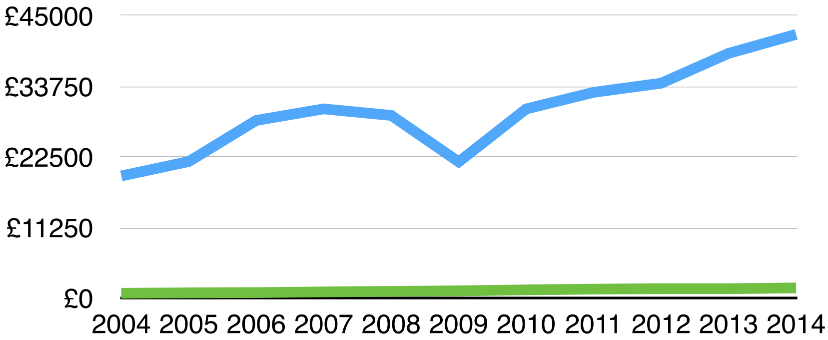
USS: WHAT'S HAPPENING

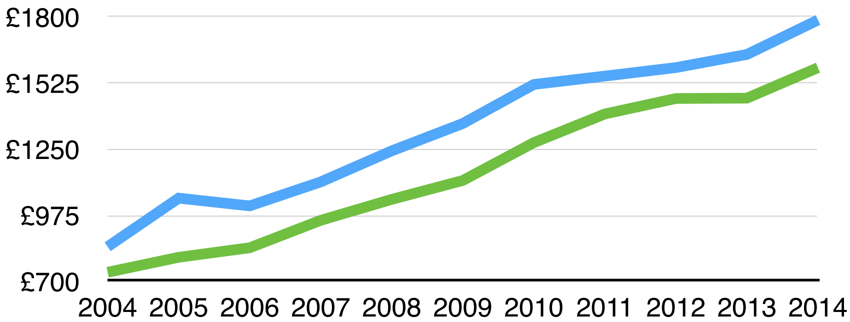
The 'deficit' explained

Performance of the USS fund 2004-2014

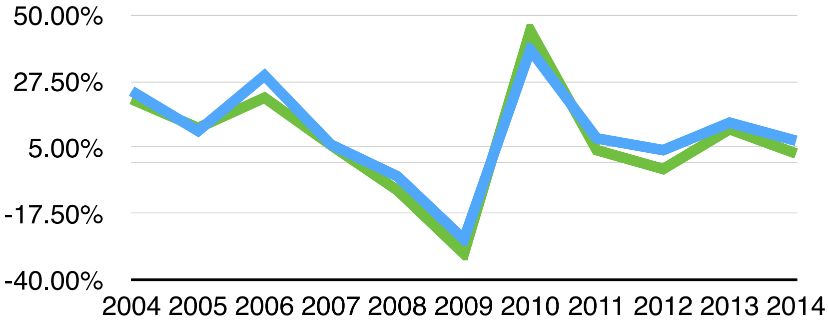


The Pension fund is healthy and growing

The first chart here shows the historic value of your pension fund (blue line) against the liabilities, money going out (green line), each year over the last decade. The values are in millions of pounds, and the value of the fund at 31 March 2014 was given as over £41 billion. The gap between the two lines is the fund's surplus. If the USS were a country, then, it would sit around the 80th position in terms of GDP, and it would have no national deficit. The second chart shows the amount of money coming in from your contributions each year (blue line) over that same time, against those liabilities once more (green line). Again, figures are in millions. Clearly, the scheme has more money going into it than going out.



The third chart here shows the performance of the USS fund's investments (blue line) against the FTSE 100 over the same period (green line) (FTSE figures taken at 31 March each year to map in comparison with the 31 March reporting date of USS). In 8 out of 10 years, the investments in your pension fund have grown faster than the FTSE, and we've seen a better recovery from the economic crisis of 2008/09 in our scheme investments than the FTSE managed. Your pension fund is well-managed, is healthy and growing.



So why is there talk of a deficit?

There are two issues here; a.) pensions regulations and b.) the decisions of the USS trustees to calculate the deficit in certain ways, and how this in turn drives investment policy that actively increases deficit.

Pensions regulations

There is a requirement of each pension scheme to demonstrate that it could pay all the benefits that have accrued should all contributions income cease. So, all current and future pensions between now and roughly the end of the century need to be covered by a scheme's current surplus. There is a legal requirement to provide a formal valuation in these terms every three years (Pensions Act 2004). The current USS valuation takes a snapshot of the assets at 31 March 2014 (A) and calculates current and all future benefits (B). The surplus or deficit of the scheme is therefore *A minus B*.

Now, in the case of a single employer scheme, that is right and proper - benefits accrued should be protected and paid. But does it make sense in a multi-employer scheme such as USS, where the likelihood of all HEIs coming to an end simultaneously is only a scenario conceivable within Science-Fiction? Mark Taylor-Batty's motion to the 15 October Senate addresses this, and requests that the University Council consider options to lobby for an adjustment for multi-employer schemes, one that might better represent the real-world risks of income loss.

Deficit calculation

The USS scheme Trustee is not tied by regulation in the manner in which the surplus or deficit of the scheme is calculated, as long as the *A minus B* equation outlined on page 2 is appropriately quantified. Legislation requires the assets to be calculated at market value and the liabilities on a 'prudent basis'. Room for manoeuvre (and for debate) arises here.

The USS trustee predicts the future value of the fund (and therefore the liabilities) on the expected return from gilts plus 2.75% - a simple equation, but one that returns a lower predicted result than the assets are likely to produce and therefore a higher deficit. To compound matters, due to quantitive easing, since 2011 gilts and bonds have been at all-time low values.

Anchoring the calculation of future returns of high-yield assets to the performance of low-yield gilts creates a notional deficit that is unlikely to come true, because in reality the scheme is invested around 20% in gilts. This is like predicting the growth of the sunflowers in your garden on the growth of your roses. As the future liabilities are calculated using this method, they are disconnected from the real-world valuation of the assets. It is this that creates the disliked volatility - the two calculations are not matched.

To address this, USS propose to buy more gilts in order for the prediction and the outcome to be more likely to match. This 'de-risking' is like planting more roses and cutting down some sunflowers to get your sunflower growth predictions more accurate. This strategy will result in a 1% lower estimation of future value. It increases the deficit.

Not only does the tail of fictional deficit calculation wag the dog of real-world future investment strategy in a less profitable direction, it requires increased contribution from employers and employees. A strategy that makes USS more expensive for all is something all parties might want to avoid.

An alternative

The UCU has suggested that the valuation of the future yield of the assets in the investment portfolio be based on the assets in the portfolio. This approach is legitimate, not uncommon to other pension schemes, and provides a non-volatile manner of calculating liabilities.

University and College Union