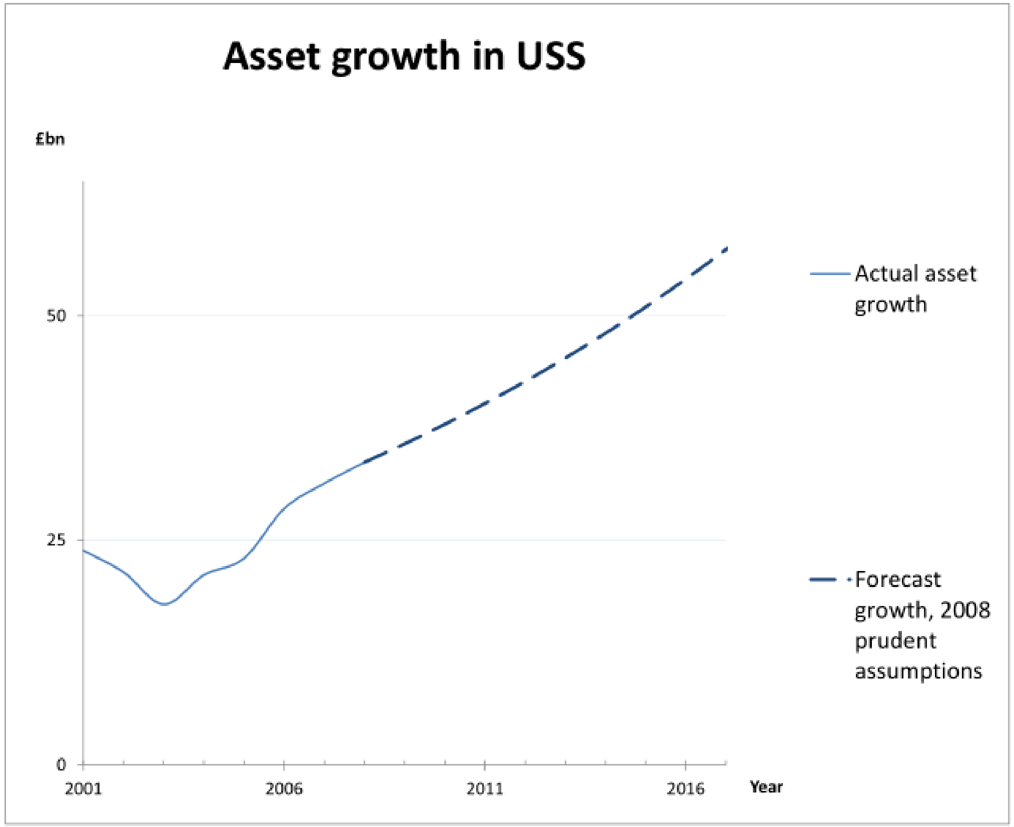
Aberystwyth

HOW TO MAKE A DEFICIT

A brief introduction to the methodology, shamanism, soothsaying, re-adjustments and committeemanship behind the USS valuations and the recent USS/UUK consultations

By Prof. John Gough – with thanks to Dr. Sam Marsh (UCU Sheffield) for permission to use graphs.

