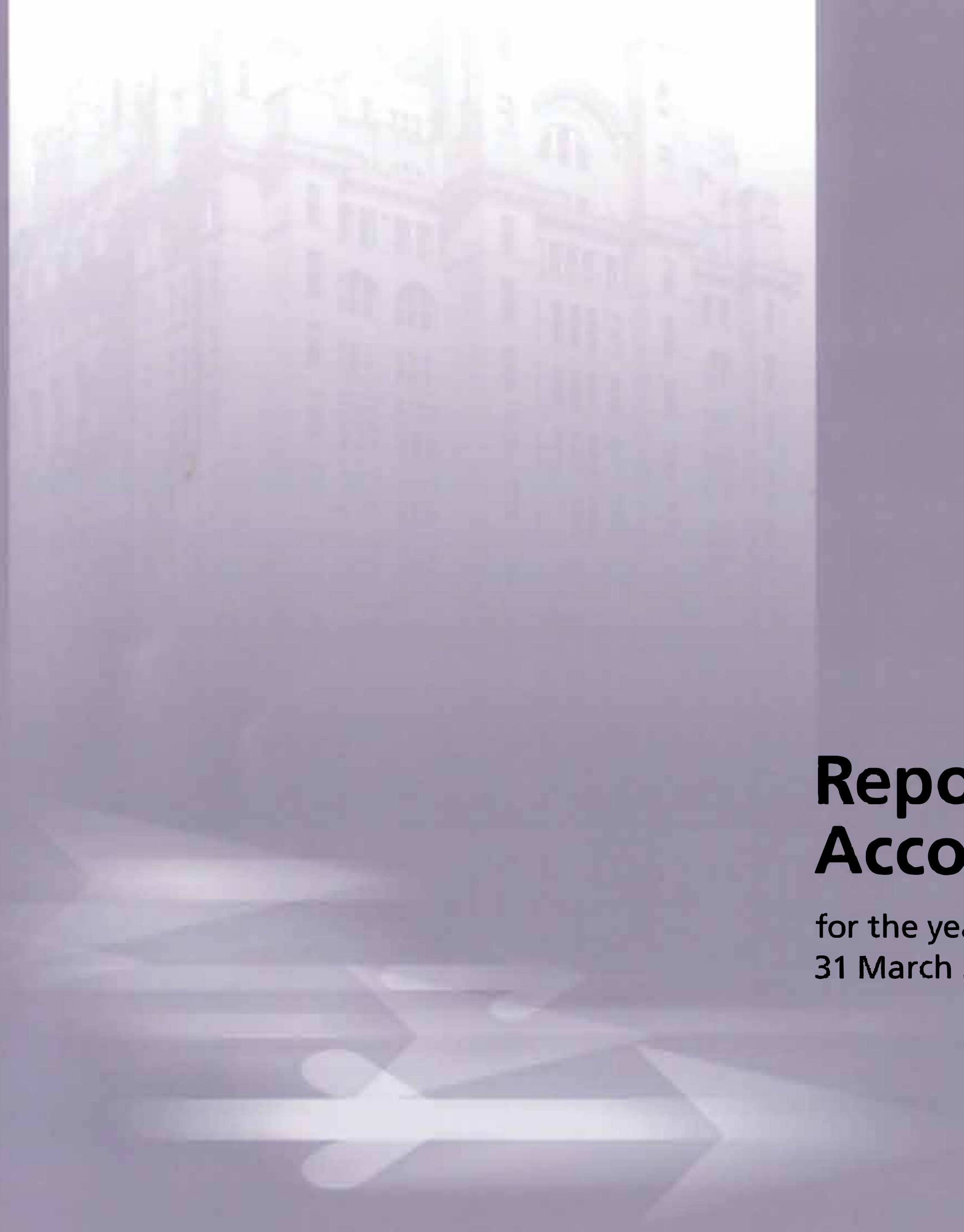
USS
UNIVERSITIES
SUPERANNUATION
SCHEME LIMITED



Report and Accounts

for the year ended
31 March 2006

Universities Superannuation Scheme Limited is the corporate trustee of one of the largest private sector pension funds in the UK with assets at 31 March 2006 of around £28 billion. It was established in 1974 to administer the principal pension scheme for academic and senior administrative staff in UK universities and other higher education and research institutions.

The head office is at Royal Liver Building, Liverpool and the London Investment Office is at 99 Bishopsgate, London.

The registered number of the Trustee Company (USS Ltd) at Companies House is 1167127

The reference number of the Scheme (USS) at the Pension Schemes Registry is 100201003

USS

CONTENTS

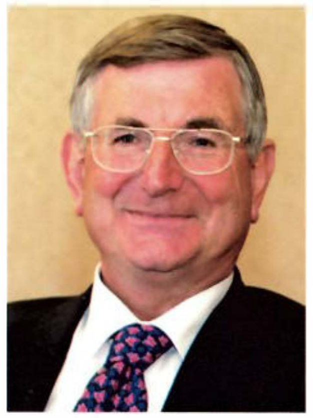
MANAGEMENT STATEMENT

The year to 31 March 2006 was another very busy year for pension schemes including USS with, in particular, changes to the tax rules governing pension schemes coming into effect on 6 April 2006 (A-day). Membership of the scheme continues to grow while another year of positive investment performance has seen the value of the fund rise to over £28 billion. The scheme's active membership increased by 5.1% from 110,000 to 115,600 and there was substantial growth in the numbers of pensioners and those entitled to deferred benefits to 44,700 (up by 5.9%) and 66,100 (up by 5.4%) respectively. The total membership at 31 March 2006 was almost 224,400, an increase of 33% in five years.

The fund's investment return for the calendar year to 31 December 2005 of 24% exceeded its benchmark of 22.8% and this helped the total value of the fund to increase to £28.3 billion at 31 March 2006. The ten-year return of the fund of 7.9% per annum comfortably exceeds both earnings growth and retail price inflation over the same period.

The officers carried out a review during the year of potential systems to replace the scheme's existing pensions administration software, the Universal Pensions Management System (UPM) from Comino plc. In July 2005, the trustee company decided that Comino's replacement software, UPM version 2, was the best solution for the company's business needs. Following a detailed feasibility study and extensive contractual negotiations, the project to replace the pensions administration system commenced in February 2006 with the system being successfully implemented to our test environment in March. The new system is scheduled to go live during 2007/08 and we are confident that it will provide a good technology platform from which we can continue to provide more than satisfactory service levels across more diverse media to an ever increasing membership.

The results of the last triennial actuarial valuation of the scheme as at 31 March 2005 revealed that the assets of the scheme at the valuation date were 77% of the accrued liabilities, having been 101% of the liabilities at 31 March 2002. The fall in the funding level arose primarily as a result of the fall in equity markets since the last valuation. The fund continues to enjoy a positive cashflow with the aggregate of contributions and investment income exceeding benefit payments, and this is expected to continue for many years. In these circumstances the deficit is not of immediate concern since USS has no requirement to realise investments to meet its pensions liabilities. There is considerable scope for variation in the funding level, depending on the various economic circumstances that can arise and assumptions used to measure the value of the scheme's liabilities, and indeed, following the excellent investment performance since the valuation date, the funding level had increased to around 89% at 31 March 2006. Nevertheless, there are increasing pressures on the funding of the scheme - a more competitive recruitment market in the sector, improving mortality and new statutory funding regulations - and these and other issues will need to be considered by the trustee company, and indeed the sector, in the coming months. We shall, however, continue to do what is necessary to ensure that the scheme can meet its obligations while remaining affordable for both employers and members.

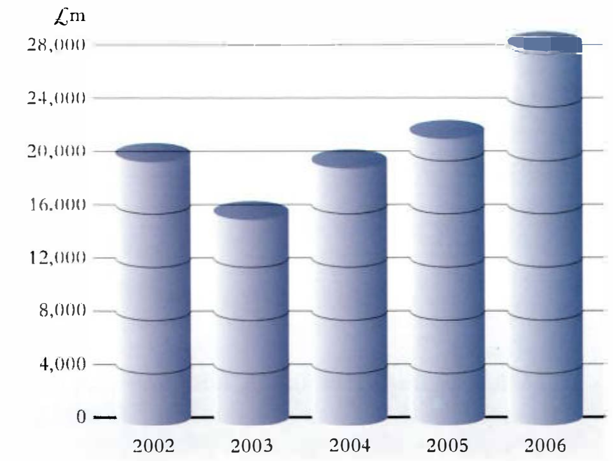


Martin Harris
Chairman

Tom Merchant
Chief Executive

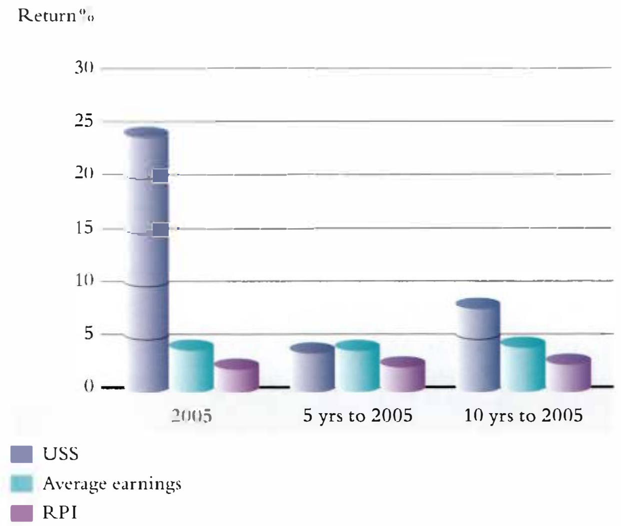
SUMMARY OF YEAR

FUND



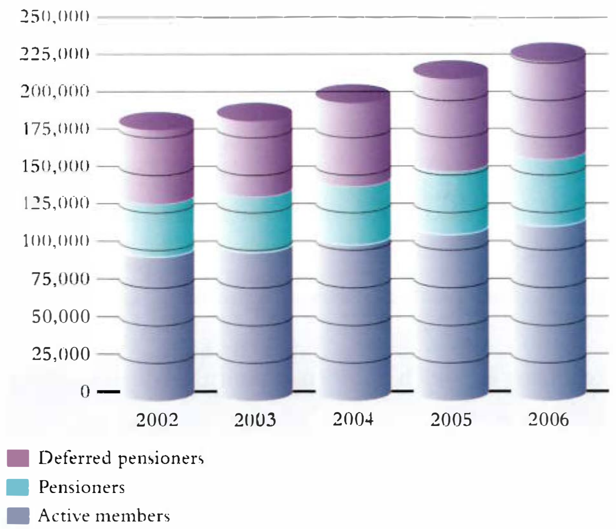
The fund's investments have increased from £20 billion in 2002 to £28.3 billion as at 31 March 2006. More details are given in the investment committee report on page 21 and in the five year summary of the fund accounts on page 77.

PERFORMANCE



Strong investment returns in 2005, together with good returns for 2003 and 2004, have seen the fund's position improve, resulting in the five year return exceeding RPI but slightly below average earnings. Over ten years, the fund has comfortably exceeded both RPI and average earnings. More details are given in the report of the investment committee on page 21.

MEMBERSHIP



The membership of the scheme continues to grow steadily. As at 31 March 2006 the total membership was 226,400 an increase of 5.4% from last year and 25.6% from four years ago. More details are given in the five year summary of the fund accounts on page 77.

