Universities Superannuation Scheme (the Scheme)
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Prepared for: Participating Employers of the Scheme
Prepared by: Aon

Review of Statement of Investment Principles

Background

In July 2019, the Trustee of the University Superannuation Scheme (USS) produced an amended version of the Scheme's Statement of Investment Principles (SIP). The Trustee is required by regulation to consult with all participating employers.

As part of this consultation we have been asked to complete a review of the SIP. This paper should be read in conjunction with the amended SIP circulated by the Trustee and the consultation letter sent to all participating employers.

Legislative requirements

The areas of legislation directly affecting the contents of a SIP are:

- Pensions Act 1995
- Pensions Act 1994, and
- Occupational Pension Schemes (Investment) Regulations 2005

Note that the provisions of sections 35 and 36 of the Pensions Act 1995 which deal with SIPs and choosing investments were modified by sections 244 (which replaced section 35) and 245 (which amended section 36) of the Pensions Act 2004. The prescribed regulations referred to in these sections of the Pensions Act 2004 are those contained in the Occupational Pension Schemes (Investment) Regulations 2005.

Further requirements have been subsequently released, most recently the 2019 responsible investment requirements for pensions schemes which are covered in more detail below.

More recently: Responsible investment

In recent years there has been growing interest in social investment for pension funds and in Environmental, Social and Governance (ESG) considerations more widely. This builds on existing guidance that pension trustees should consider factors which are financially material to the performance of an investment, including risks to the long-term sustainability of a company's performance and ESG considerations.

In June 2018, the Department for Work and Pensions (DWP) launched a consultation into strengthening the fiduciary duties of trustees, particularly regarding ESG factors. In their words, this was intended to reassure trustees that they can (and indeed should) take account of financially material risks, particularly as it pertains to ESG considerations.

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The updated regulations on trustees' investment duties were published in September 2018. We have provided further details of the precise requirements as an appendix to this paper.

SIP compliance

We believe the SIP covers everything required by the legislation noted above, and indeed goes beyond the requirements in some areas.

However, we do have some areas where the participating employers could look to clarify the Trustee view. Please note that while we are comfortable the SIP covers everything required from a regulatory point of view, we are unable to offer a legal opinion on the SIP compliance with the legislation, which should be obtained separately if required.

Areas for clarification

Whilst we note the SIP complies with the required regulation, we believe there are a few areas where the participating employers could look for further clarity of the Trustee's approach:

- **Level of detail**

  We believe the USS SIP could provide more detail in relation to the long term journey plan and the strategic portfolio allocations. The SIP refers to the types of assets that may be held, but makes no reference to the actual strategic holdings. This presumably is to allow flexibility in the Universities Superannuation Scheme Investment Management's (USSIM) management of the investment arrangements, but the participating employers could seek greater clarity in this area.

- **Levels of currency/liability hedging**

  The SIP explains that the Trustee maintains appropriate levels of currency and liability hedging, but offers no detail as to what the levels of hedging are. The participating employers may wish to understand the Trustee policy in this area, particularly in the current market environment as overseas currency exposure (expressed in GBP terms) and liability values are particularly volatile given the current macro environment and geopolitical risks.

- **Responsible investment**

  – The SIP refers (multiple times) to the fact that the Trustee expects its external managers to take action with respect to integrating ESG/stewardship into their investment processes, although there is no indication as to how the Scheme's external managers would know that this is expected of them. We would consider it best practice for the SIP to include more explicit engagement/communication with external managers as well as detail as to how this is monitored.

  – When referring to ESG as a financially material concern, the SIP wording limits the Trustee's consideration of these factors to actions taken by the Scheme's investment managers. The participating employers could seek clarity as to the extent to which ESG related factors would feature in asset allocation decisions.

- **Reviewing USSIM's performance**

  Whilst we note that the SIP contains details of monitoring the performance of USSIM at an aggregate level via comparison relative to reference portfolios, it offers no detail as to how the performance of individual direct investments managed by USSIM are reviewed. The participating employers may wish to clarify particularly how USSIM's management of illiquid direct investments is reviewed.

