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Investment beliefs and principles

Summary investment beliefs of the USS trustee

The Universities Superannuation Scheme (USS) exists to pay the benefits due to its members. The capacity for the trustee to take investment risk 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 developments that no set of assets matches perfectly.Furthermore expected returns for the fund can be improved sufficiently, after costs, to justify taking risk above the minimum practically achievable.** The appropriate horizon for USS's investment risk-taking depends on the duration of the liabilities, the profile of projected cash flows and the deficit recovery and contingency plans for the scheme (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 their obligations, the trustee sets a high-level strategic asset allocation or 'Reference Portfolio' which frames the required return and acceptable risk for the fund. Implementation and more granular asset allocation decisions are delegated to USS Investment Management.
3. **Strategic Asset Allocation and the timing of material changes are the most important drivers of the fund's financial outcomes.** The asset allocation process balances diversified risks against the expected additional returns for these risks. The main sources of return for bearing risk ('risk premia') are equity, credit, illiquidity, duration, inflation, volatility and insurance.
4. **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 'risk-free' assets increases as the investment horizon lengthens, though the sources of risk premia do not provide extra return over all time periods.
5. **Private markets provide investment opportunities and structures not available in public markets; which may provide additional returns in excess of those provided by public markets or returns which are primarily helpful in meeting the scheme's liabilities.** This type of investment enables additional returns (an illiquidity premium) and diversification benefits to be accessed.
6. **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 of any one risk but there are limits on overall risk-reduction from diversification and scenarios in which it may be less effective.
7. **Risk is multi-faceted: it is best understood and managed using multiple approaches and at all times with respect to the liabilities.** Not all investments are equally risky to all investors.
8. **Risk that is not sufficiently compensated should generally be avoided, hedged or diversified.** The key investment risk for the trustee is that returns fall materially short of what is required over the investment horizon. Volatility, though an imperfect measure of shortfall risk, is a useful metric for estimating portfolio risk and for use in recovery and contingency plans. Risk in the scheme's liabilities is concentrated in inflation and longevity and, by virtue of the cash flow valuation process, in gilt yields.
9. **Liability hedging strategies and some associated leverage can help to reduce the risks posed by the scheme's liabilities**, though there are inherent risks in leverage and appropriate controls are required.
10. **Active management can add value, after accounting for costs.** The

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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 'safe' nor always the most relevant comparators.

11. **As a large fund, there are cost, alignment and time-horizon advantages in investing primarily via in-house investment capability**; however external managers will be used where internal resources cannot be justified or obtained, and suitable alignment can be found.
12. **Investing responsibly and engaging as long term owners reduces risk over time and may positively impact fund returns.** This involves engagement as active owners of assets, focused on sustainability and good corporate governance. The fund's interests are further protected from adverse impacts by collaboration with like-minded investors and engagement with government, industry and regulators.

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