PRINCIPAL OFFICERS AND ADVISERS

The principal officers and advisers of the trustee company at 1 August 2006 are:

Chief Executive	T H Merchant
Chief Investment Officer	P G Moon
Chief Financial Officer	C S Hunter
Pensions Policy Manager	B Mulkern
Pensions Operations Manager	B Steventon
Company Secretary	I M Sherlock
Head of IT	I J Hall
Communications Manager	C G Busby
Actuary	E S Topper of Mercer Human Resource Consulting Limited Clarence House, Clarence Street, Manchester M2 4DW
Solicitors	DLA Piper Rudnick Gray Cary UK LLP India Buildings, Liverpool L2 0NH
Auditors	KPMG LLP, St James' Square, Manchester M2 6DS
Bankers	Barclays Bank Plc, 4 Water Street, Liverpool L69 2DU

The principal other organisations acting for the trustee company during the year were:

Solicitors	Clifford Chance, Dundas & Wilson, Lawrence Graham, Mitchells Roberton, Fried Frank Harris Shriver & Jacobson
Investment managers	Capital International Limited, Legal & General Assurance, Wellington Management International, Goldman Sachs Asset Management International Ltd, Merrill Lynch Investment Managers, Henderson Global Investors Limited
Investment consultants	Mercer Investment Consulting
Custodians	State Street, JP Morgan Plc
Investment performance measurement	Investment Property Databank Limited, HSBC
Retail property investment adviser and property manager	Jones Lang LaSalle
Commercial property investment adviser and property manager	DTZ Debenham Tie Leung
Property valuers	Drivas Jonas
Computer software	Comino plc, Morse Limited, General Systems Ltd
Website design	Anthony Hodges Consulting Ltd
Computer hardware	ICM Computer Solutions plc
Business continuity	Synstar/Hewlett Packard
Insurers	Royal & Sun Alliance, AIG Europe (UK)

The trustee of Universities Superannuation Scheme (USS) is the trustee company, Universities Superannuation Scheme Limited (USS Ltd), which is appointed under USS rule 20.1. The statutory power of appointing new trustees applies provided that a new trustee may not be appointed without the approval of the joint negotiating committee.

The trustee company is also the scheme administrator of the scheme for the purposes of the Finance Act 2004.

The registered office of the trustee company to which enquiries about the scheme generally or about an individual's entitlement should be sent is:

Universities Superannuation Scheme Limited
Royal Liver Building, Liverpool L3 1PY

The membership at 31 March 2006 of the principal committees was as follows:

Management Committee

Appointed by Universities UK (UUK)

Sir Graeme Davies (Chairman), Sir Martin Harris (Deputy Chairman), M S Potts, Baroness Warwick of Undercliffe

Appointed by the Association of University Teachers (AUT)

D Guppy, Lady Merrison, Professor Charles Sutcliffe

Appointed by the Higher Education Funding Councils (HEFCs)

S Egan

Co-opted

Professor John Bull, M Butcher, V Holmes, H R Jacobs

Finance & General Purposes Committee

Appointed by the management committee

Sir Martin Harris (Chairman), Professor John Bull, D Guppy, H R Jacobs, Lady Merrison, M S Potts, Baroness Warwick of Undercliffe

Investment Committee

Appointed by the management committee

V Holmes (Chairman), G Allen, Professor John Bull, H R Jacobs, Dr D C Nicholls, D Robins, Professor Charles Sutcliffe

Audit Committee

Appointed by the management committee

Dr Christine Challis (Chairman), Professor John Bull, Lady Merrison, M S Potts, Professor Charles Sutcliffe

Remuneration Committee

Appointed by the management committee

H R Jacobs (Chairman), M Butcher, Lady Merrison, M S Potts, Baroness Warwick of Undercliffe

Rules Committee

Appointed by the management committee

H R Jacobs (Chairman), A D Linfoot, J W D Trythall

Advisory Committee

Appointed by UUK

Dr A Bruce, A D Linfoot, C Vidgeon

Appointed by AUT

Dr A Roger (Chairperson), J Guild, Dr S Wharton

Nominations Committee

Appointed by the management committee

Professor John Bull (Chairman), Sir Graeme Davies, Professor Charles Sutcliffe, Baroness Warwick of Undercliffe

Joint Negotiating Committee

Independent Chairman

Sir Kenneth Berrill

Appointed by UUK

Dr A Bruce, I Crawford, C Vidgeon, A D Linfoot, C Morland

Appointed by AUT

Dr J Anderson, A Carr, Ms C Cheesman, Dr A Roger, Dr T McKnight

MANAGEMENT COMMITTEE MEMBERS as at 1 August 2006

Sir Martin Harris, Chairman

Martin Harris (62) is deputy chair of the North West Development Agency and Director of the Office for Fair Access. He has been a director of USS Ltd since 1 April 1991 deputy chairman from 1 July 2004 and chairman from 1 April 2006. He was Vice-Chancellor of the University of Manchester from 1992 to 2004 and Vice-Chancellor of the University of Essex from 1987 to 1992. He served as chairman of the Committee of Vice-Chancellors and Principals (now UUK) from 1997 to 1999.

DIRECTORS

Professor John Bull CBE

Professor Bull (66) was Vice-Chancellor of the University of Plymouth from 1989 until his retirement in 2002. An economist and accountant by discipline, he had a particular interest in the finance and management of higher education. He became a co-opted member of the USS board in 2004. His is currently chairman of the Plymouth Hospitals NHS Trust, the Devon and Cornwall Learning and Skills Council and of Dartington College of Arts.

Michael Potts

Michael Potts (67) is Pro-Chancellor of the University of Liverpool, having served as President of the Council and Treasurer to the university between 1993 and 2004. He is a chartered accountant and retired from Coopers & Lybrand in 1993 after 20 years as senior partner in the Liverpool office. He is currently President of the North West Cancer Research Fund, having served as Chairman for nine years and is a non-executive director of a number of private companies. He was appointed a Deputy Lieutenant for the county of Merseyside in 2000, High Sheriff in 2006 and has been a director of USS Ltd since 1999.

Lady Merrison

Lady Merrison (67) was appointed the second pensioner director of USS Ltd in October 2003 succeeding Angela Crum Ewing. She was formerly a lecturer in medieval history at the University of Bristol. Following early retirement she served as a non-executive director in the fields of banking, media and health insurance. She is currently chairman of The HTV Pension Scheme and director of two other pension schemes. She is also president of the Guild of Friends of the Bristol Royal Hospital for Sick Children and sits on several trusts.

Professor Charles Sutcliffe

Charles Sutcliffe (58) teaches finance at the ISMA Centre of the University of Reading; and previously worked at the universities of Newcastle and Southampton. From 1981 to 1985 he was an elected member of Berkshire County Council and a trustee of the Berkshire Local Authorities Superannuation Fund. Between 1973 and 1985 he was auditor of the Reading Association of University Teachers. Since 1985 he has been a member of the Research Board and the Research and Development Group of the Chartered Institute of Management Accountants, and vice-chairman of the Research Board since 1997. He was appointed as an AUT (now UCU) nominated director of USS Ltd in 2001.

Baroness Warwick of Undercliffe

Diana Warwick (61) was appointed chief executive of Universities UK (formerly the Committee of Vice-Chancellors and Principals) in 1995. Previously she had been for three years Chief Executive of the Westminster Foundation for Democracy and from 1983-1993 she was the General Secretary of the Association of University Teachers, representing some 30,000 academic and senior staff in UK universities. She was a member of the Employment Appeals Tribunal from 1984 to 1999 and the Standing Committee on Standards in Public Life from 1994 to 2000. From 1985 to 1995 she served as a board member of the British Council, was a governor of the Commonwealth Institute until 1995, and a member of the TUC General Council between 1989 and 1992. She has honorary degrees from Bradford, Open and London universities.

Howard Jacobs

Howard Jacobs (53) became a co-opted member of the board on 1 October 2002 immediately after his retirement from the solicitors, Slaughter and May, where he had been a partner since 1986, specialising in employment law and pensions law. He is now a consultant with that firm and does other governance-related advisory work. He is a vice-president of ICAN the national educational charity for children with speech and language difficulties.

Michael Butcher

Michael Butcher (59) became a co-opted member of the board on 1st November 2004 having retired from IBM where he held a variety of technical, sales and marketing positions in UK and Europe, latterly as Tivoli EMEA Marketing Director. He is a member of the audit committee at Loughborough University and a director of the IBM UK pension fund. He continues to take an active interest in the effective use of IT.

Virginia Holmes

Virginia Holmes (46) was formerly chief executive of AXA Investment Managers in the UK, and managing director of Barclays Bank Trust Company. She is currently non-executive director and chair of the audit committee of JP Morgan Fleming Claverhouse Investment Trust. She became a director of USS in September 2005.

Dave Guppy

Dave Guppy (61) has worked in the computing service at University College London since 1979. Prior to that he worked in similar roles at the London Hospital Medical College, a software co-operative and IBM. He was President of University College London Association of University Teachers (2002/04) and served as Vice-Chair of the national AUT computer staffs committee (1998/2003). He is currently a member of the national executive committee of the UCU and is its Vice-President for one year in 2005/06. He was appointed a director of USS Ltd in 2005.

Steve Egan

Steve Egan (48) is acting Chief Executive of HEFCE. He was educated at the Universities of Loughborough and Bath and joined HEFCE as Director of Finance and Corporate Resources in 1996. Steve's responsibilities at HEFCE have included advising the Government on the financial needs of higher education, and promoting improvements in the sector's leadership, governance and management. He also has a leading role in promoting equality, diversity, and sustainable development, and in ensuring that the £6 billion of public money routed through HEFCE is well spent. He is a keen advocate of better regulation and has overseen significant reductions in the accountability burden on the HE sector.

Sir Ivor Crewe

Ivor Crewe (60) was appointed Vice-Chancellor of the University of Essex in 1995, having first joined the University as a lecturer in Government in 1971. He served as President of Universities UK from 2003 to 2005 and remains a member of UUK's board and executive committee. He is a board member of the Universities and Colleges Employers' Association and of the Leadership Foundation for Higher Education. He was appointed a director of USS in April 2006.

MANAGEMENT COMMITTEE

The management committee submits its thirty-first annual report on the progress of USS. Separate reports on the activities of the other main committees of USS follow this report.

Committee members

There were four changes in membership of the committee during the year. Mr A S Bell retired on 31 July 2005 and was succeeded as a co-opted director by Mrs V Holmes on 1 September 2005. Mr J W D Trythall retired on 31 August 2005 and was succeeded as a University and College Union (UCU) (formerly AUT) appointed director by Mr D Guppy on 1 September 2005. Sir Howard Newby ceased to be the Higher Education Funding Councils' (HEFCs) appointed director on 31 January 2006 and was succeeded by Mr S Egan on 1 February 2006. The chairman, Sir Graeme Davies, retired on 31 March 2006 and was succeeded as a Universities UK (UUK) appointed director by Professor Sir Ivor Crewe on 1 April 2006. Sir Martin Harris assumed the role of chairman and Professor John Bull assumed the role of deputy chairman with effect from 1 April 2006. We are most grateful to Sir Graeme, Mr Trythall, Sir Howard and Mr Bell for their contribution to USS matters during their terms of office.

Under the articles of association of the trustee company, the management committee comprises the trustee company's board of directors. Four of the directors on the board of the trustee company are appointed by UUK; three are appointed by UCU, of whom at least one must be a USS pensioner member; one is appointed by the Funding Councils; and a minimum of two and a maximum of four directors are co-opted directors appointed by the management committee. UUK, UCU and the Funding Councils have the power to remove their respective appointed directors. The articles of association also provide for the removal of any director where (in relevant circumstances) he or she is prohibited from acting as a director.

The co-opted directors are appointed with the prior approval of the joint negotiating committee and are independent in that they have no connection with any of the participating employers. The approval of that committee is not, however, required for the reappointment of a co-opted director on the expiry of his or her period of office. USS Ltd directors normally serve a three year term but are eligible for reappointment. The management committee has decided that co-opted directors serve for a maximum of three three-year terms, subject to it considering a further three-year term in exceptional circumstances (which would then be reported in this report).

