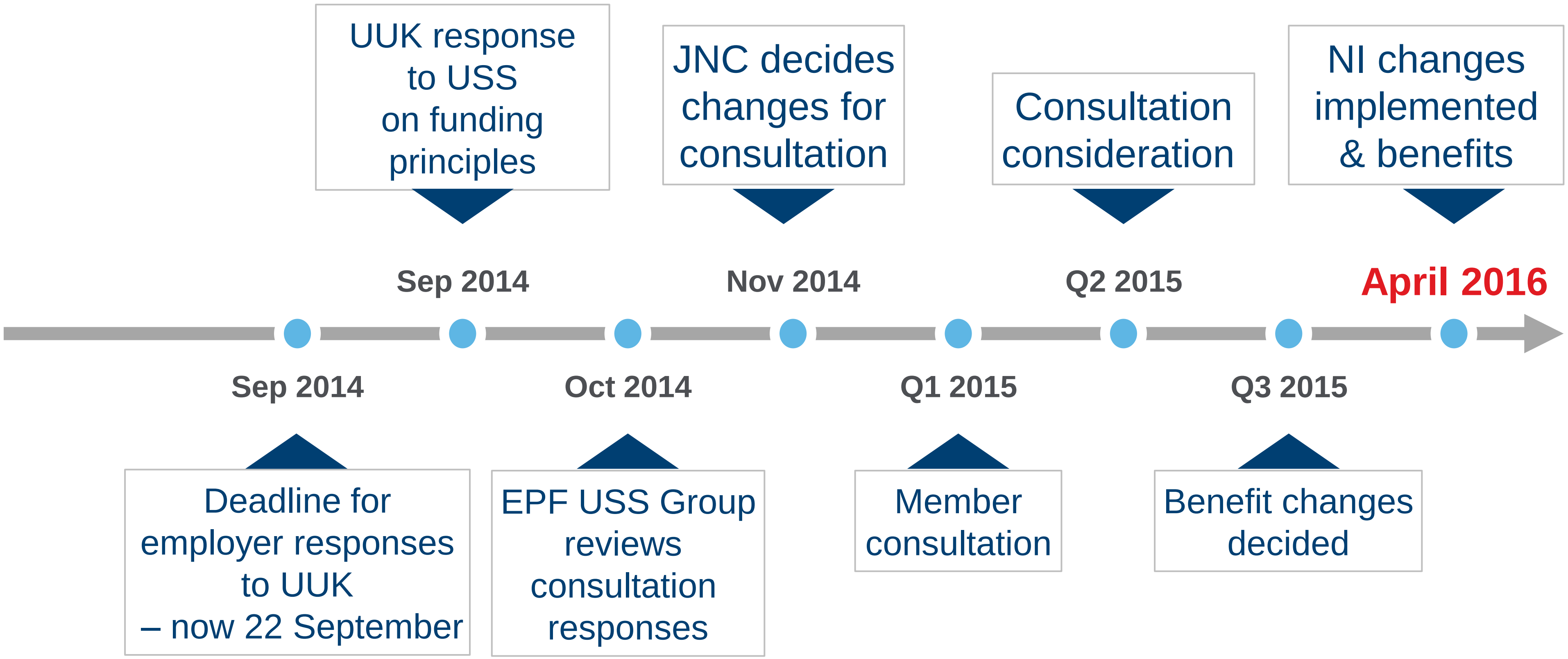
- Discussions with UCU continue in USS Funding and Benefits Group
- UCU response to the employer proposals focused on improvements to the CRB section and opposition to DC benefits
- Proposed ballot for industrial action
- Proposed guidelines for employers in relation to potential industrial action

Communications

- Briefing issued to employers in July for communicating with employees
- FAQs on the EPF and USS websites

- Summary funding statement annual report with 2014 valuation outcome to be issued in October
- Report on outcome of UUK consultation to be circulated to employers in October
- Communication with governing bodies
- Circulation of further modelling and briefing for employers
- Preparation for employer consultation with affected employees in 2015
- Employer communication with employees – legal aspects

