

The Universities Superannuation Scheme statement on responsible investment

June 2018

Introduction

As a pension fund with liabilities extending decades into the future, it is in USS's interests to encourage the companies, assets and markets in which it invests to focus on delivering sustainable investor value. USS believes that investing responsibly, by integrating material environmental, social, ethical and corporate governance (ESG) issues into investment decision making, and engaging as long-term owners, both reduces risk and positively impacts fund returns.

USS's approach to responsible investment (RI) revolves around the effective stewardship of all our assets, focusing in particular on sustainability and good corporate governance. The majority of the scheme's investments are managed internally and our investment process and approach to stewardship is tailored to the scheme's long-term investment requirements.

Our fiduciary duty and its implications for responsible investment

USS is a multi-employer pension fund with more than 350 member institutions, governed under trust law to invest and pay pensions for almost 400,000 individuals. The scheme contains two sections – the USS Retirement Income Builder, which provides a defined benefit (DB) pension to members on retirement, and the USS Investment Builder, a defined contribution (DC) fund. These sections have different restrictions placed on them which we need to respect in our responsible investment approach.

In the USS Retirement Income Builder section, the responsible investment strategy must be consistent with the scheme's responsibility to treat our members' financial interests as paramount. In line with the [legal advice](#) received for this section, if there are financial costs associated with doing so, USS cannot make investment decisions purely by screening on ethical or moral grounds and operating divestment policies. Where ESG factors are material to the financial performance of an investment, however, our investment managers can and must integrate them into their decision making as outlined in the [USS Statement of Investment Principles](#).

Ethical factors can, however, be taken into account if either of the following two tests are passed:

First, where a choice can be made between two otherwise equivalent investments without risk of significant financial detriment to the scheme; and

Second, where

- the trustee's longstanding and ongoing relationship with the membership has, over time, helped the trustee form an objective but specific view on a given non-financial factor relevant to a certain investment opportunity; and
- the trustee is satisfied that there is no risk of significant financial detriment to the scheme in taking account of the non-financial factor in respect of that investment opportunity; and
- the trustee has good reason to believe the members, or a substantial proportion of the members, would share as between themselves that specific view on that non-financial factor and absent any clear opposition from members to that specific view.

If either of these two conditions are met, an ethical issue can be used to drive an investment decision.

Within the USS Investment Builder section, there is an opportunity for participants to reflect their own ethical concerns in their pension's investments. This is because the law is more flexible in relation to DC arrangements

and, as long as a member has a clear understanding that the investment criteria may lead to a lower return, it is acceptable to permit members to select funds reflecting their own ethical views. To provide our members with the ability to reflect their views, the USS Investment Builder offers a number of ethical fund options. The Ethical Lifestyle and Ethical self-select funds are based upon an ethical policy which draws upon best practice and the indications of USS member preferences identified in surveys of their views.

USS responsible Investment strategy

USS's RI activities cover all asset classes in all markets in which we invest, including public equities, fixed income, private markets and property. They apply not only to assets managed internally by USS Investment Management but also to assets managed by our external asset managers (see below).

The scheme's RI interests are furthered by collaboration with like-minded investors and engagement with government, industry and regulators. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the trustee expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

What issues do we cover in RI?

ESG factors may be of a medium to long-term nature and are often difficult to quantify. ESG matters routinely considered by the fund include, (but are not limited to):

- bribery & corruption risk management
- climate change
- consumer and public health
- corporate governance
- customer satisfaction
- cyber security
- environmental performance management
- executive remuneration
- health and safety
- capital practices
- human rights
- innovation; research and development (R&D)
- intellectual capital management
- reputational risk
- succession planning
- the social impacts of corporate activity
- stakeholder relations
- supply chain management
- transparency and disclosure

The scheme's activities as a responsible investor fall into three core areas:

Integration:

We seek to include financially material ESG considerations within investment decision-making processes. By integrating material ESG considerations with a financial bearing into our investment methodology, USS seeks to identify mispriced assets and enable our portfolio managers to make better investment decisions to enhance long-term performance. We do this as we believe additional returns are available to investors who take a long-term view and are able to identify where the market is overlooking the role played by material ESG considerations in corporate and asset performance. Systematic mishandling of ESG issues can also be an early indicator of wider mismanagement or financial problems. There is good evidence that poor corporate governance decisions affects the interests of long-term investors.

Engagement, voting and stewardship:

As a long-term investor we believe we have an obligation to act as stewards of the assets in which we invest and to behave as active owners, using our influence to promote good ESG practices. We believe that such stewardship can both help prevent or avoid value destruction and reduce the negative impacts companies can have on the environment and society. The trustee does this in a manner which is consistent with its investment objectives, legal duties and other relevant commitments (see above). To guide the scheme's actions in this area, and to inform the companies in which we invest of our position, USS has separate Global Asset Stewardship Principles which include the following areas:

- Long-term value creation
- Environmental and social issues
- Ownership rights
- Effective leadership and oversight
- Alignment of interests
- Transparency

The ultimate objective of USS's stewardship activities is to safeguard our investments in the long-term interests of our members. Part of our fiduciary duty, therefore, is to monitor the assets we hold and to take appropriate action if there are concerns that could impact investment returns. We engage with investee assets in all global markets, as well as with external fund managers and regulators to protect the scheme's assets and returns for our members.

Market transformation activities:

Universal investors are those who, like USS, 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. **USS believes that we have a role to play in promoting the proper functioning of markets, from which we benefit as a universal investor.** This includes engagement with policy-makers and regulators in markets in which we invest, to articulate the concerns of asset owners and long-term investors. Such engagement can and does cover such varied issues as accounting standards to climate change policies.

We seek to ensure that externalities and market failures, such as pollution, climate change or systemically weak corporate governance standards, do not affect market-wide, long-term economic performance.

Oversight of external managers

USS's responsible investment strategy applies to all the assets in which the scheme invests, whether this is via portfolios run by USS Investment Management or other external managers. As a result, the scheme has processes in place to assess and monitor how potential or existing managers are addressing RI factors. The inclusion of ESG factors in due diligence prior to the appointment of external managers applies to both the USS Retirement Income Builder and USS Investment Builder funds, and to public and private markets or assets.

Oversight of the RI strategy

The USS board regularly reviews the approach the scheme takes to responsible investment to ensure that it remains appropriate for the scheme. As part of that process, the board will review this RI statement annually.

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