On appointment all directors receive detailed information from the company secretary relating to the trustee company, the scheme and their duties. This includes a trustee pack issued by the NAPF containing appropriate publications, including a copy of *Pension Scheme Trustees* issued by the Pensions Regulator. Copies of all scheme documents are held at the trustee company's registered office and are available for inspection by the directors. They visit the registered office in Liverpool and the investment office in London where they take part in an induction programme and receive information on the company and the role they are expected to undertake. They meet key members of the management teams in the respective offices. They are invited to attend an appropriate trustee training course initially and a follow-up course approximately 18 months later, and as a member of the management committee receive regular periodic updates on their responsibilities and current developments, legal or otherwise, from the trustee company's advisers. They are also encouraged to attend appropriate conferences, seminars and professional presentations.

Performance evaluation

An internal review of the performance of committees and individual members was carried out using the Law Debenture's Trustee self-assessment questionnaire. All management committee members and officers completed the questionnaire and the audit committee independently assessed the results. The audit committee expressed the view that the results of the exercise indicated that both the management committee and the chairman were fulfilling their roles satisfactorily.

Trustee knowledge and understanding

The Pensions Act 2004 relating to trustee knowledge and understanding came into force on 6 April 2006 together with the Pensions Regulator's accompanying code of practice. The management committee accepted a recommendation from the officers that the chairman of each principal committee produce a skills requirement profile for their committee and for each committee member to use the self-assessment questionnaire produced by Mercer Human Resource Consulting to identify their level of knowledge and understanding. All committee members and officers are currently completing the questionnaire and the results assessed against the skills requirement profile for each committee of which the individual is a member. The results will be used to provide each committee chairman with an analysis of the level of knowledge and understanding of members of their committee compared to the requirements identified in the skills requirements profile for that committee; and to identify any training needs for individuals or groups of committee members. Where appropriate, training sessions will be arranged to bridge any identified gaps.

Responsibilities of the management and the executive

The trustee company and the scheme are controlled through the management committee (the trustee company's board of directors) which meets at least five times a year. The management committee's main roles are to ensure that the scheme is adequately funded, that its standards of administration are at a level with which the members and participating employers are content, that the scheme's investment policy is appropriate for the scheme's liabilities and that the scheme continues to meet the developing needs of the UK higher education sector.


Jo Cunliffe, HR Manager.

The specific responsibilities reserved to the management committee include: determining the investment policy and investment management structure of the fund; setting long term strategy and approving an annual budget for the trustee company; reviewing investment, operational and financial performance; approving scheme mergers and major capital expenditure; reviewing the organisation's systems of financial control and risk management; ensuring that appropriate management development and succession plans are in place; approving the appointment of independent directors (subject, on initial appointment, to the approval of the joint negotiating committee), members of sub-committees of the management committee and senior management; approving staff remuneration policy; approving amendments to the scheme rules (subject to the approval of the joint negotiating committee); the admission of new institutions and removal of existing institutions; determining policy on treatment of participating employers who leave the scheme; determining the schedule of contributions; determining interest rates to be charged or paid in specific circumstances and settling claims in excess of £50,000 (up to £200,000, above which funding council approval would be required).

The management committee has delegated the following responsibilities to the chief executive and the officers of the trustee company: managing the trustee company against plans and budgets; stock selection and asset allocation decisions (within bands approved by the management committee); the development and recommendation of strategic plans for consideration by the management committee; implementation of strategies and policies established by the management committee and the exercising of trustee company discretion in the determination and payment of benefits. In particular, day-to-day investment decisions are the responsibility of the chief investment officer, reporting to the investment committee.

The roles of the chairman, the chief executive and the chief investment officer

The chairman leads the management committee in the determination of its strategy and in the achievement of its objectives. The chairman is responsible for organising the business of the management committee, ensuring its effectiveness and setting its agenda. The chairman has no involvement in the day-to-day business of the organisation. The chairman facilitates the effective contribution of each of the directors and constructive relations between the directors and the officers of the trustee company, ensures that directors receive accurate, timely and clear information and ensures that there is adequate communication with the scheme's stakeholders.

The chief executive has direct charge of the organisation on a day-to-day basis and is accountable to the management committee for the effective running of the trustee company and the provision of services to the institutions and membership of USS.

The chief investment officer is responsible for the investment performance of the internally managed fund and for monitoring the performance of the external investment managers and reporting on these matters to the investment committee.

Committee meetings

The number of full management committee meetings and other committee meetings attended by each director during the year are shown below. Figures in brackets indicate the maximum number of meetings in the period in which the individual was a member of the relevant committee.

	Management	Investment	F&GPC	Audit	Remuneration	Rules	Nominations
Sir Graeme Davies	7 (7)	–	–	–	–	–	2(2)
Scott Bell*	0 (3)	0 (2)	–	–	0 (2)	–	–
Professor John Bull	7 (7)	3 (4)	5 (5)	4 (4)	–	–	2(2)
Michael Butcher	7 (7)	–	–	–	1 (1)	–	–
Sir Martin Harris	7 (7)	–	5 (5)	–	–	–	–
Howard Jacobs	7 (7)	4 (4)	5 (5)	–	3 (3)	6 (6)	–
Lady Merrison	7 (7)	–	5 (5)	4 (4)	1 (1)	–	–
Sir Howard Newby**	4 (6)	–	–	–	–	–	–

	Management	Investment	F&GPC	Audit	Remuneration	Rules	Nominations
Michael Potts	6 (7)	–	5 (5)	4 (4)	2 (3)	–	–
Professor Charles Sutcliffe	6 (7)	4 (4)	–	3 (4)	–	–	2(2)
J W D Trythall	3 (3)	2 (2)	2 (2)	–	2 (3)	2 (2)	–
Baroness Warwick	6 (7)	–	5 (5)	–	3 (3)	–	2(2)
Virginia Holmes	3 (4)	2 (2)	–	–	–	–	–
Dave Guppy	4 (4)	–	3 (3)	–	–	–	–
Steve Egan	1 (1)	–	–	–	–	–	–

*Mr Bell was absent from a number of meetings due to ill-health.

**Sir Howard Newby was absent from a number of meetings due to a clash in dates with HEFCE board meetings.

Regular reports and papers are circulated to committee members in a timely manner in preparation for all committee meetings. These papers are supplemented by information specifically requested by committee members from time to time. The management committee papers include the minutes of the meetings of all the principal committees of USS.

Institutions

At 31 March 2006 there were 378 institutions which had become member institutions by completing a deed of accession. They comprised all the 'old' UK universities (ie those established prior to 1992), including the constituent schools and colleges of the universities of London and Wales, all the colleges of the universities of Oxford and Cambridge and 238 other institutions.

Changes in institutions participating occurred as follows:

New participating institutions:

St Benet's Hall*
Lhasa Limited
The Biochemical Society*
Society for Experimental Biology*
Arts and Humanities Research Council*
Liverpool University Press 2004 Limited
The Young Foundation
Educational Competencies Consortium Ltd
Florida State University IPA UK*
Open College Network Eastern Region
UK Socrates-Erasmus Council
The Challenge Fund Trading Company Ltd*
University of Wolverhampton*
Glasgow Caledonian University*
University of the West of England*
University of Bolton*
Canterbury Christ Church University*
University of Winchester*
Oxford Said Business School

* denotes an institution admitted only for employees who had been members of USS whilst in a previous employment.

Institutions which ceased to participate:

Ludwig Institute St Mary's Branch
Royal Institute of International Affairs
Brunel Institute of Organisation and Social Studies
University College Winchester
University of Cambridge Challenge Fund
International Research Foundation for Open Learning
The Arts and Humanities Research Board
Xceleron Ltd
Sams Ardtoe

Scheme membership

During the year 18,664 new members joined the scheme and at 31 March 2006 the total membership, including pensioners and those entitled to deferred benefits, was 226,400 compared with 214,900 a year earlier. Further details of the changes in membership during the year are contained in the section "Membership Statistics" on page 48 and over the five years ended 31 March 2006 in the Summary on page 77.

The proportion of eligible new employees of participating institutions choosing not to join USS was 17% compared with 18% last year.

Members are now able to share pension scheme benefits with their ex-spouse in the event of divorce. There were 3,063 requests for information up to 31 March 2006 and 226 ex-spouses now have benefits in the scheme in their own right as a result of pension sharing.

Expansion and flexibility

In February 2006 the trustee company lifted the moratorium on mergers with other pension schemes in the higher education sector. This followed a detailed review of the expansion policy during 2005, which concluded that it was appropriate for USS to continue to extend an option for schemes in the sector to merge with USS. Some of the terms for merging have changed, in that only limited benefit variations are acceptable for deferred and pensioner members that transfer, and there will be a limitation on the number of mergers undertaken in any one year (a maximum of three to four). The financial terms for merging remain largely unchanged.

The government's pensions reform

There have been major legislative changes during the year to implement the government's radical revisions to the occupational pension scheme environment. On 6 April 2005 a number of features of the Pensions Act 2004 came into effect, notably with the creation of the Pensions Regulator, which is the new regulatory body for work-based pension schemes in the UK. The Pension Protection Fund (PPF) also opened for business at the start of the year, to provide compensation to members of defined benefit pension schemes formerly operated by insolvent employers. During the year, USS has been in liaison with the Board of the PPF as it has developed its format for the risk-based levy, and USS has also confirmed itself as a "last-man standing" multi-employer scheme for the purposes of the PPF.

The Finance Act 2004 introduces changes to the tax rules governing pension schemes, with the revisions coming into effect on 6 April 2006 (known as A-day). Overall, the new rules provide a simpler framework within which registered pension schemes must operate, and during the year the trustee company has taken key decisions on the extent to which the new flexibilities might be adopted by USS (within the existing funding constraints). Detailed consultation has been undertaken with institutions on matters such as the new tax free cash limits, increased scope to pay additional voluntary contributions and treatment following the removal of the statutory earnings cap. Internal preparations for A-day have been progressed throughout the year putting the trustee company in a good position to administer the new arrangements in a timely and effective manner.

Rule amendments

During the year rule changes were considered by the committee which resulted in seven amending deeds being executed. Details of the rule amendments are given in the report of the joint negotiating committee on page 31.

Working parties

Over the year a number of working parties were set up to review and make recommendations on specific issues:

Expansion working party

At its meeting on 6 May 2005 the working party finalised its recommendations for the future policy for expansion of the scheme. During the year these recommendations were considered by the Finance and General Purposes Committee and Management Committee which has resulted in the lifting of the moratorium described in the "Expansion and flexibility" section above.

Irregular working party

The working party met on two occasions during the year to continue its development of refinements to the rules for members who have more than one pensionable employment. Meetings have also been held with relevant institutions to discuss some of the initial proposals and work will continue in 2006 to finalise the details of the recommendations to management committee.

Pension increases

Rule 15 of USS provides that pensions in payment, deferred pensions and deferred lump sums payable from the main section shall be increased in a similar manner to the increases provided for official pensions under the Pensions (Increase) Act 1971 (although increases on the amount of pension which represents the Guaranteed Minimum Pension (GMP) are treated differently - see below). USS pensions were increased by 3.1% on 21 April 2005.

On 21 April 2006 USS pensions which satisfied certain qualifying conditions and began before 26 April 2005 were increased by 2.7% with smaller increases applying for pensions which began after that date. Deferred pensions and deferred lump sums were increased by the same rate.

