USS

Comparison of adjustments to the assumed rate of inflation between 31 March 2020 and 31 March 2021

Question

A JNC representative asked the Trustee to provide the adjustment used to the inflation assumption derived from the CPI curve for 31 March 2021 analogous with those used by the Trustee for funding purposes for 30 March 2020 as contained on page 4 of the Actuarial valuation – March 2020 report. The two sets of assumptions and a short supporting explanation are provided below.

Please note that UUK has separately confirmed to the Trustee the inflation assumptions it wished to apply for the purposes of the benefit modeller provided to support the employers' consultation process.

Response

This note confirms the adjustment used to the inflation assumption adopted by the Trustee for considering the cost of benefits with an inflation cap of 2.5% as at 31 March 2021 having taken into account the advice of the Scheme Actuary.

The underlying CPI inflation assumption as at 31 March 2021 that was used in "USS Briefing: the likely outcome of a 2021 valuation" was a curve with a single-equivalent average of 2.5% p.a. (this may be compared with the single-equivalent average at 31 March 2020 of 2.1% p.a.). On that assumption, and using a consistent assumption about the volatility of future CPI inflation to that made in the 2020 valuation, at 31 March 2021 pension increases before and after retirement were assumed to be 3bps higher than the CPI curve for current benefits (either uncapped or with soft cap of 5%), and 55bps lower than the CPI curve for benefits in line with CPI with a minimum of 0% and maximum of 2.5% a year (the corresponding adjustments at 31 March 2020 were 5bps higher and 35bps lower).

The assumptions adopted by the Trustee on future CPI and pension increases depend on market conditions at the relevant date having taken actuarial advice from the Scheme Actuary. The difference in the assumptions at 31 March 2020 and 2021 reflect:

- The change in the difference between the nominal and index-linked yield curves at the two dates
- The allowance for an inflation risk premium (at 31 March 2020 it was assumed to be zero whilst at 31 March 2021 an allowance with an average of 0.5% p.a. was made)
- A change to the expected difference between RPI and CPI following the announcement on RPI reform. At 31 March 2020 this was 1.1% p.a. in the period to 2030, reducing linearly over the period to 2040 to a long-term difference of 0.1% p.a. At 31 March 2021 the expectation for the difference was 1.0% p.a. in the period to 2030 and 0.1% p.a. thereafter.

The shape of the resulting CPI inflation curve at the two dates was also considered.

The inflation assumptions were advised by the Scheme Actuary as being appropriate for considering the funding position and indicative contribution requirements of the Scheme as at 31 March 2021 (and for the 31 March 2020 valuation) and not necessarily appropriate at other dates or for other purposes.