Investment Beliefs ~~and principles~~

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Part A: Defined Benefit Investment Beliefs

The Universities Superannuation Scheme ('USS' or 'Scheme') exists to pay the benefits due to its members. The capacity for the Trustee to take investment risk, in relation to the defined benefit section is based on the covenant of the employers and its associated tolerance for the level and variability of contributions. The beliefs of the Trustee guide the Scheme's governance and strategic management, as well as the alignment sought between the Trustee and its agents. They help provide an anchor for considered and consistent investment decisions.

1. **The ability to pay the Scheme's benefits as they fall due depends on a range of uncertain factors (e.g. demographic trends, regulatory developments) that no set of assets can perfectly hedge. Furthermore, expected returns for the Scheme can be improved sufficiently, after costs, to justify taking risk above the minimum practically achievable.** The appropriate horizon for USS's investment risk-taking depends on the duration of the liabilities, the profile of projected cash flows and the deficit recovery and contingency plans for the Scheme (the sponsor covenant).
2. **High quality governance and decision making is critical to success. The right decisions need to be made by the right people in a timely manner within requisite controls, reporting, review, oversight and regulatory compliance arrangements.** The Trustee board focuses on policy setting, including risk and return objectives, appropriate delegation, constraints and reporting requirements. In order to fulfil their obligations, the Trustee ~~sets~~defines risk and return objectives and converts them into a high-level ~~strategic~~investment strategy. This theoretical asset allocation ~~or 'Reference Portfolio' which frames~~is referred to as the ~~required return and acceptable risk for~~Valuation Investment Strategy ("VIS") and is consistent with the ~~Scheme.~~Trustee board's risk and return objectives. Implementation and more granular asset allocation decisions are delegated, within limits, to the Scheme's internal manager, USS Investment Management Limited ('USSIM').
3. **Strategic Asset Allocation and the timing of material changes are the most important drivers of the Scheme's financial outcomes.** The asset allocation process balances exposure to a diversified set of risks against the expected additional returns for these risks. The main sources of return for bearing risk ('risk premia') are expected to come from equity, credit, ~~duration, inflation,~~ illiquidity~~,~~ complexity~~, volatility~~ and ~~insurance~~other factors. Other exposures such as foreign exchange offer less reliable risk premia but are expected to provide valuable source of portfolio diversification. Risk premia are not static over time but fluctuate in function of investors' preferences, economic and market conditions. Risk premia can be negative over extended periods of time and their existence does not guarantee a return compensation even over an extended time horizon.
4. **The investment strategy has a relatively long-term horizon in line with the covenant and liability profile; the Trustee may justifiably hold some investments over many years.** The probability of 'return-seeking' assets outperforming 'liability matching' assets increases as the investment horizon lengthens, though it does not become a certainty at any horizon.

5. **Private markets provide investment opportunities and structures not available in public markets.** They may provide opportunities for additional returns (including illiquidity & complexity premia), diversification, protections or other desired characteristics relative to public market assets.
6. **Diversification through effective portfolio construction allows risk to be mitigated and spread across a range of factors.** It reduces the adverse impact on the Scheme's investments of any one risk but there are limits on overall risk-reduction from diversification and there are scenarios in which correlation between asset classes increases and diversification may be less effective.
7. **Risk is multi-faceted: it is best understood and managed using multiple approaches and at all times with respect to the liabilities.** Not all investments are equally risky to all investors.
8. **Risk that is not sufficiently compensated should generally be avoided, hedged or diversified.** The key investment risk for the Trustee is that returns fall materially short of what is required to pay out benefits to members as they fall due. Risk in the Scheme's liabilities is concentrated in inflation and longevity and, by virtue of the cash flow valuation process, in gilt yields. Risk in the Scheme's assets is driven by the potential for adverse price movements, lower than expected cash flow generation and permanent impairments (e.g. default losses). ~~Volatility, though an imperfect measure of shortfall risk, is a useful short-term metric for estimating portfolio risk and, asset-liability risk exposure.~~
9. **Liability hedging strategies and associated leverage can help to reduce the risks posed by the Scheme's liabilities,** though there are inherent risks in leverage and appropriate controls are required.
10. **Active management can add value, after accounting for costs.** The behaviours and constraints of market participants result in inefficiencies and mispricing in most markets some of the time and these inefficiencies can be accessed for profit by skilled managers. The use of active, passive or customised indexation approaches is based on the balance of expected advantages. Commonly used market indices are not always 'safe' nor always the most relevant comparators.
11. **As a large pension scheme, there may be cost, alignment and time-horizon advantages in investing via in-house investment capabilities.** The internal manager (USSIM) will use in-house investment management expertise where beneficial to the Scheme and members. USSIM will appoint external managers where internal resources cannot be justified, developed or obtained for the desired allocations, and suitable terms and alignment can be established externally.
12. **Investing responsibly and engaging as long-term owners reduces risk over time and may positively impact Scheme returns.** This involves engagement as active owners of assets, being focused on sustainability, good corporate governance and the Trustee's investment managers (internal and external) taking into account all financially material considerations in relation to the selection, retention, and realisation of investments. This includes ESG considerations (such as, but not limited to climate change) where these are considered relevant financial factors by those managers. The Scheme's interests are further protected from adverse impacts by collaboration with like-minded investors and engagement with government, industry and regulators.