That part of the pension payable from the main section of USS which represents the pre-1988 GMP is generally not increased by USS as increases are paid by the Department of Work & Pensions Benefits Agency, as are increases in excess of 3% on that part of the pension which represents the post-1988 GMP. More detail on the way in which increases are applied to the GMP is given in the USS booklet *Pension Increases - Information for USS Pensioners* which has been issued to all USS pensioners and also on the USS website in the section 'Other Publications' entitled *Payment of Retirement Benefits*.

Rule 15 also provides that pensions payable from the supplementary section shall be increased to the extent that the trustee company, acting on actuarial advice, decides. As a result, pensions arising from the supplementary section were increased at the same rate as those that applied to the main section.

Contribution rates

The rates of contributions payable by members and institutions between 1 April 2005 and 31 March 2006 were as follows, unchanged from the previous year:

USS Main Section	Member	6% of salary
	Institution	14% of salary
USS Supplementary Section	Member	0.35% of salary
	Institution	Nil

Actuarial matters

The last full actuarial valuation of the scheme was carried out as at 31 March 2005. This revealed that the assets of the scheme at the valuation date were 77% of the accrued liabilities based on projected pensionable salaries with a past service deficit of £6,568 million. The institutions' contribution rate was maintained at 14% of annual salary and the employees' contribution rate was maintained at 6.35% of pensionable salary.

The results of the actuarial valuation were discussed at the meeting for representatives of USS institutions which was held in London on 1 December 2005. The full text of the actuary's report to the institutions' meeting has been published and copies were sent to all institutions in February 2006. It is also available on the USS Ltd website.

No changes were made to the funding objective or the method of valuation, which was a market value approach. The assumptions which have the most significant effect on the result of the valuation are those relating to the rate of return on investments (i.e. the valuation rate of interest) and the rates of increase in salaries and pensions. In relation to the past service liabilities the financial assumptions were derived from market yields prevailing at the valuation date. It was assumed that the valuation rate of interest would be 4.5% per annum, salary increases would be 3.9% per annum (plus an additional allowance for increases in salaries due to age and promotion in line with recent experience) and pensions would increase by 2.9% per annum. In relation to the future service liabilities it was assumed that the valuation rate of interest would be 6.2% per annum, including an additional investment return assumption of 1.7% per annum, salary increases would be 3.9% per annum (also plus an allowance for increases in salaries due to age and promotion) and pensions would increase by 2.9% per annum.

The actuary examined the mortality experience of active members and pensioners and was comfortable with maintaining the existing assumptions for deaths pre and post retirement based on that experience. He also maintained the same allowance for ill-health retirements as was adopted for the 2002 valuation, based on experience since the last valuation.

The result of the actuarial calculations is that the scheme has moved from having a past service surplus of assets over liabilities at 31 March 2002 of £162 million to a deficit of £6,568 million at 31 March 2005. There is a surplus of £56 million attributable to the supplementary section leaving a past service deficit of £6,624 million in the main section.

The actuary also carried out valuations of the scheme at 31 March 2005 on different bases. At that date, the scheme was 126% funded using the MFR prescribed assumptions introduced by the Pensions Act 1995 and 110% funded in terms of the Pension Protection Fund regulations introduced by the Pensions Act 2004. Although not referred to in the valuation report, and not a requirement for USS, the actuary estimated that the funding level at 31 March 2005 using the FRS 17 formula was approximately 90%.

The institution contribution rate required for the future service benefits alone is 14.3% of salaries. The management committee, acting on actuarial advice, deemed that it was not necessary or appropriate at this stage to adjust the contribution rate to cover the additional 0.3% and it was agreed that the institutions' contribution rate would remain at 14% of salaries.

As can be seen by the disparity between the MFR and PPF bases of valuation on the one hand and USS's own assumptions on the other hand, the USS assumptions have been and remain conservative. The scope for variation in the funding level is substantial, depending on the various economic circumstances that can arise. For example, increasing the valuation rate of interest by 1% would reduce the liabilities by approximately £4 billion and indeed the increase in the assets of the fund since 31 March 2005, referred to below, has considerably improved the position. The fund continues to enjoy a positive cashflow with the aggregate of contributions and investment income exceeding benefit payments and this is expected to continue for many years. USS is a long-term investor with long-term liabilities and addressing the deficit reported above does not necessitate precipitous short-term action.

Nevertheless, the management committee recognises that there are a number of issues which it, and indeed the sector, needs to address in the coming months which impact on the funding of the scheme. The increase in the promotional salary scale already experienced, the implementation of the new pay spine and the move to a more competitive recruitment market in higher education with the potential for further salary increases arising from the introduction of increased student fees are important factors. Also, improving mortality, the introduction of the Pension Protection Fund levy and new statutory funding regulations all put pressure on the funding of the scheme and increase the likelihood of an increase in the contribution rate at some point in the near future. These are issues which the management committee will be considering and on which it will be consulting with employers during 2006.

The actuary monitors movements in the funding level of the scheme on an ongoing basis and reports on this regularly to the USS committees and officers. The strong investment performance of the scheme has seen the funding level increase during the year and, as at 31 March 2006, the actuary estimated that the assets of the scheme had increased to approximately 89% of the liabilities. He also estimated that, on the FRS 17 basis, the scheme would be over 100% funded at that date.

Further information on the funding of the scheme is given in the trustee's funding statement on page 36.

Accounting matters

The financial statements of the scheme for the year ended 31 March 2006 are set out on pages 61 to 69; and the auditors' statement about contributions and trustee's summary of contributions are set out on pages 71 and 74. The financial statements have been prepared and audited in accordance with Sections 41(1) and (6) of the Pensions Act 1995.

The accounts of Universities Superannuation Scheme Limited (the trustee company) are set out in pages 78 to 89 and show an increase in operating costs from £25.1 million in 2004/2005 to £32.5 million in 2005/2006. This represents a 29% increase in administration costs (to £11.8 million) and a 30% increase in investment management costs (to £20.7 million).

The increase in administration costs is due almost entirely to the payment this year, for the first time, of the Pension Protection Fund levy of £2.6 million. The levy was introduced by the Pensions Act 2004. Excluding this amount, administration costs increased by approximately 1%.

The increase in investment costs is due partly to increases in the base fees of the external managers, which are linked to market values, and to the performance fee for one manager whose performance has significantly exceeded target.

Full details of the operating costs and a review of the activities for the year are given in the Directors' Report & Accounts on page 78.

Investment policy

The arrangements for management of the assets and custody, together with the approximate proportion managed by each manager at 31 March 2006, were as follows:

(a) 59.3% was managed internally by the trustee company's London Investment Office (with JP Morgan as custodian), of which 52.0% were securities (or alternative investments or cash) and 7.3% were property assets. The internally managed fund has a balanced mandate.

(b) 4.5% (which until 23 March 2006 had been managed by Goldman Sachs Asset Management International with a UK equity mandate) was held by the London Investment Office (with JP Morgan as custodian) in a transition account;

(c) 9.5% was managed by Capital International Limited (with State Street as custodian) with a global equity mandate;

(d) 9.6% was managed by Wellington Management Company (with State Street as custodian) with a global equity mandate;

(e) 3.8% was managed by Legal & General Investment Management (with State Street as custodian) with a UK corporate bond mandate;

(f) 12.1% was administered internally on the advice of HSBC James Capel Quantitative Techniques with a mandate to track the FTSE All-Share Index of UK equities (with JP Morgan as custodian);

(g) 1.1% was managed by Henderson Global Investors Limited with a mandate to provide an enhanced return to that of the FTSE All-Share Index of UK equities (with JP Morgan as custodian).

The year to 31 December 2005 was an excellent year for pension fund performance with positive returns for the average fund for the third consecutive year following three years of negative performance. The fund returned 24% for the year; comfortably ahead of its benchmark return of 22.8%.

Further details of the investment targets, investment performance and amounts managed by each manager are given in the report of the investment committee.

It is a requirement of the Pensions Act 1995 that the trustees of each pension scheme draw up and maintain a statement of investment principles. This statement must lay down the investment objectives of the pension scheme and explain why these objectives are suitable for the particular circumstances of the scheme. The management committee has taken the view that, for USS, this statement should provide significantly greater information about the management of the scheme's investments than is required under the Act. The statement was revised during the year to reflect the revised investment management structure. The final text, which was agreed following consultation with the participating employers, appears on pages 42 to 47.

The paragraphs on corporate social responsibility have been simplified from those which were included in the original statement which was first published in 1997. A more detailed briefing on this issue, which may be amended from time to time, and USS's policy statements on corporate governance, are published on the USS Ltd website, as is the full statement of investment principles.

Corporate governance

The directors of USS Ltd continue to acknowledge their responsibility for ensuring that the company has in place appropriate systems of internal control which are designed to give reasonable assurance that:

- financial information used within the scheme or for publication is reliable and that proper accounting records are maintained;
- assets are safeguarded against unauthorised use or disposition;
- the trustee company and the scheme are being operated efficiently and effectively;
- relevant legislation is complied with;
- appropriate risk management systems are in place.

Any system of internal control, however, can only provide reasonable and not absolute assurance against material misstatement or loss and cannot eliminate business risk.

The management committee of USS receives reports, generally on a quarterly basis, from the other main committees: the finance & general purposes committee, the investment committee, the audit committee, the remuneration committee, the rules committee, the joint negotiating committee, the nominations committee and the advisory committee. The functions of these committees are set out in the reports which follow this report.

Internal audit within the trustee company now consists of the head of internal audit and two full-time assistants, one of whom will be on maternity leave from August 2006. It reviews the operation of the internal control systems affecting the trustee company and the scheme and where relevant at external suppliers. Each year the head of internal audit, in conjunction with senior management, carries out a formal evaluation of the risks facing the organisation and the audit programme is determined in the light of this evaluation. The chief executive's senior management team considers regular reports from the head of internal audit and reviews the risk management and control process to consider whether any changes to internal controls, or responses to changes in the levels of risk, are required. Any weaknesses identified in these reviews are discussed with management and an action plan is agreed to address them. Through regular reports by the head of internal audit, the audit committee monitors the operation of the internal controls in force and any perceived gaps in the control environment.

The directors confirm that they have established internal control procedures such that they comply with the Turnbull Guidance in the Combined Code on Corporate Governance where relevant.

The management committee, through its audit committee, has reviewed the effectiveness of the process for identifying, evaluating and managing the key risks affecting the scheme.

Administration

The service provided to members and institutions continues to be monitored each quarter. Reports showing achievements compared with targets are reviewed by the finance & general purposes committee and are discussed at meetings of the institutions' finance officers' group, a liaison committee which met twice during the year. All statutory and internal targets have been met satisfactorily.

The annual meeting with institutions' representatives took place in London in December 2005 with a report of the proceedings available on our website.

The trustee company reviews its activities regularly in conjunction with its advisers to ensure that the scheme remains fully compliant with all relevant legislation and other requirements.

During the year there were five instances of late payment of contributions by institutions: one was the late payment of premature retirement scheme contributions and four were late payment of Prudential AVCs. Each late payment occurred as a result of an administrative problem or oversight by the institution concerned and in each case contributions were subsequently remitted in full. None of the late payments was required to be reported to the Pensions Regulator.

Member AVC contributions to the Prudential are no longer included in the schedule of contributions. However, the trustee company will report institutions to the Pensions Regulator where their payments of AVCs to the Prudential are consistently late. No such reports were made during the year.

The Pensions Regulator issued guidance in May 2005 on the circumstances in which trustees of occupational pension schemes should report late payments of contributions to the Pensions Regulator. The guidance covers the period until a scheme becomes subject to the new scheme funding requirements, and confirms that trustees are only required to report where late payment constitutes a significant risk to the members' interests or the payment is still outstanding after 90 days.


Kathy Jones, Admin Secretary.