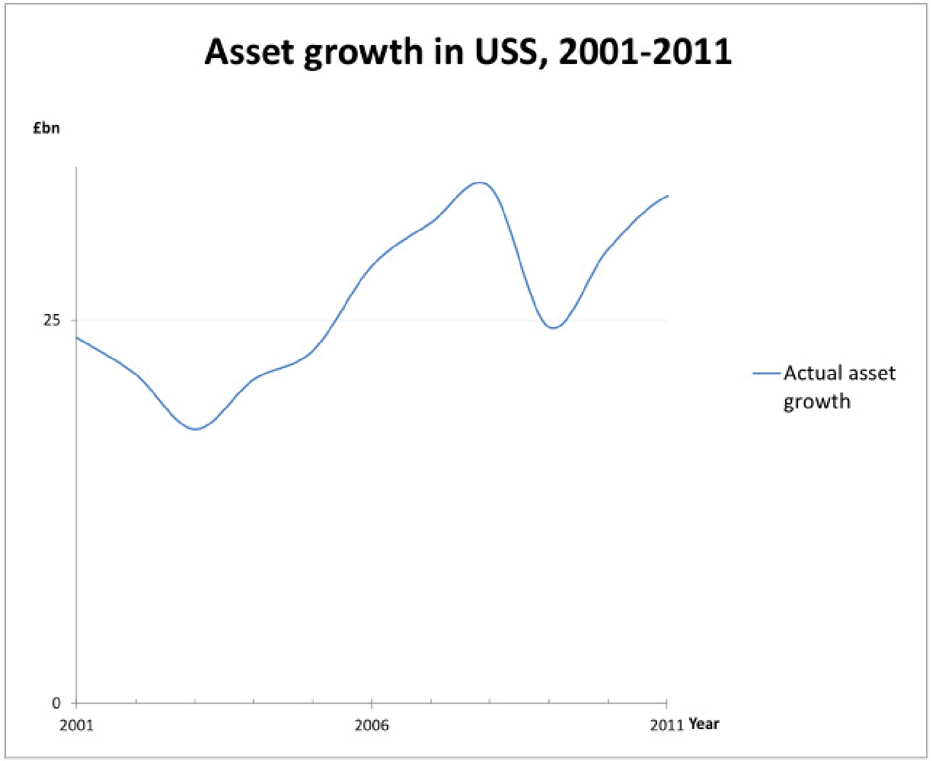
USS Assets



- USS valuations happen every 3 years.
- The last time a valuation showed that the final salary scheme was viable was in 2008.
- The graph shows the actual asset values up to 2008, and the then predicted growth up to today.

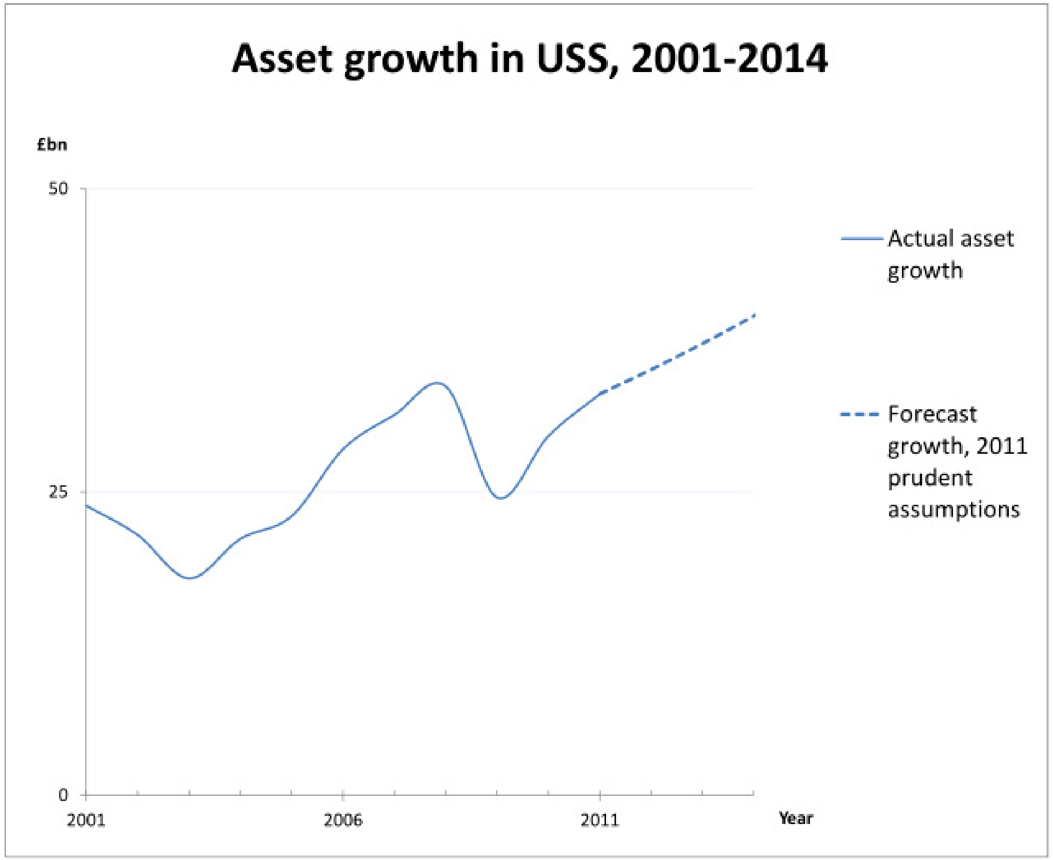
- We'll be seeing a few more graphs like this!