Timeline – going forward



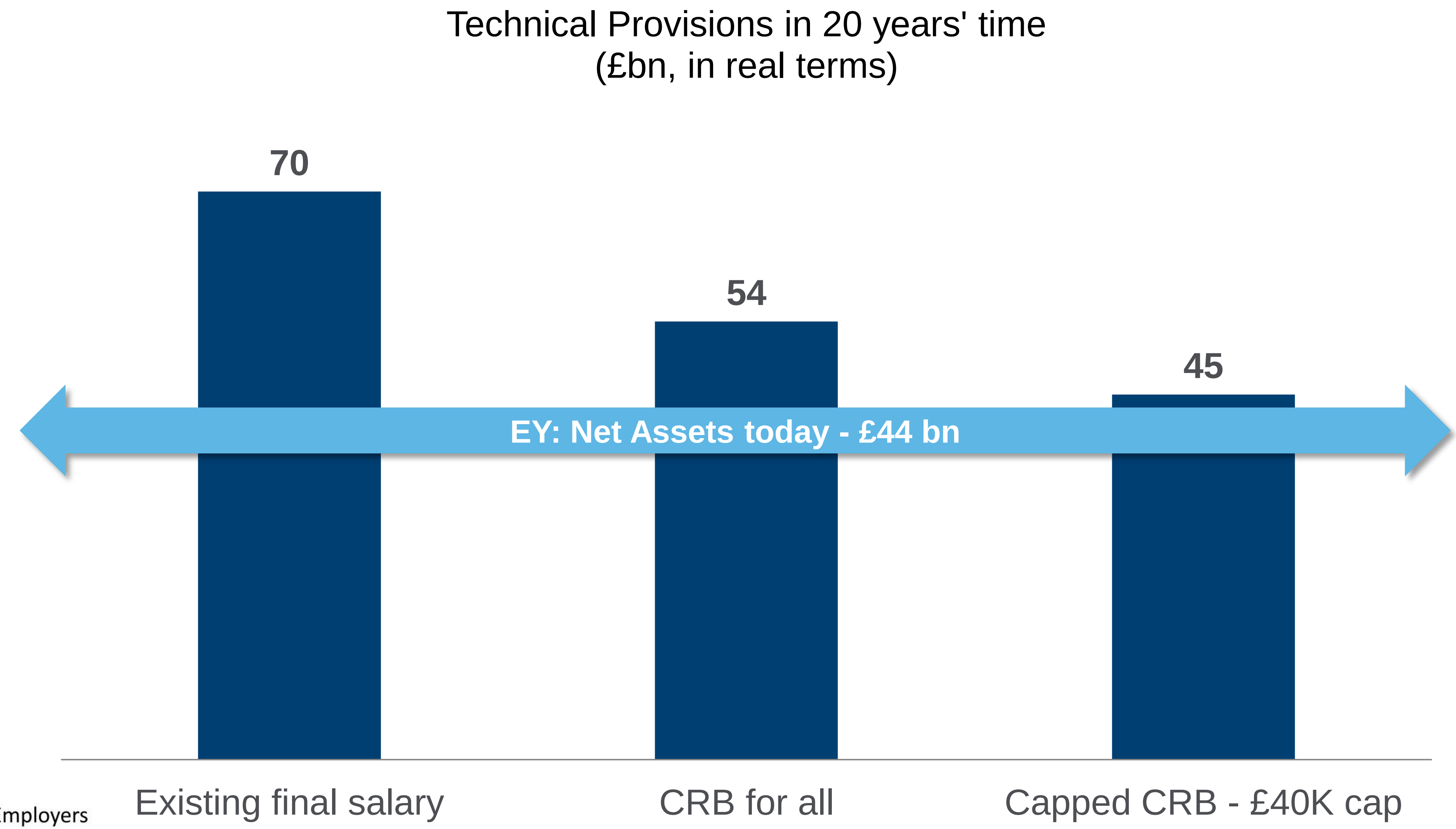
POSSIBLE TIMETABLE

Event	Date	Note
UCU branch briefings in Manchester, Glasgow, London, Birmingham	18 to 25 July	
Special pre-92 branch decision-making conference	Fri 19thSeptember	To discuss SWG/negotiators' report and decide on next action.
USS Board	*24 September*	*Important valuation assumptions and tech provisions for consultation*
Ballot period (if necessary)	Wed 1 to Mon 20 October	
Ballot closes	Mon 20 October	Action could start eo Oct/beg of Nov
USS JNC	*22 October*	*Proposed scheme design formally tabled*
USS JNC	*13 November*	*USS will want scheme design settled?*
USS Board	*20 November*	*Finalise technical provisions, agree terms for formal consultations (60 days) on changes*
USS Board	*Jan 2015*	*Refinements following consultations*
USS Board	*Mar 2015*	*Final/implement*

QUESTIONS ?

