

USS: Consultation on the proposed assumptions for the scheme's technical provisions and recovery plan

Response by the University of Oxford

The University is pleased, via UUK, to take part in the formal consultation by the Universities Superannuation Scheme (USS) on the 2014 actuarial valuation, its proposed assumptions for the technical provisions, and the recovery plan.

This response has been prepared by a working party set up by University Council to consider the funding and benefits of the USS. Membership of the working party was carefully determined so as to avoid or minimise conflict of interest. In reaching its views, the working party has sought specialist advice from independent actuaries.

The importance of good communication to support a well-informed and constructive debate

The working party wishes to repeat to UUK its request for a better flow of information in connection with revision of the pension scheme. In our earlier response to UUK's paper on benefits reform, we sought better examples of the impact of UUK proposals on members' pensions: UUK has provided this for lower salary earners, and we look forward to more detail for higher earners as the likely benefits package becomes clearer.

In the present context of the valuation, we would remark on the published articles, open letters, and electronic postings from academics, universities and the UCU challenging fundamental aspects of the valuation – not least the "Gilt+ " approach for setting the discount rate. We are aware that this issue has been the subject of exchanges between the UCU and the Trustee for much of the summer, and, if progress is to be made now on acceptance of the valuation, it is vital that USS provide further information to give a thorough justification for using the "Gilt+ " approach. More generally: given the informed questioning from members who are expert in financial and statistical analysis, much more needs to be done to present arguments in response to the full range of points that are understandably being made.

It would also be helpful to show meaningful comparisons with other schemes in terms of the assumptions and the costs and benefits that are under consideration. (The chart circulated today by UCEA does not provide sufficiently complete comparative information to satisfy an academic audience.)

We recognise that there are both expert audiences and lay ones for this material, and so it would help to provide separate presentations tailored for each.

The valuation

Assuming that USS can provide clarity over its proposed methodology, we have, with regret, to acknowledge the substantial funding shortfall of the scheme and the consequent inevitability of material benefit reform. We are in broad agreement with UUK on the type of

benefit reform package needed to deal with this shortfall and with UUK's preliminary concerns on the valuation approach and assumptions. We have independently identified certain valuation assumptions that should be looked at further, and we note that these largely overlap with those identified by UUK.

The assumptions that we would question could have a small but significant effect on what is possible within the funding, affordability, and risk constraints. We consider that it is crucial that the proposed valuation approach strikes an acceptable balance between ensuring the scheme is on a sound footing for the long term and ensuring that, within those constraints of sustainability, the scheme provides the best achievable benefits structure. We agree with UUK's view that there is some scope within the assumptions to move this balance further towards protecting the interests of employee members. In our response below, we have provided more detail of the areas that we believe warrant further consideration.

Inflation risk premium (IRP)

We note that reducing the IRP to 0.2% p.a. would not be out of line with other schemes. However, this level of IRP and the proposed further gradual reduction to 0.1% p.a. imply a certain level of inflation hedging which will increase over time. We have been given insufficient detail about this inflation hedging (both current and future) to justify the proposed changes to the IRP. More information is needed from the USS Trustee to support their proposal before these changes can be accepted.

CPI

The Statement of Funding Principles agreed at the last valuation provided for a *prudent* margin to be included in the discount rate and mortality assumptions. Other assumptions were to be based on a *best estimate* view of future experience. We understand that the best estimate assumption for CPI is now RPI less 1% p.a., and so setting CPI inflation at RPI less 0.8% p.a. adds an additional layer of prudence that was not present at the 2011 valuation. We support the transparency of the methodology adopted for the 2011 valuation, and therefore propose that the CPI assumption is set on a best estimate basis.

Salary inflation

We would expect the discussions with various stakeholders to have produced an appropriate assumption, though we see that some commentators are referring to historical evidence to challenge the use of RPI + 1% p.a for underlying cost-of-living salary inflation. We note though, that salary inflation will have limited significance if the link with final salary is broken and defined benefits accrue only on a CRB basis in future. We think that such a move looks to be unavoidable in order to limit the risk in the scheme, and so we do not wish to comment further on salary inflation.

Life expectancy

We would ask the USS Trustee to incorporate the most recent version of the standard mortality table available at the valuation date (i.e. CMI 2013). We note that increasing the long-term improvement rate to 1.5% p.a. would be in line with typical current market practice.

Other demographic assumptions

The consultation states that many of these assumptions are based on scheme experience. However, it appears there are some that are not: we should like to have a more detailed explanation of how these assumptions have been derived.

Discount rate

This is a key assumption for the valuation, and we do not believe enough information has been provided by the USS Trustee to enable us to comment on their proposal to adopt gilts +1.7% pa as the initial discount rate. We should like to understand the degree of prudence achieved in setting a discount rate of gilts + 1.7% pa and would like information on the Trustee's view of the probability of achieving this return given the scheme's current investment strategy.

The recovery plan

Length of the recovery plan

We believe that a recovery plan of 20 years is reasonable and supported by the strength of the employers' covenant. The covenant review undertaken by E&Y for the USS Trustee concluded that the covenant was robust over a 20-year period with a strong likelihood that it would remain robust beyond 20 years. We would urge UUK to negotiate with the USS Trustee on this point.

We hope this response will assist UUK in pursuing the negotiations with the USS Trustee on the valuation assumptions, and we shall of course be very happy to discuss any of the above points further.

For the University of Oxford
Council's Working Group on USS
27 November 2014