Statement of Trustee on fiduciary obligations and investment approach

1 December 2016

Trustee statement on fiduciary obligations and investment approach for USS as a whole (Both USS Retirement Income Builder and USS Investment Builder)

1. Background: USS as a whole

1.1. USS's overall approach to investment policy and decision-making for the scheme as a whole must be consistent with the trustee company's fiduciary and other duties as confirmed by legal advice and the trustee's legal framework.

1.2. That legal advice and framework is clear that the trustee company must carry out its investment duties in line with:

- the scheme's trust deed and rules;
- trust law duties, and in particular the duty when exercising a power to consider relevant matters (and to disregard irrelevant ones), taking care not to fetter discretion;
- legislation – particularly the wide investment power conferred by Pensions Act 1995 and the requirements to produce and comply with a Statement of Investment Principles;
- regulatory materials from The Pensions Regulator; and
- case law – in particular that pension scheme assets should be invested in the "best interests" of beneficiaries, this being taken to mean their best financial interests.

1.3. Against that backdrop we can articulate how those legal responsibilities and the concept of fiduciary duty in relation to responsible investment apply across the scheme and this is set out below.

2. Key Principles: USS as a whole

2.1. The trustee's primary duty is to invest scheme assets in the best financial interests of beneficiaries.

2.2. It is appropriate to take into account ethical, environmental, social and governance factors (**ESG factors**) where these are relevant financial factors. Put another way, the key point is whether a given factor is – or is not – a **financial** factor. A financial factor which is also an ESG factor will be relevant. However, an ESG factor which is **not** a financial factor will not be relevant unless stage two of paragraph 2.5 below applies. Some examples of ESG factors are noted below, but each of these may not be financial factors in any given case[1].

2.3. Non-financial factors should not drive the investment process and should be considered only where there is no risk of significant financial detriment to the scheme.

2.4. The trustee company's investment approach incorporates these principles, so that the trustee (or USS Investment Management Limited where the investment discretion has been delegated to it) applies a series of questions/considerations as part of the investment process, as noted below.

2.5. There are two stages to this approach, as follows:

Stage One

- Relevant financial factors are identified, including relevant ESG factors.

[1] Examples of ESG factors include: human rights, health & safety, employment practices; innovation, research and development; customer satisfaction, consumer and public health; environmental performance management, climate change; corporate governance, succession planning, intellectual capital management, executive remuneration; reputational risk, transparency and disclosure; and social impact of corporate activity.

Once relevant financial factors have been identified, consideration can be given to the inclusion of any non-financial factors in the investment process.

Stage Two

Non-financial factors can be taken into account in two situations:

- First, to make a choice as between two otherwise equivalent investments without risk of significant financial detriment to the scheme; and
- Secondly, where (i) the trustee's longstanding and ongoing relationship with the membership has, over time, helped the trustee form a specific view on a given non-financial factor relevant to a certain investment opportunity; and (ii) 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 (iii) the trustee has good reason to believe that members would share the trustee's view on that non-financial factor.

3. How do these principles apply to the USS Retirement Income Builder and USS Investment Builder elements of USS?

3.1. USS Retirement Income Builder (Defined Benefit)

- The trustee is required to invest scheme assets in the best financial interests of members and beneficiaries and must take into account all relevant and material considerations when making investment decisions. The principles outlined at paragraph two above are consistent with those key duties and the trustee will continue to apply those principles when considering USS Investment Builder investments, as it has always done.

3.2. USS Investment Builder (Defined Contribution) – as a whole

- When considering USS Investment Builder investments and constructing the Defined Contribution (DC) investment range as a whole, the trustee will apply the principles outlined above in the same manner as it applies those principles to USS Retirement Income Builder investment decisions.

3.3. USS Investment Builder – default strategy

- When constructing and monitoring the USS Investment Builder default strategy the trustee will apply the principles outlined above in the same manner as it applies those principles to USS Retirement Income Builder investment decisions.

3.4. USS Investment Builder – self-select options

- The general principles set out above still apply, but with a nuance accepted by both The Pensions Regulator and the Law Commission.
- This nuance is that both The Pensions Regulator and the Law Commission envisage trustees offering self-select options which will take account of non-financial factors even where these factors could result in the self-select option in question producing lower returns than would otherwise be the case.
- However, it is important to recognise that the trustee would have to make clear to members the background, structure and risks of the self-select option.
- Also, the trustee would not be permitted to offer a self-select option with no regard to its financial performance: the trustee's primary duty for the USS Investment Builder remains to provide members with a pension at retirement. However, for self-select options the trustee is able to (and does) take non-financial factors into account alongside financial ones to a greater extent than is possible for USS Retirement Income Builder or for the USS Investment Builder default strategy.

- Accordingly, whilst still applying the principles above as the primary considerations the trustee can reasonably decide to offer ESG investment for the USS Investment Builder self-select options that will or "may produce a lower return"[2] than non-ESG comparators.

[2] Para 10.113 Law Commission Consultation Paper 215-Fiduciary Duties of Investment Intermediaries