We go back in time to 2011



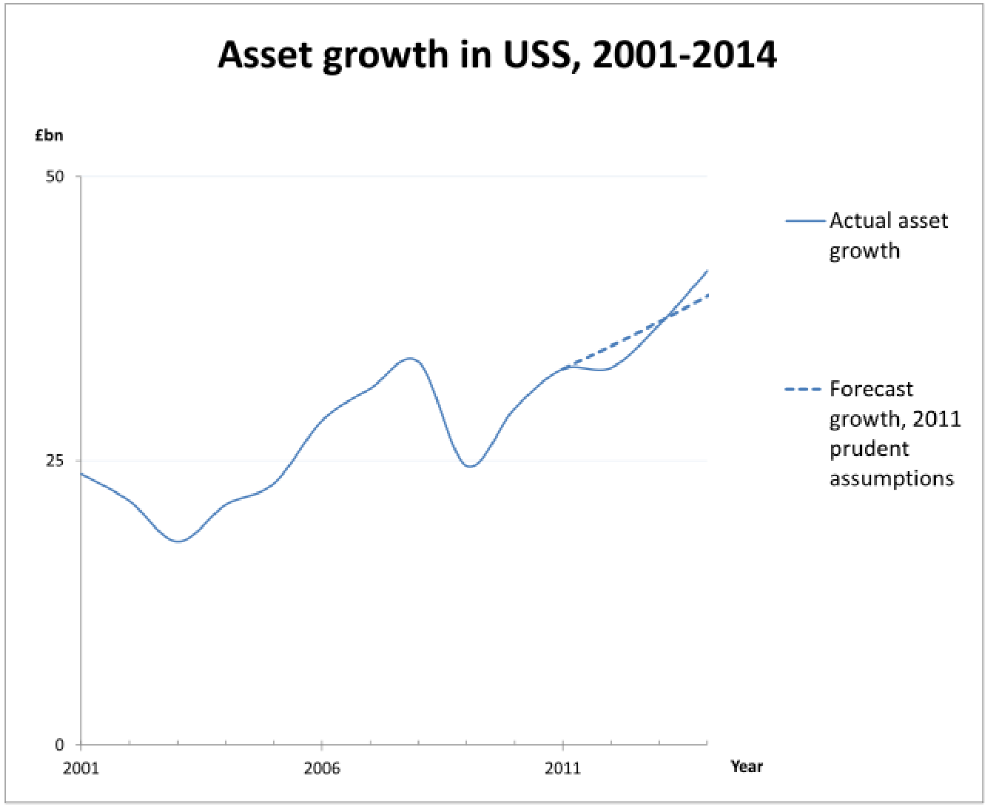
- This is the USS asset growth during the first decade of the millennium.
- Note the two dips – the dotcom bubble bursting and the 2008 financial crisis.
- It's 2011 - valuation time! - USS Trustees meet to do some math.
- Time to tighten our belt? – cue the violin music.
- What are the trustees going to say?

USS Trustees Predict the Future - 2014



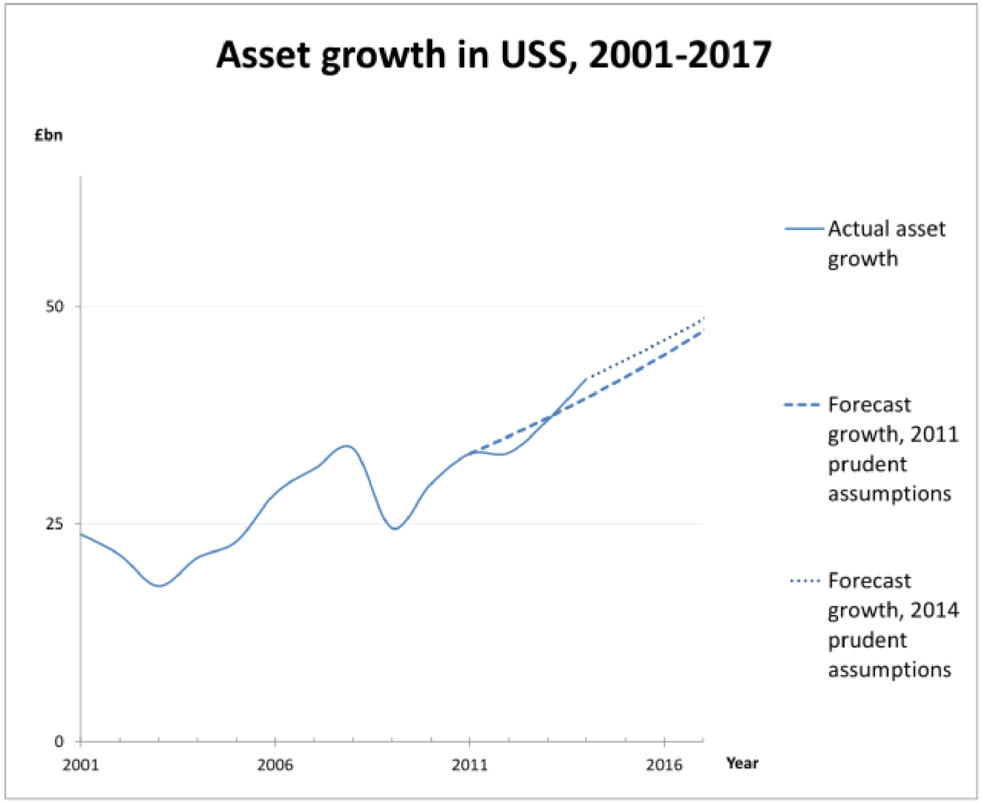
- You get out a ruler …
- Put one end at the point on the graph at t = 2011 …
- Choose a reasonable looking angle …
- Draw a straight line up to the next valuation date, t = 2014.
- Child's play!