Dispute resolution procedures within USS Ltd provide for the pensions operations manager, on the application of a complainant, to give a decision on a dispute and for the trustees or managers, on the application of the complainant if they are unhappy about that decision, to review the matter in question and either confirm or alter the decision. The review is undertaken by the advisory committee, augmented for this purpose alone by two members of the management committee (one nominated by UUK and the other by UCU). The augmented advisory committee met on four occasions to consider the decisions given by the pensions operations manager at stage one of the internal dispute resolution procedure. Four cases were considered and the stage one decision taken by the pensions operations manager was upheld in two cases. In the two other cases the enlarged advisory committee did not uphold the stage one decision and used its wider powers to make a recommendation for an award to be granted.

Since the statutory prohibition in April 1988 of compulsory membership of occupational pension schemes as a condition of employment, now contained in Section 160 of the Pension Schemes Act 1993, around one sixth of employees eligible to join USS have elected not to do so, which means that they will either be participating in the State Second Pension or have a personal or stakeholder pension, or a combination of these arrangements. It should be noted that the rules of USS prevent an institution from paying contributions (in respect of an "eligible employee" under the rules) to a pension arrangement other than USS.

Regulatory changes for A-day came into force on 6 April 2006. During the year our pensions administration processes and systems were updated, training was provided to USS Ltd staff and policy updates were provided to the institutions. The officers carried out a review during the year of the potential systems to replace the scheme's existing pensions administration software, the Universal Pensions Management System (UPM) from Comino plc. In July 2005 the trustee company decided that Comino's replacement software, UPM version 2, was the best solution for the company's business needs. Following a detailed feasibility study and extensive contractual negotiations, the project to replace the pensions administration system commenced in February 2006 and the application was successfully implemented to our test environment in March. The new system is scheduled to go live during 2007/08.

Retirement age for deferred members

In accordance with the Court Order agreed on 29 April 2004 we wrote to all institutions asking for details of the contractual terms used for past and current members of USS. We wanted to establish whether the contracts issued by institutions expressly or implicitly granted a right to retire before age 65 on an unreduced pension. Where a member had such a right, that member's contractual pension date was the earliest date he/she would be entitled to retire on an unreduced pension from USS under the terms of his/her appointment or contract of employment.

Retirements team: *From left* - Steve Worthington, Jane Hughes, Helen Charnock, Uche Egenti, John Kenyon, and Robert Grimson.

From this information we identified which former members of the scheme, who had retired or transferred their benefits out of USS, would be entitled to an additional payment. This information also enabled us to identify the date that current deferred pensioners in the scheme could draw their benefits without actuarial reduction.

We amended our procedures to collect this information for all new members of the scheme and to note any changes in contractual pension date when a member moves between institutions. This is because benefits are based on a member's contractual pension date in respect of his/her final appointment prior to leaving the scheme.

The benefits relating to members affected by the Court Order were recalculated for pensioners, private transfers-out, deferred and deceased members. The club transfers were placed on hold whilst USS Ltd awaited agreement from the Cabinet Office on a proposed administration charge which the club schemes required before they would accept the revised transfer payments.

The total sum paid out under this exercise by way of additional benefits as at 31 March 2006 has been included in the financial statements of USS.

It is accepted that that there will be ongoing claims for payments beyond this date as a number of contractual pension dates cannot be established and there may be members who cannot be easily traced.

Communications

The programme of member presentations included 48 institution visits, addressing approximately 6,700 members. The number of members attending during the year was substantially higher than in previous years due to the larger amount of press coverage about pension schemes generally but in particular the A-day changes from April 2006.

We have continued to develop the website throughout the year to provide more information to members and institutions. The benefit modeller was amended to comply with the new A-day regulations and to provide details of the new retirement cash options. Also changes were made to the AVC modeller to reflect the new maximum added years AVC contribution of 15% and the removal of the 40 years' maximum service restriction.

Further information about Prudential has been added for members, which includes bonus reports, fund reports and bonus rates.

The communications team now have the facility to update a number of website pages in-house which has resulted in a cost saving on the monthly maintenance fee.

The institution advisory panels continued to meet during the year. There are currently 23 institutions represented on the panels and they provide very valuable feedback on proposed changes and new procedures. Feedback from the panel has been used to trial the UPM web access system. This is now live with around 130 institutions and 270 users.

An A-day modeller, which was sent to around 2,000 high earners, was well received with positive feedback from those who have used it. The release of this was followed up with high earner presentations at various institutions.

During the year a full review of all USS publications was made. The new *guide for members* was issued prior to April 2006 together with the service statements. Additionally a CD-Rom was issued with the member guides launching 'USS Pensions TV'. Pensions TV is a series of presentations explaining various aspects of the scheme; these presentations can be viewed on a PC with the CD-Rom or via the USS website. Three programmes were included with the initial launch with more planned for the future.

Financial advice is something many of our members have requested in the past and particularly leading up to April 2006, many members had some very important financial decisions to make. An agreement with the Personal Finance Society lead to 230 financial advisers receiving direct training from USS Ltd on the scheme. Once the advisers receive this training their details appear on the USS website for members to access financial advice. The advisers were selected on their qualifications, being the highest level of retirement planning qualifications awarded by the Chartered Insurance Institute (CII).

Workshops were also held during the year to explain the changes to USS from April 2006 to institution contacts.

Disclosure requirements

The general rights which members and beneficiaries have always had to request information under trust law have been greatly supplemented by statutory disclosure requirements which now apply under the Occupational Pension Schemes (Disclosure of Information) Regulations 1996. Where the requirement is for a document to be available for reference by an interested person, it is met by the provision to each institution from our Liverpool office of a Disclosure Kit containing the required documents. Other information, for example *A Guide for USS Members*, must be provided to every new member and supplies are available from our Liverpool office to enable institutions to issue them as part of their appointment procedures. Individual statements are required on the occurrence of certain events such as leaving service, retirement or death and these are provided by our Liverpool office as part of the processing of such benefits.

Enquiries about the scheme generally or about an individual's entitlement should be sent to the trustee company's registered office.

Transfer values paid during the year were determined in accordance with the Pension Schemes Act 1993 and appropriate regulations. No transfer values paid represented less than their full cash equivalent.

USS has had no employer-related investments during the year.

Acknowledgements

The chairman would like to thank his predecessor, Sir Graeme Davies, for his significant contribution to the board during nearly 18 years' service on the management and other committees, including 10 years as chairman. During this time he played a significant role in leading the scheme through many changes and a substantial growth in both the membership and assets. His wise counsel was of immense value.

He would also like to thank Mr J W D Trythall for his considerable contribution during nearly 18 years' service on the management and other committees. Prior to being an AUT appointed director in October 1988 he was an AUT appointee to the JNC for over three years. Mr Trythall remains as the UCU appointee to the rules committee and continues to be a significant contributor in this area.

Mr J P Williams retired as company secretary on 31 July 2005. John was involved with USS since the beginning of the scheme and the trustee company is appreciative of his dedication to the organisation and the service that he has given since 1974.

The management committee wishes them all a long and happy retirement.

The management committee also wishes to record once again its appreciation of the services given by all those who are concerned with the administration and management of USS, including the staff of the trustee company in Liverpool and London and the officers of the institutions which participate in the scheme. It wishes also to thank the various USS consultants and advisers who, by their specialist knowledge and experience, make a valuable contribution to the work of the trustee company.

Signed on behalf of the management committee.

Sir Martin Harris
Chairman

INVESTMENT COMMITTEE

The investment committee advises the trustee company on all matters relating to the investment of the fund's assets. Throughout the report, performance returns relate to calendar years, which is the investment industry standard.

Highlights

- Stock markets were strong in 2005 with the fund returning 24% after rising 8.9% in 2004. The 10-year return on the fund stands at 7.9% per annum compared with earnings growth of 4.6% per annum and retail price inflation of 2.6% per annum. Including net cash flow and capital movements the value of the investments in the fund rose from £21.7 billion at 31 March 2005 to £28.2 billion at 31 March 2006.
- The investment committee, as mentioned in last year's report, has now completed its review of investment policy and concluded that the fund should invest up to 5% of its total assets in alternative investments by 2008, with consideration to be given to increasing this to 20% over the medium term, and reduce its equity holdings by an equivalent amount. The rationale for this move is that such assets (private equity, infrastructure, commodities and currencies) can achieve similar returns to equities whilst at the same time enhancing the risk diversification of the fund, which is otherwise invested purely in equities, bonds and property. An asset liability modelling exercise was completed as part of the review and endorsed this decision.
- The investment committee also concluded as part of this review that some assets that had previously been managed externally would be brought back in-house to be managed by the internal investment team. As a result Goldman Sachs were relieved of their mandate to run a high performance UK equities portfolio in March 2006. In June 2006, Legal and General and Henderson were relieved of their corporate bond mandate and enhanced UK equity index mandate respectively. All the assets from the Goldman Sachs and Legal & General portfolios are now run by the USS investment team on active UK equity and bond strategies. The Henderson portion will be taken into the UK index fund.
- USS continues to take a leading stance on corporate governance and other extra financial issues as described in the paragraph on responsible investment below. The underlying theme remains to encourage investors and those companies in which they invest to give appropriate weight to issues likely to affect value in what, by most conventional investment criteria, is the comparatively distant future, e.g. 5, 10 or even 20 years time.


Fitzwilliam House, London

Investment management

The fund's investments are divided between those under the direct control of USS Limited and those managed externally. The internal investment team at the London Investment Office (LIO) manages the majority of the assets. A separate fund designed to match the performance of the FTSE All Share is run in house on advice provided by HSBC Quantitative Techniques. Henderson Global Investors ran part of the All Share Index Fund on an enhanced performance basis until June 2006. The balance of the fund is run on specialist mandates with Capital International and Wellington having a global equity remit.

Goldman Sachs ran a UK equity portfolio until the end of March 2006 and Legal and General a corporate bond mandate until June 2006. All these managers were rewarded partly on an ad valorem basis and partly on their performance.

Because of the move towards a greater proportion of the fund in alternative asset classes a number of smaller managers and vehicles are being employed to facilitate this. The largest of these managers, running more than £200 million in infrastructure projects, is Capital Partners, who have been in place since September 2005.

Jones Lang LaSalle and DTZ Debenham Tie Leung advise on investment and property management of the retail and commercial portions of the property portfolio respectively. For these services they are remunerated primarily through a management fee and in some cases they may benefit from transaction fees. The investments are stated at market value and details of the changes and values are summarised in note 9 of the USS accounts on page 66.

Responsible investment

The committee believes that the members of USS are best served by the investment professionals who have direct stewardship of USS's assets giving due consideration, as an integral part of their investment decision making, to extra financial issues such as good corporate governance practices and sound management of social and environmental issues. This is of particular importance given that the fund is receiving money for investment today to receive pensions which in some cases will still be in payment in more than 50 years time.


Golden Square, London

The responsible investment team has implemented USS's strategy of being an active and responsible owner, playing a leading role in a number of initiatives which the committee believes will both protect and enhance the value of the fund over the long term. Examples include assessing the investment risks associated with climate change (by membership of the Institutional Investors Group on Climate Change), the investment risk relating to the pharmaceutical sector business model (via PharmaFutures) and with corporate governance practices particularly in the US. The enhanced analytics initiative, to which USS provides financial and human resource support, remains an important part of our strategy going forward in our endeavours to include extra financial issues in investment research.

More broadly the committee is encouraged that several major pension funds are now voicing support for a more long-term approach to investment management. USS has been involved from the outset of this debate and learning from such projects as the Marathon Club is being integrated into all aspects of how USS operates. This is an ongoing project.