Part B: Defined Contribution Investment Beliefs

The Scheme exists to provide a suitable range of default and self-select investment options to members ~~and to pay the benefits due to its members.~~allowing consideration for the membership profile and the variety of ways in which members can take their benefits. The beliefs of the Trustee articulate key assumptions and investment principles underpinning the design and ongoing maintenance of the DC plan, in order to:

- assist members in delivering their desired retirement outcomes
- convert the risk appetite and return requirements of members into a suitable investment design, and
- provide sufficient choice to reflect the diversity of requirements and the uncertainty faced by most members.

The beliefs guide the Scheme's governance and strategic oversight, the range of investment strategies available to members, their considered and consistent implementation, as well as the alignment sought between the Trustee and its agents. They help provide an anchor for considering the nature of the DC offering provided to Scheme members.

1. **The investment structure will take into account the hybrid DB/DC benefit design and overall engagement objectives.** Primary areas of engagement include assisting members in understanding the purpose of the plan, encouraging them to save for their retirement and providing education around their retirement options. The structure of the investments and the associated explanatory material reflect these aims.
2. **The Trustee will provide a range of investment options, including default and self-select funds.** These funds are designed to meet the needs of a wide range of representative members of the Scheme, based on membership information. For the large number of Scheme members who typically do not themselves make a specific selection, the default fund strategy will act as the members' selection. It aims to deliver a high quality investment solution based on the Trustee's understanding of representative members' characteristics, circumstances and, as possible, their attitudes to risk and return.
3. **The investment structure should reflect the benefit flexibility that members have up to and into retirement.** Members of a DC Scheme have flexibility in how they access their retirement benefits (e.g. cash, annuity, drawdown) and there are special considerations for a hybrid Scheme such as USS. The investment structure will be developed over time to support this flexibility through the provision of pre-built lifestyle strategies and/or options within the wider self-select range reflecting needs across the saving life-cycle.
4. **For the default fund strategy, asset allocation will adjust around a glide-path consistent with assumed member risk tolerance throughout the member's savings life-cycle.** The default fund strategy cannot capture all differences across individual members. However, a higher risk tolerance may be assumed when members are far from retirement, with the aim of increasing expected real returns and retirement wealth. In later stages of the savings lifecycle, the accumulated investment pots will typically be greater and the ability subsequently to make good any material losses is reduced. The default fund investment strategy and the self-select fund options provided should also align as much as possible with how the member is likely to use their savings at and into retirement.
5. **The self-select-fund range should offer a degree of customisation.** The funds available for self-selection should allow individual members to reflect a reasonable range of preferences, for example, for strategies

offering higher or lower risk, exposure to particular asset classes, 'Ethical Investment' or compliance with Sharia law.