But hold on! We can check how they did?



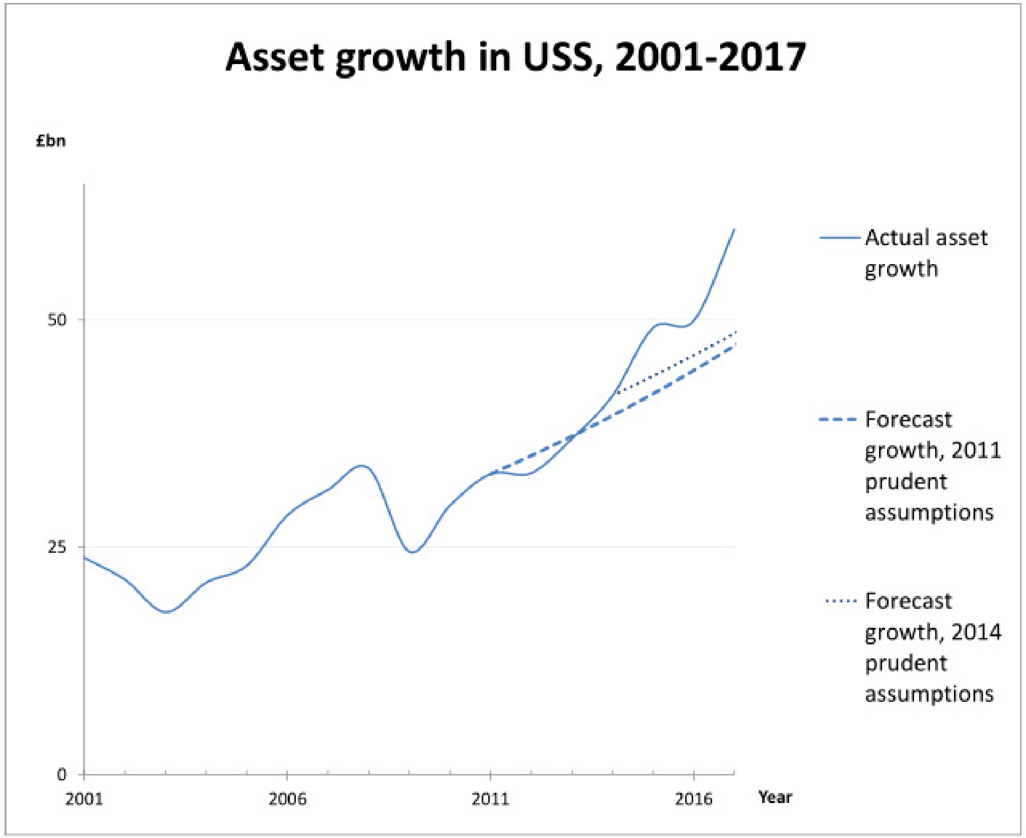
- **Not too bad actually!**
- Though it wasn't a straight line after all.
- It even managed to be right at one time (like a stopped watch).
- If they were a bit more optimistic (i.e., held the ruler at a steeper angle) then they'd have gotten the 2014 value right.
- **However, they argued to ditch the final salary scheme, and cap defined benefits to £55,500.**

2014 – Back to the Future!



