From: Adam Ozanne
Sent: 04 October 2017 16:39
To: President
Cc: E Astle; Luke Georghiou; Registrar; Stephen Dauncey; Karen Heaton; Henorthwest; Christine Haswell (CHaswell@UCU.ORG.UK); Gregory Lane-serff; Philippa Browning; Kamie Kitmitto
Subject: USS valuation and consultation

Dear Nancy,

I am writing to you on behalf of University staff who are members of USS – all of whom UCU represents – to request a copy of the University's submission to the current USS consultation with employers, the closing date for which we understand has been extended to this Friday, 6th October. We also request a follow-up meeting to the one we had with Colin Bailey and Karen Heaton on 30th January 2017 to discuss USS.

You will recall that prior to the meeting on 30th January we sent Colin and Karen a copy of the attached paper, which set out our concerns about the way the 2017 USS valuation exercise seemed to be going at that time, and in which we suggested that we follow Cambridge University's example and establish a joint University/UCU USS Working Group, drawing on relevant expertise in the University, to help improve and strengthen the University's contributions to discussions about the future of USS.

Regrettably, despite some expressions of interest from Colin and Karen at the January meeting, we have not heard anything more about the proposed working group despite the University having been asked by USS to comment on the 2017 valuation. Moreover, our concerns about the valuation have increased following a series of, what we regard to be, scaremongering reports in the media over the summer about a supposed USS deficit. It seems to us that the purpose of these reports and pronouncements from Bill Galvin and others is to soften up USS members into accepting unnecessary erosion, or even ending, of the Defined Benefit part of the scheme. Such a change would not only be detrimental to pensions and shift the burden of risk quite unfairly from employers to employees, but would also mean that TPS pensions offered by post-92 universities, like MMU down the road, will become even more superior to USS pensions in pre-92 universities, resulting in a loss of competiveness compared with new universities. Already, just in the past year, we understand a number of senior managers have left the University to go to MMU.

In contrast to recent media reports, the 2017 USS annual report shows that cash flows are positive, the employer covenant is robust, the contributions from active members cover broadly pensions in payment and will continue to do so for the foreseeable future, and there is £60bn in assets to back that up. The scheme is one of shared risk with over 350 employers supporting each other. Despite this, it is being claimed that USS faces a deficit of around £5.2bn and that contributions need to go up by an unacceptably large 6-7% in order to maintain the current level of benefits.

However, the assumptions, or "technical provisions", underpinning these claims have, as you have no doubt seen, been widely criticised by experts, including 50 professors in a letter to the Financial Times on 20th September who demanded that more details of USS's valuation methodology be released.

We would welcome discussion with the SLT about these vitally important matters. In addition to the points we raised in the paper we sent in January, we would like to discuss the more recent criticisms that have emerged in the FT and elsewhere of the assumptions used by USS and its actuary, Mercer, in the 2017 valuation. In particular, we would like to know what you think about the following, and what the SLT is doing to inform itself better on these matters:

1. The 2017 valuation assumes a fall in the expected long-term nominal investment return from 4.7% to 2.8% since 2013. But **how can expected investment returns have fallen by 40% in four years?** Surely a collapse in returns on this scale would be reflected in the equity or bond markets? Equity markets in high income countries are up 51.7% in the last four years (11% per year). These assumptions are consistent with a 0.33% per year return on investments after CPI. How can this rate of return be possible without a global recession?
2. The 2017 valuation assumes an increase in general pay growth from CPI (2.6%), to RPI + 1% (4.4%). In 2014 the USS assumed cumulative pay growth over the following four years of 16%, but general pay increases have fallen well short of this, cumulatively increasing by only 5.8%. USS's estimates of the deficit assume that in future general pay will rise at a rate of RPI +1% (equivalent to 4.4% per year). **What evidence is there that universities will award cost of living increases at this rate?** Furthermore, the ONS and the RSS has repeatedly warned that the RPI is a flawed measure of inflation, and should not be used, so why are the USS using it to estimate the deficit?
3. Furthermore, **why does the valuation assume salaries will grow at CPI+2% when estimating future liabilities but only CPI (RPI+1%) when estimating pensionable salary contributions and asset growth?** These assumptions not only contradict one another but are at variance with actuarial standards.
4. The 2017 valuation assumes life expectancy is increasing by 1.5% per year. However, there has been little increase in life expectancy since 2011; in fact no appreciable increase at all for women. The Institute and Faculty of Actuaries estimates that mortality is around 11% higher in 2016 than would have been expected based on the historical trend. This means life expectancy is lower, which will reduce USS's liabilities. **Why does the USS ignore mortality data and assume that life expectancy will increase at 1.5% per year?**
5. USS's investment team have done an excellent job for members. In fact it has won industry awards for its success. **USS has achieved positive real returns in 34 of the past 35 years; so why does the valuation assume it will make real losses in 3 out of the next 10 years?** Quite apart from being rather insulting towards the investment team, the assumption is equivalent to assuming that a biased coin, which in the previous 35 tosses has come up heads 34 times, will come up tails in 3 out of the next 10.
6. Finally, **what do you think of Test 1, the proposed de-risking strategy, and under what circumstances do you believe it would make sense, in the near future, for USS to actually switch its assets into a "self-sufficiency" gilts+0.75 portfolio?** We believe Test 1 is profoundly misguided because the gap between the self-sufficiency portfolio and USS's existing portfolio tends to widen precisely when it makes least sense to move to a self-sufficiency portfolio – for example, in the months following a

> Brexit referendum when a further round of quantitative easing artificially inflated the price and thereby reduced the yields on gilts. Shifting assets into gilts in such circumstances in order to achieve "self-sufficiency" makes no sense at all. Buying bonds at very low yields exposes the fund to unnecessary price risk if yields subsequently rise, which they do when Bank of England policy follows Federal Reserve Policy. Interest rates have already risen 3 times in the U.S. and will almost certainly rise in the UK for the first time in 9 years before the end of this year.

The above, highly dubious, assumptions have contributed significantly to the supposed deficit, so that overall there are very good grounds for believing the 2017 valuation is overly pessimistic to an extreme degree. Indeed, even accepting the technical provisions, because the fund has grown from around £42bn in 2013 to £60bn in 2017, the picture is not as bad as portrayed: the "best estimate" surplus, which was £3.5bn (or 8.4%) in 2014, has gone UP to £8.4bn (or 13.7%) in 2017; while the technical estimated deficit has gone DOWN from £5.3bn (or 12.7% of £42bn) in 2014 to £5.2bn (or 8.7% of £60bn) in 2017.

Our concern is the future. The potential cost of future benefits calculated by the current USS methodology is very expensive and will continue to be expensive. However, if the investments and assets were considered appropriately, as outlined above, the future for the scheme, employers and its members looks positive. As the 50 professors asked, "Why do we apply lower standards to an institution entrusted with £60bn of investments to provide for our retirement, than for our academic research?" We sincerely hope the SLT is doing better and is willing to draw upon expertise within the University to inform its contributions to the USS consultation, and that it will resist ill-considered attacks upon USS and the dismantling of what is currently an excellent scheme.

We look forward to seeing the University's contribution to the USS employer consultation and meeting with you or other members of the SLT to discuss these matters.

Kind regards,

Adam

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Out recently: "*Power and Neoclassical Economics: A Return to Political Economy in the Teaching of Economics*", Palgrave Macmillan, 2016. Available from:
http://www.palgrave.com/gb/book/9781137553720

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