AL INVESTMENTS OF THE FUND

f Investment	Fixed Interest £m	Equities £m	Other £m	Properties £m	Cash and Equivalent £m	31 March 2006 Total £m	Total %	31 March 2005 Total £m	Total %
tments under the t control of USS Ltd									
d securities									
K	86.1	4,966.6	–	–	–	**5,052.7**	**17.9**	**4,286.4**	**19.8**
verseas	799.6	8,381.4	–	–	–	**9,181.0**	**32.5**	**6,414.8**	**29.6**
rty									
K	–	–	–	2,056.4	–	**2,056.4**	**7.3**	**1,799.6**	**8.3**
Stockbroker balances									
K	–	–	–	–	502.7	**502.7**	**1.8**	**155.0**	**0.7**
verseas	–	–	–	–	(285.5)	**(285.5)**	**(1.0)**	**76.6**	**0.4**
tion (formerly GSAM)									
K	–	1,238.3	–	–	8.6	**1,246.9**	**4.4**	**–**	**–**
verseas	–	24.7	–	–	2.5	**27.2**	**0.1**	**–**	**–**
ative investments									
K	–	36.4	3.1	–	–	**39.5**	**0.1**	**–**	**–**
verseas	–	192.8	–	7.9	14.8	**215.5**	**0.8**	**–**	**–**
otal	885.7	14,840.2	3.1	2,064.3	243.1	**18,036.4**	**63.9**	**12,732.4**	**58.7**
tments managed internally e basis of external advice									
fund									
K	–	3,390.1	–	–	27.7	**3,417.8**	**12.1**	**2,659.1**	**12.3**
verseas	–	1.9	–	–	–	**1.9**	**–**	**–**	**–**
tments managed externally ive)									
erson									
K	–	323.6	–	–	–	**323.6**	**1.1**	**252.8**	**1.2**
verseas	–	–	–	–	–	**–**	**–**	**–**	**–**
otal	–	3,715.6	–	–	27.7	**3,743.3**	**13.2**	**2,911.9**	**13.4**
tments managed externally ve)									
al International									
K	–	373.0	–	–	42.4	**415.4**	**1.5**	**312.1**	**1.4**
verseas	–	2,253.5	–	–	7.5	**2,261.0**	**8.0**	**1,665.0**	**7.7**
ngton									
K	–	198.6	–	–	2.8	**201.4**	**0.7**	**220.9**	**1.0**
verseas	–	2,454.3	–	–	59.2	**2,513.5**	**8.9**	**1,821.9**	**8.4**
M									
K	–	–	–	–	–	**–**	**–**	**1,021.9**	**4.7**
verseas	–	–	–	–	–	**–**	**–**	**–**	**–**
& General									
K	1,041.3	–	–	–	33.7	**1,075.0**	**3.8**	**997.2**	**4.6**
verseas	–	–	–	–	–	**–**	**–**	**–**	**–**
otal	1,041.3	5,279.4	–	–	145.6	**6,466.3**	**22.9**	**6,039.0**	**27.9**
investments									
K	1,127.4	10,526.6	3.1	2,056.4	617.9	**14,331.4**	**50.7**	**11,705.0**	**54.0**
verseas	799.6	13,308.6	–	7.9	(201.5)	**13,914.6**	**49.3**	**9,978.3**	**46.0**
	1,927.0	23,835.2	3.1	2,064.3	416.4	**28,246.0**	**100.0**	**21,683.3**	**100.0**
entage at 31 March 2006									
K	4.0	37.2	–	7.3	2.2		**50.7**		
verseas	2.8	47.2	–	–	(0.7)		**49.3**		
l percentage	6.8	84.4	–	7.3	1.5		**100.0**		
l percentage at 31 March 2005	7.9	82.0	–	8.3	1.8				**100.0**

USS investment performance results

The fund's benchmark is as follows:

UK equities	40%
Overseas equities	40%
Fixed interest	10%
Property	10%

The performance of the various fund managers for the year to 31 December 2005 is shown below:

	% Fund Return	**% Benchmark Return**
LIO	26.7	23.4
Capital International	27.1	26.5
Wellington	26.5	26.7
Goldman Sachs	19.3	22.0
Legal & General	8.7	9.0
UK Index	21.8	22.0
Henderson Enhanced Index	21.6	22.0
Property	16.2	19.4
Total Fund	24.0	22.8

The property portfolio continued to underperform returning 16.2% during the year against its benchmark of 19.4%. Over the 10 year period the property portfolio has returned 11.9% per annum versus a benchmark return of 12.7% per annum.

The total fund return, including property, was 24% in 2005 against a benchmark of 22.8%. Over the 10 year period the fund has returned 7.9% per annum against a blended benchmark of 8.7% per annum.

Property

The UK property market, as measured by the IPD Universe, produced a strong total return of 19.4% in 2005. The key driver of returns was inward yield shift, with capital values growing by 11.8% compared to a 2.7% increase in rental values. The IPD all property equivalent yield fell by 70 bps. Although equities were the best performing main asset class in 2005, property continues to be the best performer on a 5 and 10 year basis.

Strong investment demand has continued to force yields further downward in 2006. In the twelve months to the end of March 2006, the IPD Monthly Index returned 4.4% (20.9% year on year). This pressure has caused the IPD equivalent yield to break the 6% barrier for the first time, with initial yields falling to 5%. The continued inflow of investment into the UK property market is expected to result in further yield compression during the remainder of 2006.

The office sector has become the best performer, driven by the Central London markets, where rental growth is again being seen. Offices are widely forecast to continue to provide the strongest returns in the short to medium term. The outlook for the retail sector is less encouraging than in recent years, with returns from retail warehousing also slowing. Industrial rental growth is expected to be subdued, although investors are likely to continue to be attracted by the marginally higher than average income yield offered by the sector.

New property acquisitions for the fund have included Manchester Fort Shopping Park, a recently completed major retail warehouse scheme, together with a freehold office investment located in Golden Square, London W1. These totalled £208.3m. Investments were also made in two European indirect vehicles: Henderson's European Retail Property Fund and the Rutley

European Property Fund Ltd. Disposals were dominated by the £126.9m portfolio sale of a number of office and industrial properties, including Viables, Basingstoke (which completed after the year end); Camborne Business Park, Cambridge; Kingsthorne Park, Livingstone; and 3 Longwalk, Stockley Park.

Graham Burnett, Head of Property

The three largest properties (Manchester Fort Shopping Park, Telford Shopping Centre and the Gyle Shopping Centre) worth a total of £840million were transferred in March to three separate property unit trusts in exchange for units in the unit trusts. The fund is now in a position to be able to reduce its interests in those properties by selling units rather than having to sell a whole property. This will increase flexibility, enabling (if necessary) more gradual changes to the structure of the whole portfolio to be made.

Construction works are advancing at Grand Arcade Cambridge. This major shopping centre development is being undertaken by the fund in partnership with Grosvenor Ltd. The John Lewis department store is programmed to open in readiness for Christmas trading 2007, with the shop units following in spring 2008. With regard to Trinity Quarter, Leeds, the Public Inquiry relating to the Compulsory Purchase Order concluded in April, with the Inspector's decision expected Autumn 2006.

The fund's property portfolio produced a total return of 16.2% in the year to December 2005, underperforming the 19.4% return achieved by the benchmark of the IPD Universe. The direct property portfolio was independently valued by Drivers Jonas as at 31 March 2006 at £1,042.3m and a breakdown by sector and tenure is shown below, together with details of the indirect property investments.

	Freehold £m	**Leasehold £m**	**Indirect £m**	**Total £m**	**%**
Retail	50.0	35.7	670.2	755.9	36.8
Retail warehouse	247.3	–	226.0	473.3	23.0
Office	295.3	60.8	–	356.1	17.3
Industrial	251.4	33.4	–	284.8	13.8
Agricultural	0.6	–	–	0.6	–
Developments	66.3	–	76.8	143.1	7.0
European	–	–	4.6	4.6	0.2
Mixed fund	–	–	36.5	36.5	1.8
Other	1.5	–	–	1.5	0.1
TOTAL property	912.4	129.9	1,014.1	2,056.4	100.0

DISTRIBUTION OF ASSETS

The portfolio distribution as at 31 March 2006, along with the comparative figures for the preceding year, is set out below:

	2006			2005		
	£m	£m	%	£m	£m	%
UK fixed interest						
British Government						
Conventional	144.7			222.4		
Index-linked	–			–		
Other debentures & loan stocks	982.7			924.8		
		1,127.4	4.0		1,147.2	5.3
Overseas fixed interest						
North America	226.3			316.2		
Europe	354.9			99.9		
Japan	218.4			143.7		
Far East	–			–		
Other	–			–		
		799.6	2.8		559.8	2.6
Total fixed interest		1,927.0	6.8		1,707.0	7.9
UK equities						
Resources	1,596.1			1,430.0		
Basic industries	791.1			259.4		
General industrials	871.5			285.6		
Consumer goods	856.8			1,402.7		
Services	2,747.3			2,211.7		
Utilities	366.9			291.2		
Information technology	120.8			149.7		
Financials	2,846.7			2,195.9		
Collective investment schemes	5.7			3.2		
Managed funds	326.8			252.8		
Derivatives	–			–		
		10,529.7	37.2		8,482.2	39.1
Overseas equities						
America	3,431.6			2,587.6		
Japan	2,890.2			1,761.2		
Europe	4,065.2			2,853.1		
Far East	2,439.5			1,761.9		
Other	490.0			345.0		
		13,316.5	47.2		9,308.8	42.9
Total equities		23,846.2	84.4		17,791.0	82.0
Total securities		25,773.2	91.2		19,498.0	89.9
Property (incl. indirect property)		2,056.4	7.3		1,799.6	8.3
Cash deposits		300.1	1.1		280.6	1.3
Other Investment balances		116.3	0.4		105.1	0.5
Total investments		28,246.0	100.0		21,683.3	100.0

LARGEST EQUITY HOLDINGS

A list of the fund's largest twenty equity holdings together with the percentage of the fund which they represent, is shown below:

	Value £m	%
BP	709.6	2.5
Royal Dutch Shell	671.4	2.4
HSBC Hldg	590.2	2.1
Glaxosmithkline	521.5	1.8
Vodafone Group	512.6	1.8
RBOS	356.6	1.3
Astrazeneca	314.7	1.1
BHP Billiton	276.8	1.0
Barclays	258.8	0.9
Rio Tinto	250.2	0.9
HBOS	195.0	0.7
Lloyds TSB Group	188.9	0.7
Anglo American	186.1	0.7
Total SA	185.9	0.7
BG Group	152.7	0.5
Tesco	149.3	0.5
Prudential	144.7	0.5
British American Tobacco	134.7	0.5
BAE Systems	134.3	0.5
Bank of America	133.6	0.5
	6.067.6	21.6

A list of all the fund's holdings along with corporate governance issues is available on our website: **www.usshq.co.uk**

Signed on behalf of the investment committee

V Holmes
Chairman

FINANCE & GENERAL PURPOSES COMMITTEE

The finance & general purposes committee was established under the authority of the management committee in January 1984.

Its purpose is to consider and report to the management committee on any matters relating to the structure and management of USS Ltd as the corporate trustee of USS, other than those which have been allocated to the investment, audit, remuneration and rules committees.

In essence, inter alia, it:

- Undertakes detailed work on behalf of the management committee and makes recommendations to it on major policy issues.
- Gives preliminary consideration to major issues, which it is intended should be brought to the management committee.
- Oversees the detail of revisions to the USS Ltd risk management profile and policy and submits annual reports to the management committee.
- Gives detailed consideration to financial estimates and performance against estimates.
- Approves capital expenditure with limits agreed by the management committee.
- Monitors communication with, and levels and quality of service provided to, member institutions and individual members.

