All is for the best in this, the best of all possible pension schemes

> "Most notably, we expect real interest rates will revert to historical norms sooner than is currently priced into the market. That is far from pessimistic. Indeed, some (including the Pensions Regulator) have questioned whether we have been too optimistic."
>
> Bill Galvin, Group CEO, Universities Superannuation Scheme Ltd.
> https://www.uss.co.uk/how-uss-is-run/views-from-uss/addressing-the-facts-of-the-uss-valuation

Hmmm, that does sounds positive, doesn't it? But what else would one expect from the Pangloss of Pensions? A man whose assessment of the scheme since the last triennial valuation (when, to **ensure** future sustainability, benefits were reduced and contribution rates increased) was "It's done pretty well". This comment made at a time at which further dramatic cuts are, in his view, *again* essential to *ensure* future sustainability

Before November, the assumption was that for the next 10 years (from the valuation date, 1 April 2017), investment returns would be CPI -0.53% p.a. (i.e. there would be consistent real term losses for the next decade). Then at year 11, returns would mysteriously suddenly jump to CPI + 2.8% decreasing to CPI + 1.7% by year 21. This is in the public domain, see page 3 of https://www.ucu.org.uk/media/8705/Progressing-the-valuation-of-the-USS-First-Actuarial-Sep-17/pdf/firstactuarial_progressing-valuation-uss_sep17.pdf.

The November 2017 valuation is still more pessimistic:

- Years 1-10: returns start at CPI - 0.53% reducing linearly to CPI -1.32%;
- Years 11-20: CPI + 2.56% reducing linearly to CPI + 1.7% by year 21;
- Years 21 +: CPI + 1.7% to year 50.

The quotation focuses our attention on the assumed improvement from CPI - 0.52% (or CPI - 1.32%) to CPI + 2.8% (or 2.56%) at year 11, and ignores the ten years of negative returns.

There are two key questions: How likely are negative returns?
and What impact do the negative returns and later "optimism" have on the "deficit"?

The first is, I freely acknowledge, difficult to answer precisely but is it really plausible that a scheme of this size will consistently *lose* money on a ten year horizon?

Contrast a recent summary of DB performance (from Roger Gray), the investment returns per annum:

- over the last 3 years were 12.76%; CPI was 1.35% per annum. 12.76-1.35=11.41%;
- over the last 5 years returns were 12.82%; CPI was 1.47% per annum. 12.82-1.47=11.35% ;
- over the last 10 years returns were 6.83%; CPI was 2.36% per annum. 6.83-2.36=4.47%.

It's interesting to contrast the (possibly excessive) optimism of the USS valuation with, for example, the 2016 triennial valuation of the Avon Pension Fund (an LGPS scheme, with Mercers as scheme actuaries) where assumed investment returns are between 2.2% and 2.7% *above* CPI throughout.

The second question is more interesting. Under the "derisking" assumptions, it takes 14 years to return the value of assets back to the 31 March 2017 values (Figure 1, which illustrates the impact of the apparently less noteworthy assumption on returns over the next ten years). The alleged deficit has to be paid back in 15 or 17 years, despite a strong covenant for at least 30 years. So the pessimistic assumptions determine the necessity for a deluge of money to be poured into the scheme.

At least I can rest assured that should the next triennial valuation reveal a need for further sweeping reductions in benefits and increases in contribution rates this will just be further evidence of the excellent management of the best of all possible schemes. I suppose that a £566,000 salary[1] might make such persistent optimism easier; must a suitably remunerated twenty-first century Pangloss conclude that *public* misfortunes make for *private* welfare?

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March 21, 2018

[1] www.bbc.co.uk/news/education-43157711

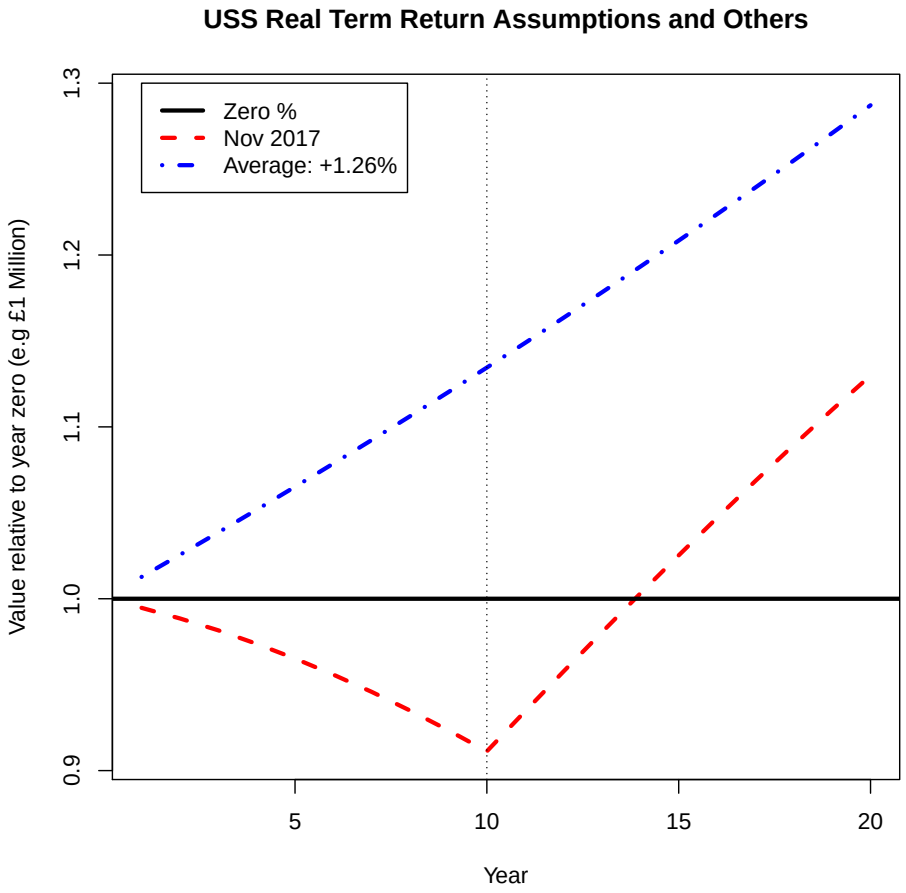

Figure 1: Relative asset value in 2017 terms on a twenty-year timescale of an asset purchased now under the Nov. 2017 derisking strategy, CPI+0% and CPI+1.26% returns (the 50 year average under the "optimistic" assumptions). So £1,000,000 invested by USS now can be expected to be worth the equivalent of £911,227 in ten years time.