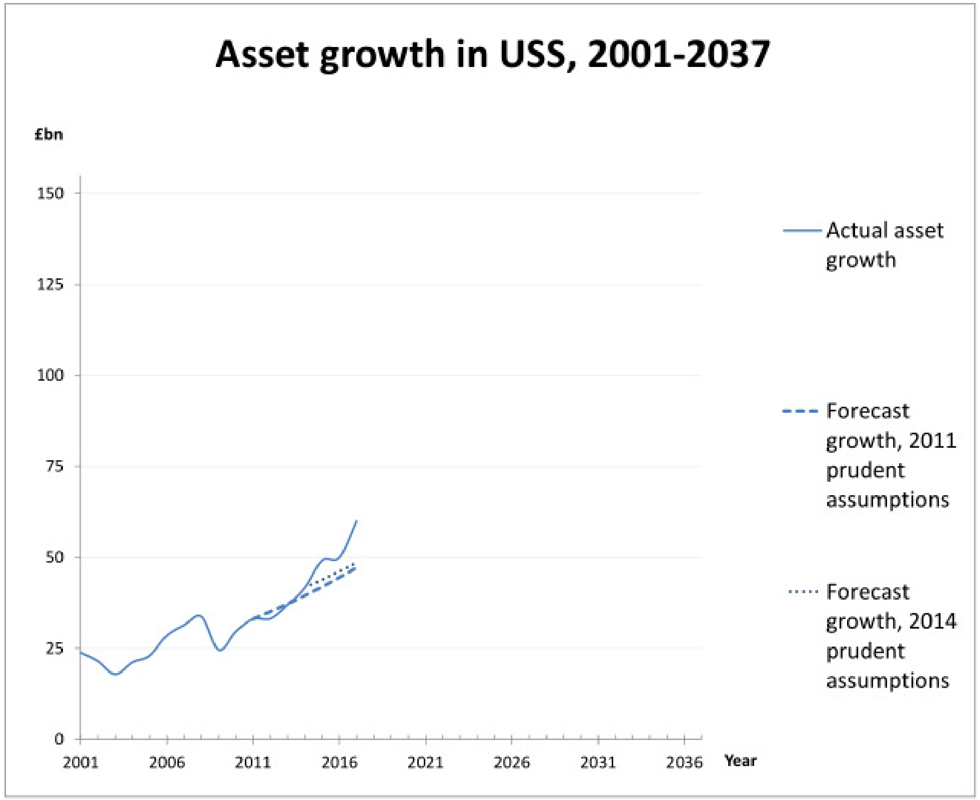
- It's valuation time again!
- USS Trustees now predict from the 2014 figure what the future assets will be up to the next valuation, 2017
- Looks rather similarly to their 2011 forecast if that was continued to 2017
- Hmmm! Maybe the ruler has gotten heavier?

How they did this time?



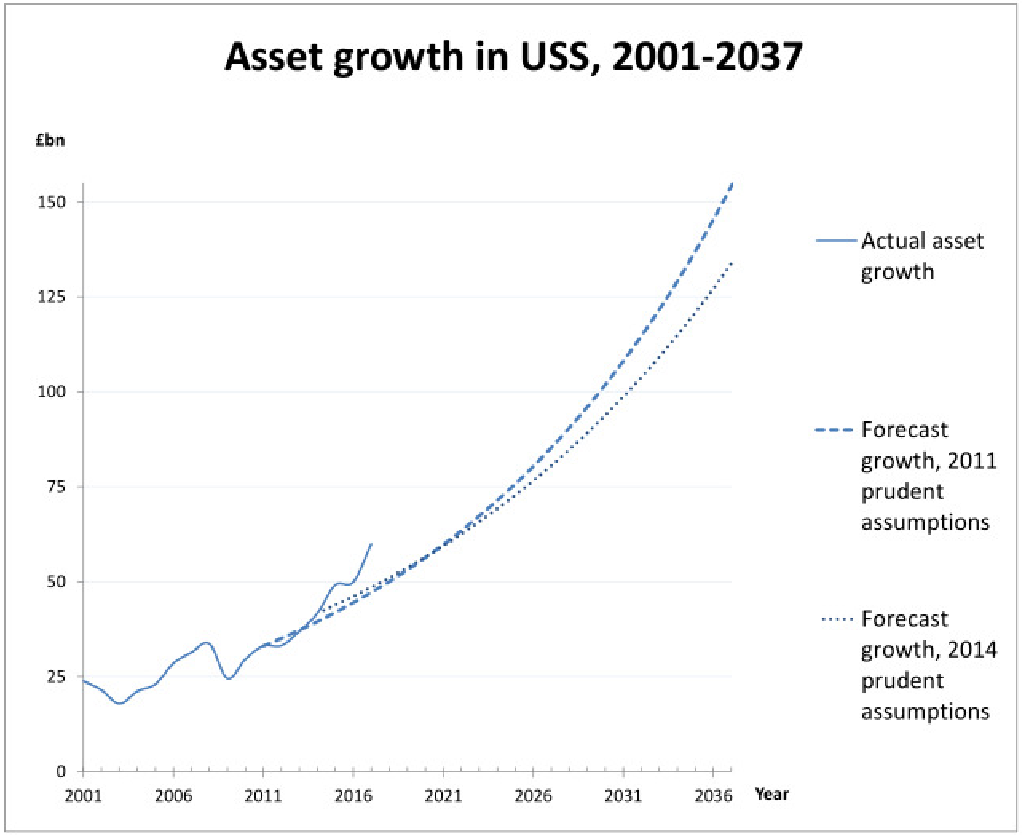
- **Not too good!**
- We're in a bull market and most of our investment is in stock, so assets went up a lot.
- The 2014 prediction looks fairly conservative now.
- **Things look good, but will the USS modellers in 2017 be upbeat in their predictions for the future?**