The committee members are appointed by the management committee and currently comprise seven members. Of the committee's seven members, three are UUK appointees to the management committee, two are AUT (now UCU) appointees and two are co-opted appointees. Mr A S Bell retired on 31 July 2005 and Mr J W D Trythall on 31 August 2005. We thank Mr Bell and Mr Trythall for their significant contribution as committee members. Mr D Guppy was appointed to the committee with effect from 1 September 2005.

During the year, the committee met on five occasions and considered matters such as the actuarial valuation of USS, cross-border pension activities, preservation, expansion of USS, insolvency and withdrawal of institutions from USS, the admission of new institutions to USS, corporate performance of USS Ltd, USS Ltd's business plan and the government's pensions reform.

Signed on behalf of the finance & general purposes committee.

Professor John Bull
Chairman

AUDIT COMMITTEE

The audit committee was established under the authority of the management committee in March 1982.

Its purpose is to consider and report on any matters relating to internal control systems, financial reporting arrangements and corporate governance.

In essence, it examines management's processes for ensuring the appropriateness and effectiveness of systems and controls and arrangements to ensure compliance with standards and arrangements under appropriate regulatory systems.

In addition it:

- Reviews the scope, planned programmes of work and findings of both the internal and external auditors and the compliance officer.
- Ensures that the accounting and reporting policies are in line with legal requirements, Financial Services Authority and other appropriate regulatory body requirements and best practice.

The committee members are appointed by the management committee and currently comprise five members; one is a UUK appointee to the management committee, two are AUT (now UCU) appointees and one is a co-opted appointee. The committee is chaired by Dr Christine Challis, an independent appointment made by the management committee. More than one member of the committee possesses what the Smith Report describes as recent and relevant experience. During the year, the committee met on four occasions. It has also met with the external auditor and the internal auditor privately each on one occasion without any officers being present. During the year, the committee has, inter alia:

- reviewed the accounts of both the trustee company and the scheme prior to approval by the management committee;
- reviewed the the external auditor's strategy for the audit of the accounts of the trustee company and the scheme;
- reviewed the internal audit function's terms of reference, its work programme and quarterly reports on its work during the year;
- received regular reports from the compliance officer;
- overseen an appraisal of the performance of the management committee and the chairman;
- expressed its continued satisfaction with USS Ltd's approach to identifying and dealing with risks to its business.

Signed on behalf of the audit committee.

Dr C Challis
Chairman

REMUNERATION COMMITTEE

The remuneration committee considers and reports on matters relating to the employment, remuneration and termination of contracts for employees within USS Ltd. It sets salaries, pay levels and performance criteria by which all staff are rewarded, with the exception of the chief executive and the chief investment officer.

The salary of the chief executive is determined following discussions between the chairman of the remuneration committee and the chairman of the management committee. The salary of the chief investment officer is determined following discussions between the chairman of the remuneration committee, the chairman of the investment committee and the chairman of the management committee.

The committee's members are appointed by and from the management committee and currently comprises five members; two are UUK appointees to the management committee, one is an AUT (now UCU) appointee and two are co-opted appointees of whom one, Mr Jacobs, is the chairman. Mr A S Bell retired on 31 July 2005 and Mr J W D Trythall on 31 August 2005. They were succeeded on 1 January 2006 by Mr M Butcher and Lady Merrison respectively. We thank Mr Bell and Mr Trythall for their significant contribution as committee members.

The committee met on three occasions during the year. Matters which have been considered include:

- salary awards to employees at the Liverpool and London offices;
- the remuneration and pay scales at the London office;
- London office bonus scheme;
- employment statistics within both the Liverpool and London offices;
- the Finance Act 2004 and its effects on the statutory earnings cap;
- reviewing corporate risk profile document.

As a result of its considerations, the committee is satisfied that the management committee can be assured that the present arrangements enable the trustee company to recruit, retain and motivate employees at both the Liverpool and London offices.

Signed on behalf of the remuneration committee.

H R Jacobs
Chairman

JOINT NEGOTIATING COMMITTEE

The functions of the joint negotiating committee are to approve amendments to the rules proposed by the trustee company, to initiate or consider modifications to the rules in conjunction with the rules committee and to consider any alterations proposed by the advisory committee arising out of the operation of the rules. The joint negotiating committee also has powers under the Articles of Association of the trustee company and under the scheme rules in connection with the appointment of co-opted directors and with the remuneration of directors.

With effect from 1 September 2005, Mr A Carr and Dr A Roger replaced Mr D Guppy and Ms J McAdoo as AUT (now UCU) representatives and with effect from 1 January 2006, Mr C O Vidgeon replaced Dr S G Fleet as a UUK representative.

The committee met on five occasions during the year. Rule changes were considered by the committee which resulted in five amending deeds being executed (Second to the Sixth Supplemental Amending Deeds). These amending deeds introduced the following changes to the USS rules:

- The second supplemental amending deed, which was executed on 23 June 2005, ensures compliance with certain provisions in the Pensions Act 2004. The Act introduced a new requirement upon occupational pension schemes to ensure that periods of paid paternity leave and paid adoption leave are treated for pension purposes in the same manner as applies to periods of paid maternity leave.
- The third supplemental amending deed, which was executed on 4 August 2005, revises the definition of 'eligible employee' under the scheme so as to be compatible with the Framework Agreement for the Modernisation of Pay Structures, which is being adopted across the higher education sector.
- The fourth supplemental amending deed, executed on 21 October 2005, introduces an amendment to the definition of 'funding council' in the scheme rules. This change is introduced as a result of the dissolution of the Scottish Higher Education Funding Council (SHEFC), and specifies that the Scottish Further and Higher Education Funding Council will assume SHEFC's role for USS purposes.
- The fifth supplemental amending deed, which was executed on 23 February 2006, facilitates enhanced protection (a new feature introduced by the Finance Act 2004) within the USS rules for individuals with large pension values, and also deals with the application of tax charges to individuals with pension values in excess of the permissible levels.
- The sixth supplemental amending deed, also executed on 23 February 2006, introduces changes to the rules of USS to provide for pensions in respect of civil partnerships.

The committee continued its consideration of the government's pensions reform proposals, which provide for some of the most radical changes seen for many years affecting pension schemes. Significant amendments to the scheme, in relation to areas such as new limits for tax-free cash, increased scope to pay additional voluntary contributions, and dealing with members affected by the statutory earnings cap, have received detailed consideration with solutions developed within an overall cost-neutral environment.

The committee has also considered the scheme's status under the Pension Protection Fund, and has expressed views to the management committee on the proposal to position the scheme as last man standing for those purposes. Administrative problem areas have been brought forward to the committee for consideration, and amendments have been made to the scheme's policy in relation to (i) members joining the scheme at or after age 60, and (ii) members retiring before age 60 and the application of reductions to transferred-in benefits (known as the seven-year rule).

The working party of the JNC dealing with employees who hold regular and variable-time employments met on two occasions during the year, and has continued to develop solutions to deal effectively with members who have more than one employment (and in particular where one of those employments is variable time). The working party's activities continue into 2006.

Signed on behalf of the joint negotiating committee.

Sir Kenneth Berrill
Chairman

ADVISORY COMMITTEE

The functions of the advisory committee are to advise the trustee company on the exercise of its powers and discretions (other than those relating to investment matters), on difficulties in the implementation or application of the rules and on any complaints received from members or participating institutions, and any other matters on which the trustee company requires advice.

Four meetings were held during the year. Dr Roger fulfilled the role of chairperson throughout the year.

The majority of questions raised on the application or interpretation of the rules of USS were dealt with by the senior officers. There were three cases which required detailed consideration by the advisory committee during the year. These cases were all related to members requesting full commutation of their benefits on the grounds of serious ill-health. In each case the full commutation was granted.

It was necessary for the committee, enlarged by two members of the management committee, to meet on four occasions during the year to consider the decision given by the pensions operations manager at stage one of the internal dispute resolution procedure. The second stage considerations were as follows:

- A member complaining about delays affecting his transfer value into the scheme - the committee recommended an award of £500 as a gesture of goodwill.
- A member complaining that they had been missold their AVC contract by the Prudential - the committee decided not to uphold the member's complaint.
- A member complaining about the distribution of the death benefits when his ex-partner died - the committee decided not to uphold the member's complaint.
- A member complaining that his benefits had been overstated and that he had suffered to his detriment as a result of this statement - the committee acknowledged that maladministration had occurred and upheld the member's complaint recommending that an award of £4,000 be paid to the member as compensation.

Signed on behalf of the advisory committee.

Dr A Roger
Chairperson

RULES COMMITTEE

In conjunction with the officers and the scheme's professional advisers, the rules committee devises and maintains procedures for all aspects of the rule amendment process, having particular regard to the desirability of simplifying those rules which are most complex, whether in terms of intelligibility or of administration.

During its third year the committee has overseen the Second to the Sixth Supplemental Amending Deeds, further details of which are included in the report from the joint negotiating committee. The committee has also been involved in the following activities:

- Overseeing the implementation of the pensions reform project within the trustee company, so that the rule amendments necessary as a result of the introduction of the Finance Act 2004 and the Pensions Act 2004 were executed effectively, and ensuring that the necessary changes to internal systems, administrative procedures and communication material were undertaken.
- Assisting with the development of the trustee company's response to the cross-border regulations.
- Agreeing the format of the rule amendments and procedural changes necessary to update the USS rules so as to be compatible with the implementation of the Framework Agreement in the higher education sector.
- Continuing the ongoing work to review administrative problem areas and propose alternative solutions.
- Providing technical information to the management committee, and finalising the rule amendments necessary, to secure USS as a 'last man standing' scheme for the purposes of the Pension Protection Fund.

The committee met on six occasions during the year.

Signed on behalf of the rules committee.

H R Jacobs
Chairman

NOMINATIONS COMMITTEE

The nominations committee was established under the authority of the management committee to deal with all matters relating to the appointment of co-opted directors and to make appropriate recommendations to the management committee.

The committee's members are appointed by the management committee and comprise the chairman of the trustee company, a UUK appointed director, an AUT (now UCU) appointed director and a co-opted director who acts as chairman. The committee supplements that membership to include, if necessary, expertise appropriate to the particular appointment.

The committee met on two occasions during the year to select and recommend to the management committee a successor to Mr Bell who retired on 31 July 2005.

Signed on behalf of the nominations committee.

Professor John Bull
Chairman

TRUSTEE'S FUNDING STATEMENT to members for the year ended 31 March 2006

Introduction

This funding statement gives some of the background and detail surrounding the nature of USS and its financial position. A number of different circumstances are considered (for example if circumstances continue exactly as they are, if all the members were to leave and transfer their benefits to other arrangements immediately and if the scheme were to be wound-up).

It is not designed to give all the details or implications of the funding of the scheme nor is it a communication which covers the particular circumstances of individual members. It is aimed at giving background information regarding the scheme, such as:

- the general funding of the scheme;
- the investment strategy of the scheme; and
- the contribution strategy of the scheme.

This information should help members to understand better how the trustee company, with its advisers, is looking after the scheme and seeking to deliver members' benefits over the long-term.

A summary funding statement will be sent to every member of the scheme each September starting in September 2006. This trustee's funding statement gives a little more detail on the matters covered in the summary statement.

