Investment Beliefs

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The trustee maintains this set of Investment Beliefs concerning investment risk and returns relative to the Universities Superannuation Scheme ('USS' or 'scheme') DB liabilities and member requirements, and the range of suitable investment options to be made available to DC members. The trustee further articulates its RI beliefs in its **Responsible Investment ("RI") Beliefs and Ambition Statement** (which can be found in the "How we invest" area of the scheme's website uss.co.uk). These state that:

- The trustee is a Universal Owner and is therefore exposed to certain market wide or systemic issues which could impact the investment returns it seeks.
- The scheme's interests are further protected from adverse impacts by collaboration with like-minded investors and engagement with government, industry and regulators.
- RI integration and high-quality stewardship in all asset classes will contribute to better outcomes for the scheme and its members.

These Investment Beliefs form the basis of the trustee's investment principles as set out in the Statement of Investment Principles. The trustee's wholly owned subsidiary, USS Investment Management Limited ("USSIM"), is required to act in accordance with the Statement of Investment Principles in performing its investment management and advisory duties. Ultimately the Statement of Investment Principles and the trustee's Investment Beliefs guide the scheme's governance and strategy managed through USSIM.

Part A: Defined Benefit Investment Beliefs

The scheme exists to pay the benefits promised to its members and beneficiaries. The capacity for the trustee to take investment risk, in relation to the defined benefit part of the scheme 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.** To meet the scheme's objectives, the trustee considers the investment, funding and covenant risks of the scheme. The appropriate horizon for USS's investment risk-taking depends on the duration of the liabilities, the profile of projected cash flows, regulatory requirements and any deficit recovery and contingency plans for the scheme (i.e. 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 its obligations, the trustee defines risk and return objectives and converts them into a high-level investment strategy. This theoretical asset allocation is referred to as the Valuation Investment Strategy ('VIS'). Implementation and more granular asset allocation decisions are delegated, within approved risk limits, to the scheme's internal manager, USS Investment Management Limited ('USSIM').
3. **Strategic asset allocation and the timing of material changes to it are important drivers of the scheme's financial outcomes.** The asset allocation process balances exposure to a diversified set of risk factors against the expected additional returns for these risk factors. The main sources of return for bearing risk ('risk premia') are expected to come from equity, credit, illiquidity, complexity and other factors. Other exposures such as foreign exchange offer less reliable risk premia but are expected to provide valuable sources of portfolio diversification. Risk premia are not static over time but fluctuate in response to investor preferences, and 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. **Risk should be managed over multiple time horizons.** 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. The trustee will also consider shorter time horizons to manage risk in between valuations.
5. As the investment horizon lengthens, the probability increases that returns on assets at the lower end of the risk spectrum such as UK gilts or cash will be lower than those on assets at the higher end of the risk spectrum such as non-government debt, publicly traded equities, property, other Private Market assets and investment in alternative strategies.

6. **Private Markets provide investment opportunities and structures not available in Public Markets.** They may provide opportunities for additional returns (including illiquidity and complexity premia), diversification or other desired characteristics relative to Public Market assets over the long-term.
7. **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.
8. **Risk is multi-faceted: it is best understood and managed using multiple approaches and with regard to the liabilities.** Not all investments are equally risky to all investors.
9. **Risk that is not sufficiently compensated should generally be avoided, hedged or diversified, taking into account the materiality of the risk, and any implementation considerations.** 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 affecting the timing and magnitude of pension payments and, by virtue of the cash flow valuation process, in changes to gilt yields and, to a lesser extent, return prospects of growth and credit assets. 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).
10. **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 collateral, counterparty and liquidity controls are required.
11. **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 the most suitable option, nor always the most relevant comparators.
12. **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 appropriate (e.g. internal resources cannot be justified, developed or obtained for the desired allocations, and suitable terms and alignment can be established externally).
13. **Responsible investment (RI) involves acting as an engaged and active long-term owner to reduce risk over time and to seek to improve risk-adjusted returns.** Active ownership involves engagement as a long-term owner of assets, being focused on sustainability, good corporate governance and actively engaging with the trustee's investment managers (both internal and external) taking into account all financially material considerations in relation to the selection, retention, and realisation of investments. This includes RI 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.
14. **Superior risk-adjusted returns are available to investors who take a long-term view of financially material considerations.**

Part B: Defined Contribution Investment Beliefs

The Defined Contribution ('DC') part of the scheme exists to provide members with a suitable range of default and self-select investment options that meets their needs, 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 perspectives underpinning the design and ongoing oversight of the DC part of the scheme, in order to:

- assist members in saving for their desired retirement outcomes
- convert the expected 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 members' needs, the hybrid DB/DC benefit design and overall engagement objectives.** Primary areas of engagement include assisting members in understanding the purpose of the DC part of the scheme, options members have to enable them to save more for their retirement and providing education around their retirement options.
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 investment selection, the default lifestyle option 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 far 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 is 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 lifestyle option, asset allocation will adjust around a glide-path consistent with assumed member risk tolerance throughout the member's savings life-cycle.** The default lifestyle option cannot capture all differences across individual members. However, a higher risk tolerance may be assumed when members are far from retirement with a longer time horizon, with the aim of increasing expected real returns and retirement wealth. In later stages of the savings life-cycle, the accumulated investment pots will typically be greater and the ability subsequently to make good any material losses is reduced. The default lifestyle option 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 strategies with certain exclusions.** 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, 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 risk and return objectives and broad asset allocation guidelines for the default lifestyle option 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 lifestyle option balances diversified risk factors against the expected additional returns for exposure to these risk factors. The main sources of return for bearing risk ('risk premia') are expected to be equity, credit, illiquidity and complexity. Other exposures such as duration, inflation and foreign exchange offer less reliable risk premia but are expected to provide valuable sources of portfolio diversification. The asset mix is 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 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 lifestyle option 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 '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. A principal source of long-term investment returns is participation in economic growth, via equity markets or otherwise. These returns may be accessed in Public Markets (i.e. listed markets) and via Private Markets (such as direct investments, co-investments or fund investments).
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 factor 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 life-cycle. For the default lifestyle option, reasonable assumptions must be made on the requirements of member cohorts across their savings life-cycle. However, not all investments are equally risky to all investors. The individual member may choose to self-assess their risk appetite within the DC self-select 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 the most suitable option 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 in respect of the DC part of the scheme where beneficial to the scheme. USSIM will appoint external managers where appropriate (e.g. 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 members.** 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 (USSIM) or cost concessions in the context of the overall USS business relationship with external managers or service providers.
15. **Responsible investment involves acting as an engaged and active long-term owner to reduce risk over time and to seek to improve risk-adjusted returns.** Active ownership involves engagement as a long-term owner of assets, focused on sustainability, good corporate governance and actively engaging with the trustee's investment managers (both internal and external) taking into account all financially material considerations in relation to the selection, retention, and realisation of investments. This includes RI 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 preferences within the scope of the self-select fund range.
16. **Superior risk-adjusted returns are available to investors who take a long-term view of financially material considerations.**