But 2017 is Valuation Time again



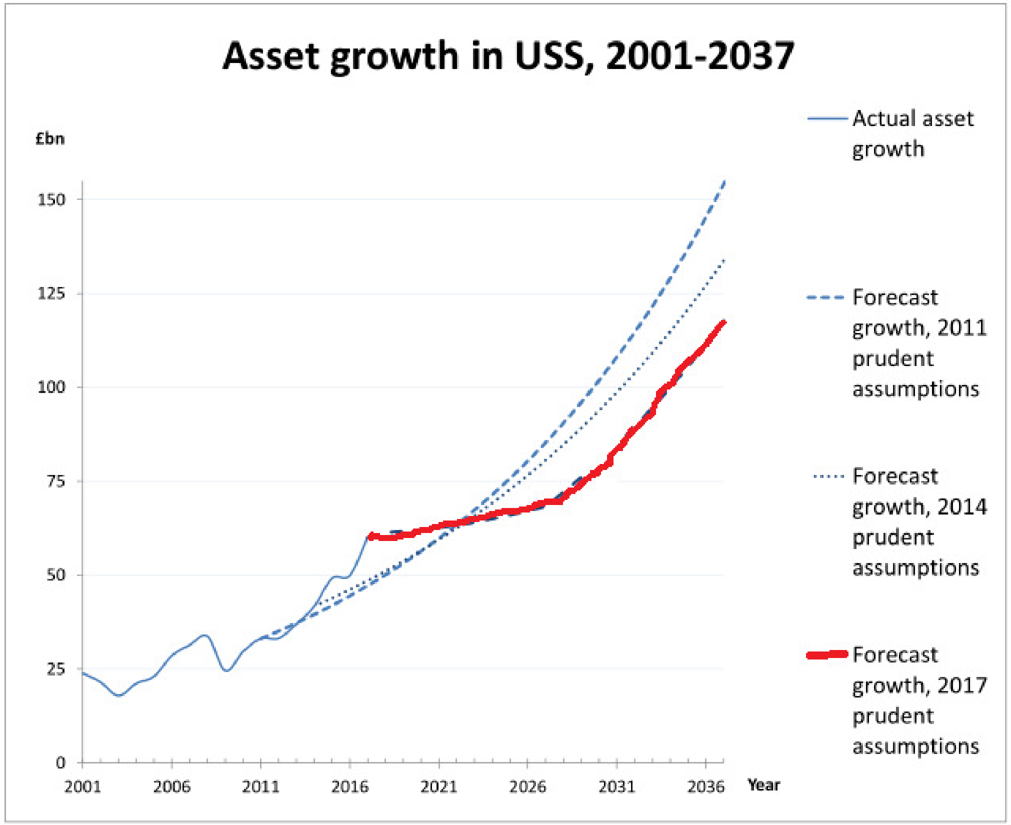
- The USS boffins now set to work in 2017 to predict the future.
- Let start with a blank canvas!
- We'll need to look at the long term predictions based on their 2011 and 2014 forecasts – ready?

But 2017 is Valuation Time again



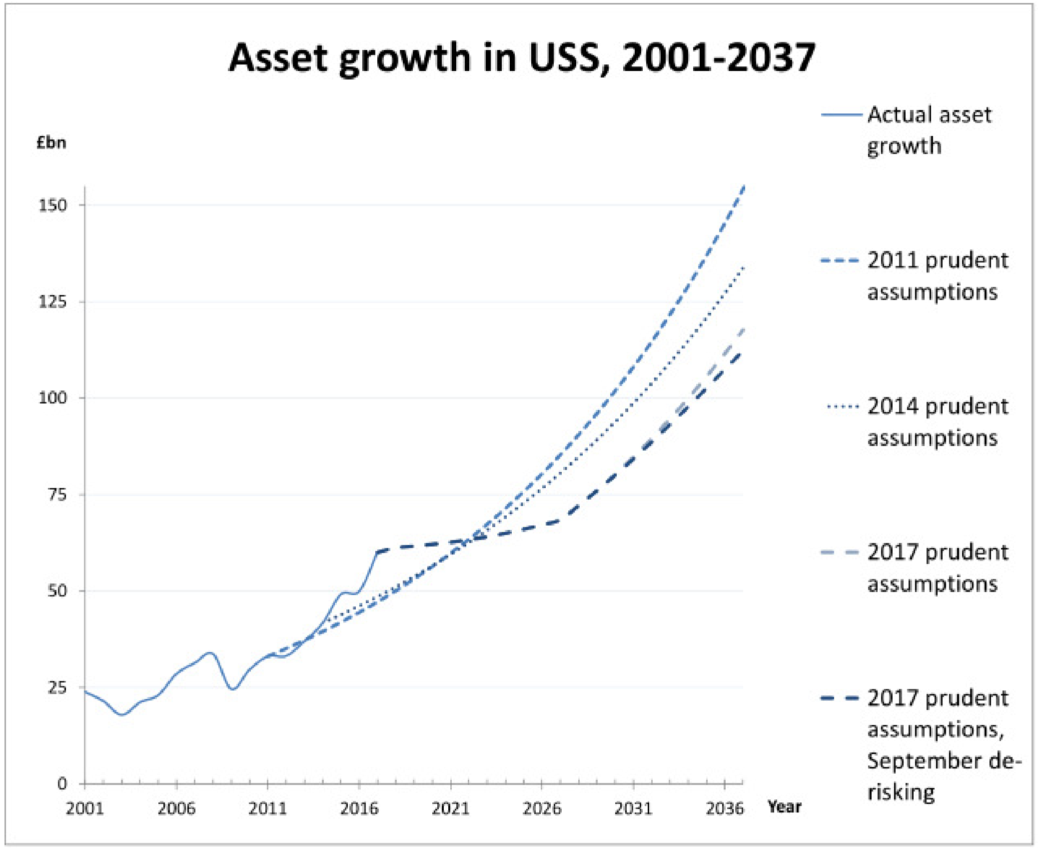
- Here's their 2011 and 2014 forecasts when run 20 years into the future.
- There's nothing wrong with the ruler: we fooled you by saying it was a straight line, it was actually an *exponential curve*. But on the timescale of 20 years into the future, we need to get a bit more technical.
- Curiously, the 2011 forecast overtakes the 2014 one despite starting lower.
- This is due to the rate of increase being worse for the 2014 curve.

