

Ombudsman's Determination

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| Applicant | Professor M |
| Scheme | Universities Superannuation Scheme (USS) |
| Respondent | The Trustee of the Universities Superannuation Scheme (the Trustee) |

Outcome

1. I do not uphold Professor M's complaint and no further action is required by the Trustee.
2. My reasons for reaching this decision are explained in more detail below.

Complaint summary

3. Professor M's complaint is about the changes to the actuarial assumptions and factors used in the calculation of a 1% pension share for his ex-wife. He says that the Trustee has not provided an adequate explanation of the differences between the figures provided on 12 May 2015 and 24 August 2015.

Background information, including submissions from the parties

4. On 12 May 2015, the USS wrote to Professor M providing details of the options available to his ex-wife in the event of a potential pension sharing order. Based on a pension share of 1% and a transfer day of 27 March 2015, the following options were stated in the letter:-
 - Option 1 – Internal transfer (with five-year guarantee). A pension of £1,231.02 (gross) per annum.
 - Option 2 – Internal transfer (without a five-year guarantee). A pension of £1,233.49 (gross) per annum.
 - Option 3 – External transfer to another approved pension arrangement. Amount available to transfer: £32,117.78.
5. In a letter to Professor M dated 29 June 2015, the USS explained the reasons why the internal transfer calculations in relation to a pension sharing order are different to

Cash Equivalent Transfer Value (**CETV**) calculations. In summary, USS' letter included the following points:-

- The 1% pension share calculation is what his ex-wife would receive from the USS if she opted to have an internal transfer and this is not equivalent to 1% of his pension.
- Where the ex-spouse has the option of an internal transfer, different factors are taken into account when calculating the pension value to reflect the different benefits that apply. For example, the ex-spouse's internal transfer option does not include an automatic lump sum payment on retirement. Also, the death benefits for a new spouse attached to the ex-spouse's pension are 40%, whereas the USS member's spouse benefits are 50%.
- Professor M's ex-spouse is female and younger than him. As her life expectancy is higher, the pension is expected to be paid for longer after retirement. The CETV entitlement from the 1% pension share is then spread over a longer period of time and is therefore lower.
- USS internal transfer options are based on financial assumptions regarding transferring out and back into the USS. When an internal transfer is selected, the USS takes the CETV entitlement and treats it like a transfer out of the USS and this is based on the actuarial assumptions provided. The USS then takes the CETV and transfers it back into the USS under a different set of assumptions, which buy less pension in the USS. Other schemes may not calculate an internal transfer in this way, however this is a decision taken by the Trustee based on actuarial advice.

6. On 24 August 2015, the USS provided another calculation of a 1% pension share for Professor M's ex-wife. On this calculation, the figures were based on a transfer day of 31 July 2015 and included the following options:-

- Option 1 – Internal transfer (with five-year guarantee). A pension of £1,066.22 (gross) per annum.
- Option 2 – Internal transfer (without a five-year guarantee). A pension of £1,068.35 (gross) per annum.
- Option 3 – External transfer to another approved pension arrangement. Amount available to transfer: £27,885.88.

7. Professor M queried the discrepancy between the 1% pension share calculations issued on 12 May 2015 and 24 August 2015. In an email to Professor M dated 9 September 2015, USS provided the following explanation of the difference in transfer calculations:-

“The actuary confirmed that there were a number of reasons for the difference in the two Cash Equivalent Transfer Value (CETV) figures quoted, change in age,

monthly factors, and the change in market conditions that underpin the calculation. The main difference however, was due to a change in the assumptions used to calculate a CETV which was implemented by the Trustees and took effect on 1 April 2015. The first CETV that was sent to you was based on a calculation date of 27 March 2015 and the second on a calculation date of 31 July 2015, thus one was calculated using the 'old' basis and one on the 'new'."

