

Study assesses risks of good and bad outcomes for university pension scheme

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New research estimates the chances that the USS university pension scheme has enough assets to pay pensions that have been promised.

The research by Professors David Miles and James Sefton from Imperial College Business School suggests that the most likely outcome is that the University Superannuation Scheme (USS) [pension](#) scheme will have sufficient funds to pay all promised pensions. However, the paper, published in the National Institute of Economic Research, also says there is a significant probability (albeit less than 50%) that the funds could be exhausted before all the accrued pensions are paid.

There is currently disagreement about whether or not the [assets](#) of the pension scheme are adequate. The USS says it has insufficient assets to cover, with high probability, the pensions it has promised to pay—a position shared by the Pensions Regulator. The University and College Union, and a number of economists, maintain that the scheme has sufficient assets—indeed may be comfortably in [surplus](#)—and neither an increase in contributions nor a cut in pension benefits is required.

The paper's authors argue that this is not a problem created by the USS trustees, University heads or the regulator. They say the real difficulty is that future returns to assets are very uncertain and that the cost of removing this risk has risen substantially because interest rates have fallen to such low levels. They also say the debate needs to focus on what is an acceptable level of risk and, in particular, on how the risk should be shared if returns do turn out to be lower than expected.

"In reality, it will be many decades before we know whether or not the scheme has enough assets," says Professor Miles, a former member of the monetary policy committee at the Bank of England. He and Professor Sefton argue that there is no single number that can reflect today the balance between assets and what will be needed to pay pensions.

"Focusing on a single number that measures 'the deficit' or 'the surplus' is misguided and cannot reflect the uncertainty inherent in pension

provision," says Professor Miles. "A debate couched purely in these terms is fruitless. Our approach instead looks at the probability of different outcomes for the balance of assets against pensions due, based on simulations for different investment portfolios and future realized rates of return."

Professor Sefton adds, "Our aim was to get away from the unhelpful and divisive position where one group says 'the scheme is in surplus' and the other says 'the scheme is in deficit.' A single number simply does not help anyone understand where we are, partly because both sides can claim they are right.

"Those who say the scheme is in surplus could be pointing to the average outcome and, in terms of probability weighted outcomes, that claim has some plausibility. The USS says there is a deficit—but that is also plausible, in the sense that there is a substantial probability that assets will not cover promised pensions."

The researchers calculated the outcomes for USS based on different proportions of low-risk assets, such as bonds, and riskier assets, such as equities, using conservative and more optimistic estimates of likely returns. They took, as a baseline, the scheme's assets and the pensions it had promised to pay in Spring 2020. This is the date that the USS used as the basis for its recent assessment of the strength of the scheme.

They found, for example, that if 75% of [investments](#) were in riskier assets, this made it more likely than not that the scheme would be able to pay its pension liabilities with no need for a rise in contributions just to make good on past promises. But in such scenarios, there was still at least a one in four chance (and often a greater chance) that the scheme would run out of money before all pensions were paid; this could leave the scheme still due to pay some tens of billions of pensions when assets were exhausted. Nevertheless, the more likely outcome was a surplus of

assets even after all existing pensions due had been paid.

"Our analysis shows that the chances of either a large surplus or a big hole in the pension fund are both high," explains Professor Miles. "And if there is a hole, it is likely to be a substantial sum that universities might struggle to find, given other financial pressures. The question that needs to be addressed is not so much is there or isn't there a deficit—but how can the risk of a large deficit be brought down to acceptable levels and how that risk should be shared."

The research, undertaken in an independent capacity, offers some principles on which the design of feasible risk sharing can be based. But Professor Miles says, "We don't pretend there is simple answer to the risk issues. But we hope our analysis can help establish a necessary condition for a way forward—namely that all sides can come closer to agreeing what the [risks](#) are with the current state of the pension scheme and so avoid a strike."

More information: The paper is available as a PDF at www.niesr.ac.uk/sites/default/...s/publications/NIESR%20Policy%20Paper%20029_0.pdf

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