Guidance for USS Consultation

Consultation on changes to the Universities Superannuation Scheme

The Consultation opens Monday, 16 March 2015.

All members of the Universities Superannuation Scheme (USS) are being consulted on proposed changes set out on the Employers' Consultation website: http://www.ussconsultation.co.uk/members

It is very important that as many members as possible make an individual response to this consultation; we are advised that if enough members raise similar points then the trustees will be obliged to take these into account.

Below is the advice from Keele UCU on points to make in your response. We highlight 5 key issues:

1. The need for a more meaningful valuation method.
2. The danger of the proposal to transfer the bulk of USS assets from equities into low growth investments, such as gilts.
3. The absence of a justification for the proposal to introduce 'individual defined-contribution' pension funds for salaries above £55,000.
4. The negative change in the value for money of the scheme.
5. The negative effect on members in the 'final salary' section.

1. The need for a more meaningful valuation method.

In the past few months the valuation method used by USS to suggest that it is in deficit has come under severe, and highly cogent, criticism (see below). Since we are being asked to accept large financial sacrifices based on this supposed deficit, it is imperative to develop a valuation that can have the general confidence of members.

The main point to make is this. The discount rate used to value USS's liabilities is currently based on the rate of return on government bonds (gilts). Distortions in the gilt market due to the government's policy of quantitative easing have produced an artificial 'deficit' that bears no relation to the real health of the pension scheme, and that fluctuates meaninglessly as the gilt rate varies. Very little of the scheme's funds is invested in gilts. The discount rate should instead be based on the estimated rate of return of the scheme's investments.

2. The danger of the proposal to transfer the bulk of USS assets from equities into low-growth investments, such as gilts.

In their paper, *USS - The need for reform,* the employers claim that

> Currently the investment risk carried by USS is relatively high due to the fact that the majority of its assets are held in equities (stocks and shares and other growth assets) rather than government bonds and other liability matching assets.

They, therefore, advocate moving the funds to supposedly safer investments.

This step, known as 'derisking', would be highly deleterious; USS's income from its investments would be reduced and it would be unable to meet its future pension payments from its income.

The notional deficit would become a real deficit.

It would be particularly disastrous to do this at the present time, when gilt yields are artificially depressed, and equity prices artificially inflated, by quantitative easing.

The risks of investing in equities are in fact exaggerated, in view of the very long-term nature of USS's investment and its strong positive cash flow, which allow it to disregard short-term fluctuations in the market. The question is discussed quantitatively in the First Actuarial report (document 5 below, section 7), which concludes that the risk of equities performing worse than gilts over a 20-year period is below 5%.

The policy of 'derisking' should be rejected. USS's current mixed investment portfolio should be retained.

3. The absence of a justification for the proposal to introduce 'individual defined-contribution' pension funds for salaries above £55,000.

This proposal will affect anyone on grade 9 or 10 (i.e., senior lecturer or above), and will be unnecessarily detrimental.

It is risky and inefficient from the member's point of view, because each member has an individual set of investments that can rise and fall separately from other members' funds and has to be administered separately.

Pooling of risk between members, providing a predictable income in retirement, is the whole point of a pension scheme, and this is most rationally done through a defined-benefit scheme.

4. The negative change in the value for money of the scheme.

The scheme is to become significantly worse value for money. Those members in the 'career-revalued benefits' (CRB) section of USS will go from contributing 6.5% of salary in exchange for a pension based on 1/80ths of salary to contributing 8% of salary in exchange for a pension based on 1/75ths of salary. These are very poor terms by the standards of other CRB schemes.

5. The negative effect on members in the 'final salary' section.

For those members currently in the 'final salary' section of USS, their 'final salary' pension will be based on their salary on 1st April 2016 (adjusted for subsequent inflation), rather than on their salary on leaving university employment. This is a serious detriment for anyone who is still rising in the salary scale. This change devalues the pension benefits that we have accrued in the past; this is contrary to basic principles of pension law and should be rejected.

Sources:

1. Keele UCU newsletters on the employers' proposed changes and the meaning of UCU's supposed deficit:
   http://www.keeleucu.co.uk/wp-content/uploads/2014/10/KeeleUCU-Pension-News-Sept-2014.pdf
   http://www.keeleucu.co.uk/wp-content/uploads/2014/10/KeeleUCU-Pension-News-Oct-2014.pdf
2. A letter from a group of leading authorities on statistics, financial mathematics and actuarial science to Sir Martin Harris, the chairman of the USS trustee board, criticising the assumptions on which the valuation is made:

http://blogs.warwick.ac.uk/files/dennisleech/letter_to_uss_trustees_re_deficit_21_nov_2014.pdf

3. Imperial College London's official response to USS's proposals, arguing that USS's figures 'are as likely to be modelling artefacts as a reflection of the underlying economic reality'.
   https://workspace.imperial.ac.uk/college/Public/pdfs/PDFS/Imperial%20response%20to%20UUK%20on%20USS%20technical%20provisions_final.pdf

4. Warwick University's critique of the ‘over-pessimistic assumptions and inappropriate methodology' in the calculation of the USS deficit. Summary available from:
   http://blogs.warwick.ac.uk/dennisleech/entry/warwick_university_uss/

5. UCU's response (compiled by First Actuarial) to the USS Trustee Consultation, providing a detailed critique of the valuation method:
   http://www.ucu.org.uk/media/pdf/9/k/ucu_usstrusteeconsultationresponse_nov14.pdf
   Note in particular:
   - the cashflow projections for the next 70 years show USS’s healthy financial position (p.26),
   - the inconsistency in the assumptions (section 5),
   - the discussion of long-term rates of return from equities and gilts (section 7),
   - the distorting effect of the choice of discount rate based on gilt rates (appendix B).

6. Recent article in 'The Actuary' by a former vice-chair of the Bank of England, critical of the thinking behind derisking:
   http://www.theactuary.com/features/2015/03/riders-on-the-storm/
   Note in particular the section on 'misreading of risk', which is especially relevant to USS.