6. **High quality governance and decision making is critical to success.** The right decisions need to be made by the right people in a timely manner within requisite controls, reporting, review, oversight and regulatory compliance arrangements. The Trustee board focuses on setting high-level ~~strategic~~risk-return objectives and broad asset allocation guidelines for the default fund strategy and providing a suitable range of self-select investment options to meet the risk and return objectives of most members, as well as appropriate delegation, controls and reporting requirements.
7. **Asset Allocation and the timing of material changes are important drivers of a fund's financial outcomes.** The asset allocation process for the default fund strategy balances diversified risks against the expected additional returns for exposure to these risks. The main sources of return for bearing risk ('risk premia') are expected to be equity, credit~~, duration, inflation, illiquidity, complexity, volatility and insurance.~~ illiquidity and complexity. Other exposures such as duration, inflation and foreign exchange offer less reliable risk premia but are expected to provide valuable source of portfolio diversification. The asset mix should be reviewed periodically, for suitability relative to evolving investment objectives and to take into account material changes to relative valuations across asset classes, which strongly influence long-run return prospects and risk of loss.
8. **Private markets provide investment opportunities and structures not available in public markets.** They may provide opportunities for additional returns (including illiquidity premia), diversification, protections or other desired characteristics relative to public market assets.
9. **For most members, particularly at earlier stages of the savings life-cycle, the relevant investment time horizon, up to (and beyond) retirement, is relatively long-term. As such, the default fund strategy and some self-select funds may justifiably hold a large proportion of growth assets relative to defensive assets.** Though underperformance may occur over periods of time, the probability of 'return-seeking' or growth assets outperforming '~~risk-free'~~lower-risk' assets such as cash or government bonds increases as the investment horizon lengthens, though outperformance of 'return-seeking' does not become a certainty at any horizon. The chief source of long-term investment returns is participation in economic growth, via equity markets or otherwise. These returns may be accessed in public or listed markets and via private markets (such as direct investments in infrastructure).
10. **Diversification through effective portfolio construction allows risk to be mitigated and spread across a range of factors.** This reduces the adverse impact of any one risk on a member's pension investments. There are limits, however, on overall risk-reduction from diversification and there are scenarios in which correlation between asset classes increases and diversification may be less effective.
11. **Risk is multi-faceted: it is best understood and managed using multiple approaches.** This spans different definitions and ways of estimating risks (e.g. volatility and/or downside risk over different time-horizons) and different member circumstances (e.g. balance between DB and DC benefits). Member risk appetite is expected to vary across their savings lifecycle. For the default fund, reasonable assumptions must be made on the requirements of member cohorts across their life-cycle. However, not all investments are equally risky to all investors. The individual member may choose to self-assess their risk appetite and self-select within the DC fund range.

12. **Active management can add value, after accounting for costs.** The behaviours and constraints of market participants result in inefficiencies and mispricing in most markets some of the time and these inefficiencies can be accessed for profit by skilled managers. The use of active, passive or customised indexation approaches is based on the balance of expected advantages and careful consideration of the associated costs. Commonly used market indices are not always ‘safe’ nor always the most relevant comparators.
13. **As a large pension Scheme, there may be cost, alignment and time-horizon advantages in investing via in-house investment capabilities.** The internal manager (USSIM) will use in-house investment management expertise where beneficial to the Scheme and members. USSIM will appoint external managers where internal resources cannot be justified, developed or obtained for the desired allocations, and suitable terms and alignment can be established externally.
14. **The Scheme will seek to maximise value for money for stakeholders.** To the extent possible and desirable, the existing USS DB capabilities and scale economies will be leveraged to achieve this objective. This may involve investment management by the internal manager (USS Investment Management Limited) or cost concessions in the context of the overall USS business relationship with external managers or service providers.
15. **Investing responsibly and engaging as long-term asset owners reduces risk over time and may positively impact Scheme returns.** The Trustee expects its internal and external managers to engage as active owners of assets, focused on sustainability, good corporate governance and to take into account all financially material considerations in relation to the selection, retention, and realisation of investments. This includes ESG considerations (such as, but not limited to climate change) where these are considered relevant financial factors by those managers as appropriate for the assets being managed. The DC member’s interests are further protected from adverse impacts by collaboration with like-minded investors and engagement with government, industry and regulators. Investment managers, as well as investee companies, should be governed and incentivised in the long-term interests of their investors. DC members may additionally choose to express specific beliefs within the scope of the self-select fund range.