Now the 2017 forecast from USS



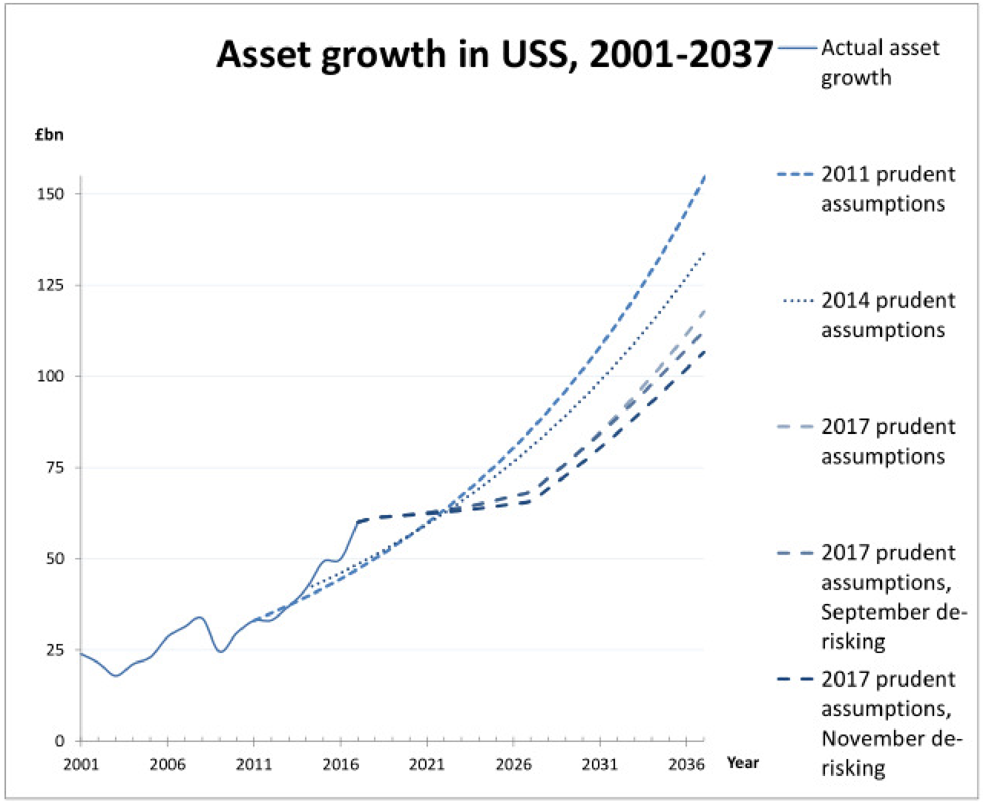
- Geez, there a gloomy bunch!
- Didn't they learn their lesson about being too conservative last time?
- Despite this, the predicted figures are **not low enough to argue that the DB scheme is unaffordable**.
- This is clearly the "**wrong answer"**.

