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Fantasy world of pension deficits

From Prof Dennis Leech and Mr Con Keating.

Sir, The sensational article by John Ralfe about the Universities Superannuation Scheme funding deficit (“Actuaries’ magic pencil hides UK university pension deficit”, FTfm, October 27) consists of little more than two unsubstantiated assertions. He says that pension liabilities should be calculated using the corporate bond rate, which he says is “objective” because it is recommended in the accounting standard FRS17/IAS19. He also argues that it is wrong to count the income from annual contributions; to do so, he says, is “deeply flawed”. This is really Alice in Wonderland economics.

First, the FRS17 rules require a calculation to convert all the future pensions promises to a single present value figure that can be pointed to as a balance sheet liability. Any discount rate can be used because the pension promises will still have to be paid when they come due: they are defined by the scheme rules and therefore not affected by interest rates. The liabilities figure is really just a number plucked from the air. So there can be nothing “objective” about the corporate bond rate.

What matters is whether the income covers the pensions. Simply comparing the assets with any figure for the liabilities calculated this way does not answer that question – except in the fantasy world assumed by the efficient markets hypothesis. But that theory has been found to be a house of cards so many times in the past that it ought to have been laid to rest long ago.

Mr Ralfe’s refusal to count income from contributions by members and sponsoring institutions is unjustified. Last year, income from contributions (£1.6bn) alone more than covered the cost of pensions in payment (£1.4bn). It is not surprising that he manages to show a deficit when he has disallowed such a large item. What this really shows is that the USS is cash rich if viewed on an ongoing basis. What is needed is an actuarial analysis of its sustainability and adequacy on the same basis rather than through Mr Ralfe’s looking glass.

He is quite wrong to say that to include contributions in this way is double counting. The money-in-money-out principle is a perfectly sustainable basis for a pension scheme that has an indefinite lifespan. The only way that his double counting arises is because he insists on viewing the scheme in terms of the FRS17 requirement that all schemes be fully funded.

Many pension scheme deficits such as this are a consequence of policy: the imposition of a transition from USS being a solvent scheme based on intergenerational social solidarity in a continuing sector to becoming just a fund with an uncertain future that is formally deemed to be unknowable except by the market; a move from a social to a market basis. Margaret Thatcher’s philosophy was that “there is no such thing as society”, only individuals in the market place. We are seeing that short-sighted and untrue philosophy worked out with tragic consequences every day for those individuals with pensions, as people like Mr Ralfe try to make it a reality.

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