27 May 2022

Consideration of cost-savings

The JNC asked for comments from the Trustee about operating costs and what actions specifically have been taken to reduce those costs in the context of mitigating the rise in contributions identified by the 2020 valuation.

The USS trustee has always had a very diligent focus on cost management and has benchmarked its performance on cost versus other providers, against whom it performs well. The trustee invests in a mix of assets that are selected to deliver the required return for the scheme, at an appropriate level of risk, and works hard to find the most cost effective approach to the required investment mix, using in-house or third party managers, or a combination.

While costs could in theory be reduced by changing the mix of assets, if such a change exposed the scheme to greater risk, or reduced the return expectation, this would result in higher contributions and/or increased reliance on the employer covenant. The impact of such a change would have an adverse impact that more than offsets any cost reductions delivered. The 2021 Annual Report and Accounts lays out these factors in detail and explains that the scheme's investment performance is measured against relevant benchmarks after deducting investment management costs in order to monitor the net impact of such decisions appropriately.

Optimising our cost base is an ongoing challenge; over recent years we have reduced the proportion of third party private equity investment in favour of in-house direct investments. We have largely disinvested from hedge funds as we did not believe that the potential future investment performance contribution merited the cost involved. And we have replaced third party fixed income investment managers with internal mandates. All of these decisions resulted in substantial savings such as the £20m saving in hedge fund fees noted in the annual report.

Below we lay out various of the different approaches we take to managing the cost base.

Value for money framework

Delivering value for money for members and employers (VfM) forms an essential part of our strategic priorities, with performance monitored through a robust set of KPIs. VfM therefore sits at the centre of our annual business planning cycle.

The planning cycle culminates in the USSL Board approving a suite of strategic objectives, focused on improving employer and member outcomes over a 3-year time horizon. A transparent presentation of the cost required to run the Scheme and deliver these strategic objectives is included in the business plan, with the first year's cost base proposal forming the budget.

We manage total costs, i.e. we manage embedded costs deducted within the Scheme's investment returns as well as scheme expenses included in the financial statements.

The internal management of a greater proportion of Scheme assets has been and remains a key focus as, despite the impact this has on our staffing and other costs, we can demonstrate that it is better value than using third parties. Last year we divested from a material proportion of our externally managed hedge funds, saving around £20m per year in embedded costs with more to come. As laid out in summary in the Annual Report and Accounts we also consider lower cost investment approaches such as passive investing which would materially reduce costs. However, with such an approach our investment strategy would not be designed to beat the benchmark and thus after costs would be expected to lag it. Additionally, given the scale of the scheme assets and the availability of liquid hedging instruments, this is not a change which would be in members' interests to assist with optimising our access to return seeking assets within an acceptable risk profile.

This can be compared to our active management strategy which has a long track record of delivering above benchmark returns over 5 and 10 year periods after having deducted all costs of delivery.

A focus on 'sustainable saves'

With support of the Executive and Board, two years ago the current CFO introduced a cost saving target in the business plan each year, requiring the identification and delivery of sustainable cost efficiencies to be delivered in year, without detriment to employer or member outcomes. £1.7m cost efficiencies were delivered in 2020/21, which will deliver £2.4m of saves p.a. run rate and we are targeting marginally higher new saves in 2021/22.

Actions delivered a broad range of savings with efficiencies of £1m in Investment Research expenditure. In addition, renegotiations of contracts with 3rd party suppliers, such as our legal panel and with our landlord for the rent we pay in London resulted in further savings, together with the decision to hand back the 4th floor office space in the Royal Liver Building. The sustainable saves programme focuses on smaller efficiency opportunities too, with cost efficiencies in printing and the contracts for shredding also contributing to on-going, sustainable cost saves. As well as driving year on year efficiencies, the sustainable saves programme helps to build a culture of cost efficiency across USS, ensuring that colleagues seek out cost efficiency opportunities as a matter of course. Progress against the saves target is reported to the Board on a quarterly basis.

Managing headcount

Proposals to alter or increase headcount are largely managed through the annual planning cycle, with detailed headcount plans by function included for each year over the 3-year planning horizon. These proposals are subject to rigorous scrutiny by the USSL Board, with initial reviews by the Pensions Committee, USSIM Board and Group Executive Committee and their recommendation to approve their elements of the business plans forms part of the USSL Board's review.

Headcount growth has been driven in recent years by ongoing increases in the capability of internal asset management teams and the teams needed to support them (in line with the strategy laid out above), however material increases in regulation under both The Pension Regulator and the Financial Conduct Authority including Master Trust and Senior Managers and Certification Regime have also increased the requirement for internal resources.

Employee compensation

The USSL and USSIM Remuneration Committees approve the remuneration policy and the design and targets for performance related remuneration. They are provided with the analysis they require to enable them to review and approve compensation proposals, as part of the annual pay cycle.

Given the importance of attracting and retaining high calibre employees in a competitive market, we offer fair salaries in comparison with market levels for the relevant skills. Salaries reflect the experience, responsibility and contribution of the individual and of their role within USS.

Annual compensation benchmarking is performed on salary and total compensation. This both minimises the disruption caused by employee turnover and any potential negative impact on employee engagement. At the same time, benchmarking is vital to ensure we deliver value for money to employers and members. We used two external benchmarking agencies: one for investment management and support services, and another aimed at pensions services roles and their support functions.

We seek to pay no more than the market median in base salary across USS, with variable compensation in USSIM closely linked to scheme performance. We have paid less than the market median in aggregate total compensation in USSIM in the last 2 years, balancing the need to retain and motivate staff with the focus on value for money.

Given the conditions following Covid-19 which impacted broad areas of the economy including our sponsoring employers, the total cost of living pay rise level in April 2021 was lower than in recent years. An overall allocation of 1.5% of total actual salary was made available for Liverpool and Group colleagues. Most higher paid colleagues in both London and Liverpool did not receive a salary rise this year, with the available funding utilised mainly for early career salary progression and promotions. Existing members of the Group Executive did not receive a salary increase.

Benchmarking

We undertake a number of cost benchmarking activities each year. CEM Benchmarking, an independent company, annually benchmarks our investment management costs against our peers. Participants' reported costs are adjusted to harmonise cost treatments and provide like-for-like comparisons using asset-mix adjusted cost/ asset ratios. Our investment management costs, which make up around 85% of total scheme costs, remain materially below the peer cost benchmark, with comparative investment management costs of £232m compared to a peer average of £333m, using the most recently available data points.

The CEM Pension Administration survey evidenced that we are cheaper than peer average in core employer and member business processing activities. However, whilst only a small proportion of total scheme cost, we are more expensive than peer average in certain other areas of administration driven by the different nature of scheme, its governance structure and the benefits it offers. We discuss these points in an article, from our Chief Finance Officer, published on our website in January 2022.

We also actively seek out other pension schemes to undertake open book cost benchmarking to identify opportunities where we may be able to further reduce cost, without adversely impacting employer of member service. We have undertaken initial pension administration benchmarking with the Railways' Pension Scheme and hope to find more schemes to work with in the coming years.