

## **USS Ltd Responsible Investment Strategy 2007-2011**

### **Introduction**

USS introduced its first strategy on Responsible Investment in 2000, adopting an iterative learning approach to the implementation of that strategy. As a result, the Fund's RI activities and focus evolved over the five years that the strategy has been in operation.

A key aspect of that strategy was to ensure regular and comprehensive reviews of the activities of the Fund in this area, and to adjust the strategy as necessary to maximise its effectiveness. These reviews occurred in 2001 and again in 2006, with other assessments taking place on an ongoing basis.

Based on the 2006 Review and other inputs, the RI team proposes the new strategy detailed in this document. This new strategy builds on the successes of the initial five years of RI activity at USS Ltd, and in reflecting the success of those five years, its focus does not differ significantly. The key new focus will be to resource better the integration of RI into the investment process of the internal Fund.

### **Strategic objectives 2007- 2011:**

The strategy is designed to ensure that extra financial factors (such as corporate governance, corporate responsibility and corporate sustainability) are internalised, where and when appropriate, within investment, and corporate decision making processes, to protect and enhance the long-term value of the Fund. It builds on the experience gained and lessons learned from the implementation of the original USS Ltd RI strategy adopted by the Fund in 2000. The Strategy will be applied to all assets, in all markets, managed by the Fund including: equities, debt (corporate and government), real estate, and alternative assets classes, including assets managed by external fund managers.

USS Ltd's strategy on Responsible Investment aims to ensure that fund management processes (both within and outside USS Ltd) continue to evolve by taking systematic account of those extra financial factors that could affect long-term return, short-term volatility or USS Ltd's reputation.

Specifically, it seeks to ensure the following:

- Work with companies to prevent value-destruction as a result of poor corporate management of extra financial factors. This will be achieved via active engagement with companies and via the investment decision making process.
- Find mis-priced assets because the market does not accurately reflect these factors, and ensure that this information is integrated into investment decision-making processes by the Fund as a whole in order to protect and enhance its long-term performance;
- Respond proactively to the evolving expectations of our institutions, our members, and UK society about the responsibility of pension funds and the assets the Fund owns with regard to these factors. This is with the proviso that this does not conflict with our fundamental fiduciary duty or corporate identity.
- Ensure USS Ltd plays its role as a Universal Investor<sup>1</sup>, where the Funds' investment returns are impacted by the returns from the economy as a whole as much as any specific industries or companies. Here, the Fund has an interest in ensuring that externalities and market failures (for example, in the form of pollution or systemic / weak corporate governance controls) do not affect market wide economic performance. USS would aim to use its position in the market to raise standards across the market and thus potentially improve the performance of all our investments.

The Strategy assumes that USS will use its influence as a large investor with companies, other investors and standards setters in a responsible and proactive manner and across all markets, where practicable.

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<sup>1</sup> Universal Investors have holdings that are so diversified that their investment returns are impacted by the returns from the economy as a whole as much as any specific industries or companies. This gives UIs a breadth of concern that aligns with whole market performance. For example, pension funds can be concerned with externalisation of costs such as pollution and training of staff, whereas an owner with a perspective limited to a particular company or industry may consider these to be unacceptable expenses because of competitiveness problems.

### **Implementing the Strategy**

There are three core aspects to this Strategy.

- **Company specific engagement.** USS Ltd will continue and increase its active engagement with companies and sectors and other assets where it is believed there are risks to the Fund's holdings (or potential holdings). This will cover the broad range of extra financial issues and markets.
- **Market acceptance of Responsible Investment.** This will continue to be a core activity area in the USS RI strategy, as the nature of RI and extra financial factors are such that there remain a number of barriers to acceptance of these issues in the traditional investment process. Similarly, there are many aspects of the current investment system that make RI difficult for investment managers to implement. USS Ltd is in a unique non-commercial position in which the Fund can use its influence to address systemic blocks to RI, from the short-term focus of investment strategies, to the lack of research on extra financial factors. This includes, where appropriate, engagement with policy makers to address shortcomings in policies which affect market performance.
- **Investment integration.** USS Ltd is unusual in the pension fund sector in that it actively resources an in house team of specialists to address RI issues of relevance to the fund. USS Ltd will make use of this specialist resource to ensure that extra financial factors are integrated into its investment and wider organisational approach and culture.

In undertaking these activities, USS Ltd will follow seven principles when making RI related decisions (see Appendix 1):

- Principle 1: Address the financial and non-financial issues in an integrated manner.
- Principle 2: Adopt a research-based approach.
- Principle 3: Work in alliances.
- Principle 4: Learn from experience.
- Principle 5: Manage expectations proactively and communicate effectively.
- Principle 6: Focus on quality of RI activity rather than quantity.
- Principle 7: Develop a flexible approach based on on-going monitoring and evaluation.