Back to the Drawing Board …



- In September 2017, USS announced that they needed to **de-risk.**
- This meant modelling for a situation where the portfolio replaces the **equities**, which have been returning the high yield up to now, with liability-matching **gilts**, which are currently losing nearly 2% of their value p.a.
- This lowers the forecast and now there's a **£5bn deficit**!
- However, DB pensions are still affordable with these predictions, but only just!
- **"wrong answer again!"**

Time to call in the UUK

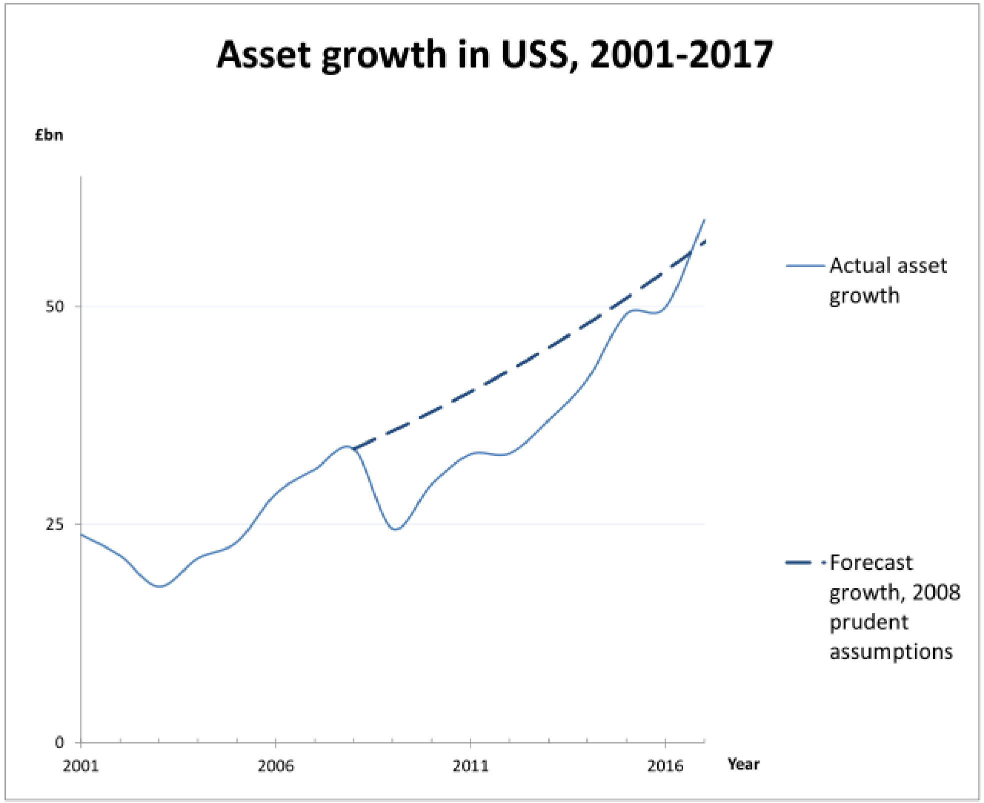


- In September-October 2017, USS invited UUK in on the discussion.
- Our VCs trusted the USS figures – if you can't trust a trustee, who can you trust?
- But the consultation ended in November 2017 with a decision to add **more de-risking.**
- This lowers the forecast yet again.
- Would you adam-and-eve it, DB pensions all of a sudden become unaffordable with these predictions!
- **"Right answer!"**

But De-risking Isn't Free!

- There is a cost to de-risking.
- With the September plan the cost is **£5.4bn over the next 20 years.**
- With the November plan the cost would be **£11.0bn over the next 20 years.**
- These are not make-believe figures!
- These are **real costs** which will have to be made to begin de-risking.
- Professor Elizabeth Treasure (and a good many of her successors) will be getting the bill from USS up to 2037. **The final figure for AU will be 10's of millions.**
- And she's **not** supporting the re-opening of national negotiations with UCU.

But We're Living in Difficult Economic Times?



- This mantra is utter garbage!
- Let's go back to the first graph slide and add the actual growth of USS assets to the 2008-17 forecast from 2008.
- Despite the 2008 crash, our assets have since overtaken the prediction made back in 2008.
- In 2008 we could afford DB. In fact, a *uncapped DB* scheme. Heck, we could even afford final salary schemes!
- **If we are ahead of where we expected to be back in 2008, why are we in bloody deficit now?**

Conclusion

- There is some pretty ropey logic behind the valuations. UCU (and, to be fair, a small group of VCs with the intellectual capacity, bravery, and common sense) have challenge the USS narrative.
- The USS want to shift the risk onto its contributors, and the UUK (our VC and most of her chums) have this swallowed hook, line and sinker.
- The "deficit" is a *notional* figure that is USS can and does manipulate.
- The USU/UUK consultation lead to a "deficit" designed by committee.
- The "deficit" is not a real figure – it's a projection based on assumptions that can and have changed at a whim.
- But … the imaginary "deficit" can all-too-easily materialise into a real deficit. This is the real risk been generated by USS and swallowed by UUK.