Universities Superannuation Scheme (USS)
Methodology and Inputs for the 2017 Valuation: Initial assessment

Response by the University of Oxford

The University is pleased, via UUK, to share its views on the USS trustee company's initial assessment of the methodology and key inputs to be used in the 2017 actuarial valuation.

This response has been approved by a working party set up by University's 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.

Early engagement and formal consultation

The University is appreciative of the material produced by USS to allow early engagement of employers on the forthcoming 2017 valuation. The University understands that this provides an opportunity to comment on the direction of travel and the University's appetite for accepting risk but it does not represent a formal consultation on the technical provisions. The formal consultation on the technical provisions is expected to be issued in July 2017 when the University will have a further opportunity to present its views on the assumptions and methodology to be adopted for the 2017 valuation of USS. As discussed in this response the University looks forward to receiving further information from USS, prior to the formal consultation, setting out the potential consequences of underwriting more risk.

General comments

The University welcomes the flexibility that USS appear to be considering for the 2017 valuation and agrees that the trustee should re-calibrate its method and inputs based on recent market and sector data.

We note that the technical discussion document seeks employer views on three key areas – all of which appear to drive the derivation of the discount rate, a key assumption for the valuation. Depending on the approach adopted in these three key areas it may be possible to justify a wide range of outcomes each with a different risk profile.

Whilst the University can consider each of the three key areas (and their corresponding inputs) in isolation, with the knowledge that one option may present "more risk" than another, the University does not feel it has enough information to understand the consequences of accepting more or less risk. The University therefore asks USS to provide further clarity in this area.

Ultimately, the University is keen to ensure that the overall level of risk incorporated into the 2017 valuation is commensurate with the uniquely robust covenant of the sector with an appropriate balance being struck between risk, providing good quality pension provision and a target employers' contribution of 18% of pay.

From the figures provided in the USS technical discussion we note that even if the sector did agree to materially increase the level of risk they are willing to accept (within a range likely to be acceptable to USS and the UK Pensions Regulator) benefit reform is still likely to be needed. This is obviously extremely disappointing for all parties.

The remainder of this response provides further commentary on the specific areas that USS requested feedback on.

Key issues on methodology and inputs

1. USS seeks views on: the approach to determining the maximum reliance which can be placed on the employer covenant in future when funding the scheme, and in particular the inputs that are used to determine reliance.

We understand that this question primarily covers the application of "Test 1" and the various variables/inputs that feed into its derivation. The University is supportive of the overall principle behind "Test 1" – that exposure to USS should not be allowed to grow without limit but does have concerns about the bespoke, technical nature of the test and the apparent sensitivity to its arbitrary/extreme scenario inputs. The University is interested to know if there are other simpler approaches to limit the reliance on covenant over time that would be acceptable to USS.

The University's overall view is that it is difficult to comment on the specific inputs of "Test 1" in isolation and any changes that could be justified (which are likely to increase reliance on the sector) need to be considered alongside future contribution requirements and potential benefit reform.

2. USS seeks views on: the future investment returns, and in particular whether employers prefer to rely on the current market view for long-term interest rates, or whether they prefer the view that long term interest rates will revert to higher levels than markets currently predict.

The University has some concerns about factoring in an increase in long-term interest rates which is not in line with market pricing.

The University also struggled to reconcile the shape of the 2014 valuation discount rate with the single equivalent rates that appear to be proposed for the 2017 valuation and felt the interaction (if any) between the contribution rates detailed in table 4 of the technical discussion document and the range of flexibility detailed in tables 2 and 6 (to assess the reliance on the sectors covenant) was unclear. The University would ask for further clarity on these areas before the formal consultation on technical provisions is issued.

3. USS seeks views on: the degree of confidence required that the assumed pension costs will prove a reliable forecast, and how much risk the employers prefer to take out of the maximum risk possible. Specifically, is the risk appetite different for funding benefits earned to date versus the benefits the sector wishes to promise in future?

The University is keen that the degree of confidence inherent in the valuation assumptions reflects the sectors uniquely robust covenant against a backdrop of limited scope to increase employer contributions. The University believes that the overall strength of the technical provisions basis should be comparable with wider market practice – although the unique position of the sector may make such comparisons difficult to reconcile.

At the recent meetings held by USS to discuss the methodology and inputs for the 2017 valuation the proposal was to aim for 60%-70% confidence. The University's initial view is that, given the requirements of the Pensions Regulator (i.e. to be prudent) and wider market practice, this proposed range of confidence is not unreasonable.

In relation to whether or not the University's risk appetite is different for funding benefits earned to date versus future benefits the University would like to understand how the difference would be treated for the purpose of the recovery plan – and in particular if adopting a less prudent basis for future service benefits would simply result in higher deficit contributions (all else equal).

4. USS seeks views on: how salaries will develop both in the short and longer term.

At present, the University is unable to comment on the future expectation of salary growth over the short and longer term. The University will be considering this in more detail prior to the formal consultation on technical provisions.

5. USS seeks views on: assumptions for the RPI/CPI gap and the inflation risk premium.

The University believes that all assumptions for determining the technical provisions, other than the discount rate and mortality assumption, should be set as "best estimate" assumptions.

6. USS welcomes any specific views on: recovery plan assumptions.

The University believes that a recovery plan of between 20 and 30 years can be supported by the strength its covenant. However, the same cannot be said of all employers who participate in USS where a longer recovery period places an even greater burden on the covenant of the strongest employers. We would be interested in the USS and employers exploring further the issue of sectionalisation of the scheme.

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 Working Group on USS

17 March 2017