8. A further and more detailed explanation of the changes in assumptions was given to Professor M in an email dated 23 September 2015. This email from the USS included the following points:-

- The main reason behind the fall in value was the change in basis of the calculation between the two dates. This change in basis made by the Trustee does not have any impact on the benefits Professor M will receive from the USS. As it is a defined benefit scheme, Professor M will receive the same amount of USS pension and lump sum before and after the change in assumptions.
- The main assumptions for the purpose of a transfer value calculation are the 'discount rate' (i.e. future rate of return on investments), inflation and life expectancy, all of which can have a significant effect on the transfer value calculated. These assumptions are reviewed by the actuary on a regular basis and are amended, when necessary, to bring them in line with current market conditions and scheme experience.
- The rationale behind the change in assumptions was to protect the USS against adverse funding implications caused by transfers paid out of the USS being at historically high levels, and also to bring the calculation method more in line with how USS employers fund the benefits across the scheme.
- At the effective date of the original calculation, 27 March 2015, CETVs were carried out using two different discount rates, one for investment returns earned pre-retirement, and one for investment returns earned post-retirement. Investment returns pre-retirement are assumed to be higher than those achieved post-retirement, as they are notionally allocated to assets which generally produce better returns.
- As Professor M was close to retirement age at the date of quotation, most of his future investment returns would have been assumed to be in line with the lower post-retirement rate. Given that a low rate of return was assumed, more money would have been needed at this point to pay his future benefits, and this was reflected in the larger transfer value dated 27 March 2015.
- At the time of the second quotation, which used a calculation date of 31 July 2015, the new transfer value basis was in effect. On this new basis, a single equivalent discount rate is assumed both pre and post-retirement that reflects the overall return received by the USS as a whole. As there is no longer any

distinction between investment returns pre and post-retirement, the future investment returns assumed in the second quotation were much higher than in the previous quotation. Therefore, less money would be needed at this point in time to pay off Professor M's future benefits, resulting in the lower transfer value.

- There are other factors that have contributed to the change in value (such as age, market conditions, etc.) but these do not have as much impact as the change in discount rate assumption detailed above.
- The amount of pension payable to members has not changed, it is just the value that has been placed on these benefits for funding purposes that has changed.

9. Professor M then raised a complaint about the basis on which the USS recalculated the 1% pension share for his ex-wife. He recognised that there would be adjustments to reflect that his ex-wife is younger than him and has a greater life expectancy. However, he did not consider that this adequately justified why a 1% pension share for his ex-wife would be much lower than 1% of the pension he would have received. In summary, Professor M said:-

- The valuation of his pension benefits for lifetime allowance purposes was £3,106,636.80 – 1% of this is clearly £31,066. Therefore, why is the CETV in the event that the 1% pension share is transferred to his ex-wife only £27,885.88, a reduction of 10.2%? Surely 1% of the capital value of his pension remains the same whether or not it is transferred as an external transfer.
- The gross monthly pension that he would receive is £12,944.32, which is equivalent to an annual pension of £155,332. Following an internal transfer, his ex-wife would receive a pension of only £1,068.35 per year for each 1% of his pension. This means that her annual pension for each 1% of his pension is £487 per year less, a massive 31.36% less than he would receive. Even allowing for her age and her greater life expectancy, there is no justification for USS to retain 31.36% of the annual pension that he would receive in the event that it was transferred to his ex-wife.

10. The Trustee did not uphold the complaint and restated the explanations given in previous correspondence. Professor M did not accept the Trustee's explanation of the differences between the figures provided on 12 May 2015 and 24 August 2015. He has therefore referred his complaint to us and provided the following explanation of the alleged financial injustice that he has suffered:-

“...you asked me to explain what loss I have suffered: the court order in favour of my ex-wife was that I should transfer USS pension assets to the value of £150,000 to her. Based on the assumptions made by USS (which I believe to be wrong and unfair), I had to transfer 5.1% of my USS pension to my ex-wife, whereas I believe

that I should have been asked to transfer closer to 4.5% of my USS pension. In other words, I have suffered a financial loss representing approximately 0.6% of my USS pension, or rather more importantly, my future pension has been reduced by 5.1% rather than 4.6%.”