BACK UP SLIDES

Keeping pensions proportionate



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Impact on members - assumptions which underpin USS modelling of future service benefits

The assumptions made in the calculations for the modelling have been agreed by UUK and UCU, and are outlined below.

Assumptions	
Comparator scheme	Proposed hybrid arrangements
Reference schemes	USS CRB / USS final salary
Salary	Increased by RPI[1]
RPI	2.8%
CPI	2.0%
DC fund growth rates	4.5% / 5.5% / 6.5%
Joint life annuity rate (long term market conditions)	23.0 (CPI increases, 5 year guarantee)
Single life annuity rate (long term market conditions)	21.5 (CPI increases, 5 year guarantee)

[1] *These assumptions make no allowance for additional promotional increases above RPI*

Detail | **Hybrid** compared with **Final salary**

In this matrix we compare **the future service hybrid benefits** with the benefits that would be payable from the USS final salary section. Positive results show that the hybrid scheme gives a higher benefit outcome; negative results (highlighted in red) show that it would give a lower outcome. Each cell gives a spread of results to illustrate the effect of the three different DC fund growth rates, as shown at the bottom of the slide.

Years to retirement	Salary at commencement														
	£30,000			£40,000			£50,000			£60,000			£100,000		
5 years		**12.5%**			**10.8%**			**-0.2%**			**-7.3%**			**-21.3%**	
	12.8%		12.2%	11.2%		10.5%	0.4%		-0.8%	-6.6%		-8.0%	-20.3%		-22.2%
15 years		**10.6%**			**7.3%**			**-1.2%**			**-6.8%**			**-17.6%**	
	11.9%		9.5%	8.8%		6.0%	1.1%		-3.3%	-4.1%		-9.2%	-13.9%		-21.0%
25 years		**9.3%**			**5.0%**			**-0.9%**			**-4.9%**			**-12.5%**	
	11.9%		7.1%	8.2%		2.3%	4.0%		-5.0%	1.2%		-9.7%	-4.5%		-19.0%
35 years		**8.3%**			**4.1%**			**1.0%**			**-1.2%**			**-5.4%**	
	12.9%		4.7%	10.0%		-0.5%	9.7%		-5.9%	9.5%		-9.4%	9.1%		-16.4%

Key Assumptions:

DC fund growth rate	5.5%	
	6.5%	4.5%

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Detail

Hybrid compared with USS CRB

In this matrix we compare **the future service hybrid benefits** with the benefits that would be payable from the USS CRB section. Positive results show that the hybrid scheme gives a higher benefit outcome; negative results (highlighted in red) show that it would give a lower outcome. Each cell gives a spread of results to illustrate the effect of the three different DC fund growth rates, as shown at the bottom of the slide.

Years to retirement	Salary at commencement														
	£30,000			£40,000			£50,000			£60,000			£100,000		
5 years		**14.4%**			**12.7%**			**1.5%**			**-5.9%**			**-20.0%**	
	14.7%		14.0%	13.0%		12.3%	2.1%		0.9%	-5.2%		-6.6%	-19.0%		-21.0%
15 years		**17.1%**			**13.6%**			**4.6%**			**-1.4%**			**-13.0%**	
	18.4%		15.9%	15.1%		12.2%	7.0%		2.4%	1.6%		-4.1%	-9.1%		-16.6%
25 years		**20.4%**			**15.7%**			**9.3%**			**4.9%**			**-3.7%**	
	23.3%		18.0%	19.3%		12.8%	14.6%		4.7%	11.5%		-0.7%	5.3%		-11.2%
35 years		**24.7%**			**19.9%**			**16.2%**			**13.8%**			**9.0%**	
	29.9%		20.5%	26.6%		14.6%	26.2%		8.3%	26.0%		4.1%	25.5%		-4.2%

Key Assumptions:

DC fund growth rate	5.5%	
	6.5%	4.5%

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