### **Fiduciary responsibilities**

This Strategy is based on the view that extra financial factors can influence the value of USS Ltd's investments and therefore should be addressed within the Fund's investment management processes. Hence, the Strategy is consistent with the Fund's fundamental fiduciary duty, in that it aims to both maximise long-term returns, and protect the Fund from downside risk. In addition, it is based upon the belief that the Fund can be both a long-term and responsible investor, achieving the returns needed to cover its liabilities, while at the same time play a role in ensuring that members can retire to a safe and stable future.

### **Expected results of the strategy**

The expectation underpinning this strategy is that it will deliver benefits over the long-term. The benefits should include:

- Protection and / or enhancement of the long-term performance of the Fund.
- The protection and enhancement of USS Ltd's reputation for professionalism and thought leadership into the RI arena, with better out-performance, a stronger reputation, and a positive impact on human resource issues.
- USS Ltd being able to demonstrate support for other asset managers and corporations who want to achieve good practice standards on governance, social and environmental factors.
- USS Ltd using its influence to encourage such good practice where it is in the asset's, and therefore, the Fund's, best long term interests.
- Better public policy decisions that are in the interests of long-term investors.
- More effective operation of the market vis à vis the inclusion of all material factors in the investment process.

## **Appendix 1: USS Ltd's Strategic Principles of Responsible Investment**

### **Principle 1: Address financial and extra-financial factors in an integrated manner**

For USS Ltd, as a mainstream and long-term investor, integration of extra financial factors (i.e. governance, social, and environmental) into investment research and decision-making (in all asset classes) is an essential part of the Fund's fiduciary duty. In addition, this integrated approach will help the Fund's investment managers identify potential mispricing of assets (both positive and negative) and hence improve the Fund's long-term performance.

### **Principle 2: Adopt a research based approach**

This strategy has its foundations in a research-based approach to identifying value destruction and mis-priced assets related to extra financial factors. A key factor in the strategy is research-based dialogue with companies and others with the aim of influencing performance or strategy. A higher level of engagement with a broader range of issues is, therefore, inevitable.

Although such a research based approach has some investment implications, it also offers several benefits. It fits well with the empowered nature of USS Ltd's London Investment Office team who all use different fund management approaches. As such, a "one size fits all" RI strategy is unlikely to be effective in USS Ltd. Based on rational judgement and credible evidence, rather than on worldviews or ideological preconception, a research based approach could allow a broad range of USS Ltd's stakeholders to find common ground and collaborate in making this development succeed for the benefit of all.

### **Principle 3: Work in alliances**

USS will continue to work in collaboration with other institutional investors, particularly pension funds, in seeking to implement its RI strategy. The additional influence, the shared learning, and the greater efficiency associated with collaboration, means that this forms a central plank of USS Ltd's approach to RI.

### **Principle 4: Learn from experience**

USS Ltd's strategy of RI over the first five years of RI activity has been based upon a learning by doing approach. This has led to significant changes in strategy and direction, and arguably far more successful RI projects. This approach will continue as USS Ltd moves into a new phase of its RI strategy.

### **Principle 5: Manage expectations proactively and communicate effectively**

Our membership and other stakeholders have different views about whether, why and how USS Ltd should implement its RI policy. With such a diverse membership, it is impossible to please all of the people all of the time. All USS Ltd's decisions on RI should be taken with the long-term performance of the Fund a key consideration. The Fund will also make additional investments in transparent communication with the aim of achieving good practice in comparison to our peers (other pension funds) as a minimum.

### **Principle 6: Focus on quality of RI activity rather than quantity**

As a pension fund with long-term targets, USS Ltd can take an approach that is different to that which many commercial pension providers are forced to adopt. Specifically, USS Ltd has the freedom to concentrate its efforts where most long term benefit should accrue, even if these efforts do not appear directly related to USS Ltd's performance over the short term. Hence, USS Ltd will seek to prioritise its resources in those areas where the Fund believes that its activities can add most value. This approach will require even more communication, joint learning and mutual trust than if we adopted a lower quality, but higher coverage approach.

### **Principle 7: Develop a flexible approach based on on-going monitoring and evaluation**

RI is a rapidly evolving subject, with new players entering the field, and good practice evolving all the time. The "learning by doing" approach has served the Fund well in this area, and on going monitoring and learning means a flexible strategy that adapts over time.