Adjudicator’s Opinion

11. Professor M’s complaint was considered by one of our Adjudicators who concluded that no further action was required by the Trustee. The Adjudicator’s findings are summarised briefly below:-

- The Trustee had acted correctly in accordance with the legislative requirements. The Trustee was legally required to monitor and review the appropriateness of the actuarial assumptions and actuarial factors used in the calculation of transfer values.
- As the USS said, in its email of 9 September 2015, there were a number of reasons for the fall in value (including change in age, monthly factors and market conditions), but the main contributor was a change in the assumptions used to calculate transfer values, which took effect on 1 April 2015.
- A detailed explanation of the change in assumptions was also given to Professor M in an email dated 23 September 2015, including the impact of the change in discount rate assumption.
- As the USS explained, the rationale behind the change in assumptions was to protect the USS against adverse funding implications caused by transfers out of the USS, which was at historically high levels. The Trustee had a duty to take into account the financial interests of all members, including members who continued to remain in the USS.
- The explanations given to Professor M were proportionate responses to his questions.
- Ultimately, it was a matter for the Trustee to decide, based on the scheme actuary’s advice and recommendation, how the transfer values should be calculated. The actuarial profession was regulated by the Institute and Faculty of Actuaries. It was not within the remit of The Pensions Ombudsman to direct the Trustee on the appropriateness of actuarial factors and assumptions that should be used to calculate transfer values.

12. The Trustee agreed with the Adjudicator’s Opinion and made no further comments.

13. Professor M did not accept the Adjudicator’s Opinion and the complaint was passed to me to consider. Professor M provided his further comments in an email dated 27 October 2017, but these do not change the outcome. I agree with the Adjudicator’s

Opinion, summarised above, and I will therefore only respond to the key points made by Professor M for completeness.

14. In his response to the Adjudicator's Opinion, Professor M said:-

- It is unfair to unilaterally impose a damaging change in the scheme's assumptions without explaining how the calculation has been done.
- Although a 1% pension share for his ex-wife should not equate to 1% of his pension, it should equate to 1% of the CETV of his pension. If it fails to do this, the USS will be retaining a part of his pension for its own benefit and at his expense.
- He accepts that his ex-wife's annual pension would be a bit lower because her life expectancy was approximately three to four years longer than his. However, this does not mean that the CETV would be lower. The drop in CETV is more than £4,000, which simply means that the USS is retaining over £4,000 based on assumptions that have not been explained.
- A change in age and the change in market conditions did not reduce the CETV of his pension during the period in question. If these assumptions did not reduce the CETV of his pension, why should the USS retain over £4,000 for each 1% of his pension? The change in the scheme's assumptions needs to be made clear, currently it is opaque. Simply calling one system "old" and the other system "new" is self-serving and allows the USS to arbitrarily retain a part of his pension.
- The discount rate, inflation and life expectancy all had no important influence on the CETV of his pension. Then why should the 1% transferred to his ex-wife be subjected to arbitrary assumptions that disadvantaged him and his ex-wife?
- Based on age and the changes in market conditions, the internal transfer option for his ex-wife in August 2015 should have been a higher pension when compared to the figures in May 2015.
- The Trustee should be able to explain to him, an intelligent man with a sound grasp of financial affairs, the changes in scheme's assumptions and how the calculations were reached. However, the Trustee has failed to do this.

Ombudsman's decision

15. I am satisfied that the information given to Professor M, as detailed in the background section above, collectively represents an appropriate and proportionate response to his enquiries about the differences between the figures provided on 12 May 2015 and 24 August 2015. Whilst I understand that Professor M has concerns about the accuracy and fairness of USS' calculations as reiterated in his recent response, we

are not an actuarial service and we are unable to provide him with the level of detail that he requires.

16. As explained by the Adjudicator, it is a matter for the Trustee to decide, based on the scheme actuary's advice and recommendations, how the transfer values should be calculated. It is not within my statutory jurisdiction to direct the Trustee on the appropriateness of actuarial factors and assumptions that should be used to calculate transfer values.
17. Therefore, I do not uphold Professor M's complaint.

Anthony Arter

Pensions Ombudsman
27 November 2017