Changes to the Trustee DC investment beliefs

As part of the consultation letter to participating employers, the Trustee has noted two new DC investment beliefs. We have listed these below and provided brief comments:

- **"Private markets provide investment opportunities and structures not available in public markets"**

  We are generally supportive of Trustees taking advantage of private market opportunities as they can offer strong risk adjusted returns. Within the context of DC portfolio arrangements, it will be important for the Trustee to consider the illiquidity of such opportunities and to ensure this is effectively communicated to members. This is an area that the participating employers may wish to clarify with the Trustee.

- **"As a large pension scheme, there may be cost, alignment and time-horizon advantages in investing via in-house investment capabilities"**

  We believe taking advantage of the in-house investment capabilities, and particularly the opportunities these present to pursue direct investments, is an effective tool available to the USS given its size. Nonetheless, it may be worth clarifying how the Trustee obtains comfort that members are receiving value for money via this approach.

Summary

We confirm the SIP complies with the regulations from an investment perspective, although we are not able to offer a legal opinion. In particular, we are comfortable the SIP complies with the new responsible investment guidelines issued by the DWP.

We have noted some areas of clarification which the participating employers may wish to clarify with the Trustee.

Appendix – Responsible Investment (RI) requirements

Introduction

The following note was issued to clients by our responsible investment specialists in September 2018, directly after the requirements were released by the Department for Work and Pensions (DWP).

DWP confirms revised trustees' investment duties

- SIP to state how trustees take account of 'financially material considerations', 'non-financial matters' and policies on stewardship.
- Money Purchase schemes will need to disclose this information online and also produce an implementation report each year.
- Proposals for a separate "statement on members' views" dropped.

In recent years there has been growing interest in social investment for pension funds and in environmental, social and governance (ESG) considerations. Various consultations and reports have been released, including a report by the Law Commission which concluded that there are no legal or regulatory barriers to pension schemes making social investments. Final regulations have now been released following consultation; these aim to help dispel trustee confusion and to give institutional investors renewed confidence, if they so choose, to begin or increase the allocation of capital to investment opportunities such as unlisted firms, green finance and social impact investment.

Background

The regulations are intended to reassure trustees that they can (and should):

- Take account of 'financially material considerations', which include but are not limited to ESG considerations including climate change;
- Fulfil the responsibilities associated with holding the investments in members' best interests;
- Have an agreed approach on the extent, if at all, to which they will take account of members' views ('non-financial matters'); and
- Use the Statement of Investment Principles (SIP) as a real, effective and regularly-reviewed guide to investment strategy.

The DWP also confirms, for the avoidance of doubt, that trustees have primacy in investment decisions. Although trustees should not necessarily rule out taking account of members' views, they are never obliged to do so.

Specific details are set out below.

SIP content, preparation and disclosure

Under the regulations, by 1 October 2019, all schemes that are required to produce a SIP will need to expand this to set out:

- How they take account of financially material considerations, including climate change, over the appropriate time horizon for the scheme;
- How they take account (if at all) of 'non-financial matters'. This means the views of members, such as (but not limited to) ethical views, and views in relation to social and environmental impact and present and future quality of life of the members and beneficiaries; and
- Their policies in relation to the stewardship of investments, including engagement, monitoring and exercising voting rights associated with investments.

A proposal for a "statement on members' views" was removed from the final regulations.

The new items must also be included in the annual report, available on request to members.

Additional Money Purchase requirements

Additional requirements apply to 'relevant schemes' (broadly, subject to a few exemptions, schemes offering money purchase benefits other than just AVCs).

From 1 October 2020, where these schemes are required to produce a SIP, trustees will in addition be required to produce an implementation report for the year setting out how they acted on the principles set out in the SIP and explaining any changes made to the SIP and the reasons for the change. If no review of the SIP has taken place, the trustees must state the date of the last review.

From October 2019, relevant schemes will also need to prepare or update their default strategy, to cover the new items detailed above.

Such schemes will have to publish the following on a website, so that it can be found by scheme members and interested members of the public:

- SIP;
- Implementation report (once this is prepared).

Members will need to be informed of the online availability of this information in their annual benefit statement. This approach is similar to that recently adopted for disclosure of costs and charges for these schemes.

Timescales

1 October 2019: Schemes will be required to update their SIP. Relevant schemes will also be required to update their default strategy, and to publish this and their SIP.

1 October 2020: Relevant schemes will be required to produce and publish their implementation statement.

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