Overview

The key points in the statement are:

- USS aims to deliver a defined set of benefits based on service and salary. The financing of these benefits is provided, mainly, by the sponsoring institutions.
- There are always uncertainties inherent in the funding of a final salary scheme. In view of this the finances of the scheme are checked regularly to see how well the fund is shaping up. The key driver is how well the investments have performed relative to the growth of the liabilities (the liabilities being the benefits payable by the scheme).
- If investments perform very well then it may be possible to improve benefits or reduce the contribution rate; more likely, unless performance is exceptional and sustained, improved returns would be used to protect the current level of contribution rates; if investments perform badly then there may be a need for institutions to contribute more to deliver the benefits.
- The current financial position of the scheme is simply a 'snapshot' as at the valuation date and can vary in the future depending on the actual experience of the scheme.
- In addition to the valuation using the scheme funding assumptions, the actuary also calculates the USS funding position on a number of other methods, including the PPF (Pension Protection Fund) basis and the FRS17 basis.
- The actuary has advised that at 31 March 2005, the date of the last actuarial valuation of the scheme, on the scheme funding basis, the assets in the fund amounted to £21.739.7 million and this covered 77% of the accumulated liabilities based on pensionable service to the valuation date and salaries projected through to retirement.
- The actuary has advised the trustee company that a cautious approach has been adopted in determining the assumptions used in the actuarial valuation. If the investment return assumption used in the valuation had been increased by 2% to 6½% (a relatively mainstream actuarial assumption and one which would still contain an element of prudence) the fund would have been in surplus.

- Acting on actuarial advice, the trustee company agreed to leave the shortfall to be addressed by investment performance rather than increasing contributions at this time, but is undertaking a review, in consultation with the participating employers, of the funding of the scheme to determine whether an increase in contributions should be made in advance of the next valuation at 31 March 2008.
- Since 31 March 2005 the financial security of the scheme has improved and the actuary has estimated that the funding level at 31 March 2006 had increased to 89%. This improvement in the scheme's financial security is largely due to the investment return on the scheme's assets since 31 March 2005 being higher than allowed for in the funding assumptions. On the FRS17 basis, the actuary estimated that the funding level at 31 March 2006 was above 100%.

Legislative requirements

On 6 April 1997 a method designed to provide protection for members of final salary (also known as defined benefit) pension schemes was created called the Minimum Funding Requirement (MFR). The MFR set a benchmark for the acceptable level of a pension scheme's assets. It was designed to ensure that, in the event of a scheme winding-up, retired members could expect their pensions to be paid in full, and other members have a reasonable expectation (but not a guarantee) of receiving the value of their pension rights by investment elsewhere. It was not designed to be a stretching benchmark, albeit many schemes currently struggle to meet it.

The MFR test compares scheme assets and liabilities in a way that links the liabilities to the current market value of certain investments; gilt-edged stocks for pensions in payment and for older scheme members, and UK equities for younger scheme members.

MFR has not worked well and new scheme funding requirements for UK final salary pension schemes were introduced by the Pensions Act 2004 and came into force in October 2005. The new requirements applied to any scheme valuation that was based on an effective date of 22 September 2005 or later. They therefore did not apply to the last USS valuation as at 31 March 2005 but will apply to the next USS valuation at 31 March 2008.

As part of the new requirements, USS will be required to publish a statement of funding principles in addition to the summary statement to members referred to above, with the first such statement being published after the 2008 valuation. In advance of that, the trustee company intends to continue to publish this funding statement to enable members to understand more about the funding of the scheme.

Benefits provided by the scheme

USS is a final salary scheme. Under this type of arrangement benefits are payable on the death, early leaving or retirement of a member and are generally dependent upon how long the member has been in the scheme at the time the benefit becomes due and the member's salary at that time.

An active member may choose to opt out of the scheme and become a deferred pensioner, becoming entitled to a cash equivalent transfer value calculated on the advice of the actuary. This is designed to be equal to a sum of money which could reasonably be expected to be sufficient to provide the benefits given up in the scheme.

There are provisions for providing discretionary benefits, for example, in the circumstances of early and ill-health retirements. Individual cases are considered by the trustee company on their merits on a case by case basis. Many members will have their benefits enhanced by additional voluntary contributions and/or by the transfer into the scheme of pension rights acquired under other arrangements. In some cases, usually cases of premature retirement, employers may purchase additional benefits for a member, to be paid for through the scheme.

Members pay a fixed contribution (currently 6.35% of pensionable salary) towards the provision of these benefits and the sponsoring institutions meet the 'balance of the cost'. There are no provisions for contributions to be made from other sources and in particular the scheme is not government backed.

Assessing the required contributions

There are always uncertainties inherent in the funding of a final salary scheme. The cost of the scheme will depend on how well the investments perform, what salary increases members receive each year and on a whole host of other matters such as how long people live, how many people leave service early or take early or ill-heath early retirement. When advising on the financial health of the scheme and contribution rates the actuary has to make assumptions about these sorts of things.

Member and employer contributions are invested in USS, a trust fund which is held separately from the assets of any of the institutions, and the contributions are managed by investment managers on behalf of the trustee company. Valuations are carried out periodically by the actuary to the scheme. Typically this is once every three years but valuations can be obtained more frequently by the trustee company. Quarterly and annual updates to the valuation are provided by the actuary on an approximate basis. If these raise particular concerns, which require a more accurate assessment of the position, then the trustee company would consider carrying out a full valuation. In the regular three yearly valuations the actuary checks that the assets built up and levels of contribution payable mean that the fund is still on course to pay the benefits expected under the arrangement.

If investments have performed poorly there may be a need to increase contributions. If investments have performed better than expected then there may be scope for benefits to be improved or contributions to be reduced. Changes in members' ordinary contribution rates would require an amendment to the rules. Clearly if investments were to perform particularly poorly over a sustained period of time, it may become difficult for the institutions to pay the increased contributions necessary to make good the position. Of course, greatly improved investment performance in the future may rectify any underfunding.

Funding position as at 31 March 2005

The last actuarial valuation of the scheme was carried out as at 31 March 2005. The actuary reported that the contributions required to meet each extra year's accrual of pension amounted to 20.65% of pensionable salary (6.35% of which is contributed by the members and the balance by the sponsoring institutions). This rate of contribution can be adjusted to reflect any surplus or deficit currently in the scheme. At the valuation date the actuary reported a deficit of £6,568.4 million. The assets in the fund amounted to £21,739.7 million and this covered 77% of the accumulated liabilities based on pensionable service to the valuation date and salaries projected through to retirement. It is this measure of coverage of assets against liabilities that the trustee company has adopted as the scheme long-term funding target. The long-term funding and contribution strategy is aimed at delivering 100% coverage on this basis.

At the previous valuation, which was carried out on 31 March 2002, the scheme was 101% funded with a surplus of £162 million. The worsening in the scheme's financial security is due to the investment return on the scheme's assets being lower than expected and to changes to the financial assumptions resulting from the fall in gilt yields.

It should be appreciated that there is a range of measures that can be used to determine the funding level of the scheme and the measure used for the USS valuation is a conservative one. Using the set of assumptions specified by the government under the MFR regulations as laid down in the Pensions Act 1995, at 31 March 2005 USS was 126% funded with a surplus of £4,507 million over the regulatory minimum.

Most schemes also carry out a valuation on a set of assumptions specified by Financial Reporting Standard 17 (FRS17). While it is not a requirement for USS to comply with this standard (as a multi-employer scheme in which the participating employers share the costs and benefits of scheme membership, USS is exempt from this requirement), the actuary has estimated that at 31 March 2005 the scheme was approximately 90% funded under the FRS17 formula.

The new requirements for scheme funding (which will impact USS following the 2008 actuarial valuation) require an assessment of a scheme's 'technical provisions' to be made. These are the amount of assets judged sufficient to provide accrued liabilities with the assessment being based on 'prudent' assumptions. If there is a shortfall on this measure then additional contributions have to be paid to clear this shortfall. The basis that USS might adopt for setting the assumptions for this purpose have not yet been determined but will ultimately have to be agreed by the trustee company acting on the advice of the actuary. However, the actuary advised that as at 31 March 2005 the scheme was likely to have been more than fully funded on a technical provisions basis.

A further valuation measure that the actuary is required to calculate is the 'solvency position'. Our aim is for there to be enough money in the scheme to pay pensions now and in the future, but this depends on the institutions carrying on in business and continuing to pay for the scheme. If an institution goes out of business or decides to stop paying for the scheme, it must pay the scheme enough money to buy all the benefits built up by members from an insurance company. If this happens for all institutions, this is known as the scheme being 'wound-up'. The comparison of the scheme's assets to the cost of buying the benefits from an insurance company is known as the 'solvency position'.

The actuarial valuation at 31 March 2005 showed that the scheme's assets could not have paid for the full benefits of all members to be provided by an insurance company if the scheme had wound-up at that date.

The liabilities if the scheme were to be wound-up were	£29,546.9 million
The scheme's assets were	£21,739.7 million
This means that there was a shortfall of	£7,807.2 million

The fact that we have shown the solvency position does not mean that consideration is being given to winding up the scheme. It is just another piece of information that we hope will help you understand the financial security of your benefits.

The actuarial assumptions

The on-going funding level has been determined using a range of actuarial assumptions, the key ones of which are:

- An investment return of 4.5% for determining past liabilities;
- An investment return of 6.2% for determining the cost of future accruals;
- Salary growth of 3.9% plus an allowance for promotional increases;
- An inflation assumption of 2.9%;
- Assets taken at market value.

An additional allowance was also made for increases in salaries due to age and promotion above the general allowance of 1% in excess of price inflation. Analysis of salary data from 2002 to 2004 has shown that there has been a more rapid progression of salary increases from that allowed for in the previous valuation's salary scale. The actuary made a cautionary reserve of £800 million in the active members' past service liabilities to take account of this, but maintained the previous salary scale for projecting future service accrual costs. Further analysis of the promotional salary scale will be carried out over coming years to determine whether the 2002-2004 experience has been a temporary phenomenon or represents a genuine long-term trend.

The actuary has advised the trustee company that a cautious approach has been adopted in determining these assumptions. When assessing the current surplus or deficit the actuary has assumed that equity investments will not out-perform fixed interest securities in the future, even though they have generally done so in the past.

The trustee company, while fully accepting this advice, is nevertheless mindful of the need to continually review the investment policies of the fund to provide assurance to members that all reasonable strategies are considered to protect their future security. A full asset/liability modelling exercise was carried out during the year with the assistance of Mercer Investment Consulting and this broadly supported the trustee company's asset allocation policy, whilst recommending some changes to the investment strategy to be gradually implemented over a period of years. This is referred to in the report of the investment committee which is published elsewhere in the report and accounts. The investment performance of the scheme is monitored regularly by the trustee company and this is also reported on in the report of the investment committee.

To help the trustee company assess the sensitivities of the funding level to changes in the actuarial assumptions the actuary has further advised that if the investment return assumption were increased by 1% to 5½% then the reported deficit would have reduced by approximately £4 billion, while if the investment return assumption were increased by 2% to 6½% then the fund would have been in surplus. Whilst the future investment return cannot be guaranteed or predicted with certainty, an assumption at March 2005 that assets would out-perform gilt-edged returns by 1% or 2% per annum would have been within mainstream actuarial practice and would still contain an element of prudence.

A further feature of the 31 March 2005 valuation was that the demographic actuarial assumptions (relating to matters such as mortality rates, ill-health and early retirement rates, etc) were generally pitched on the conservative side compared with the actual past experience of the USS membership in these areas.

Allowance was made for generally improving mortality trends with the up to date mortality table, PA92 (projected forward to 2020 to allow future expected increased longevity), being used.

Analysis for the last nine years experience shows that these tables remain appropriate.

All assumptions will be reviewed by the trustee company from time to time and in particular at the next formal actuarial valuation of the scheme, but the strategy will be to maintain a large degree of prudence in the overall long-term funding assumptions.

Is the shortfall going to be paid off?

The valuation shortfall was estimated without taking any advance credit for investment returns in excess of gilt rates available on Government fixed interest stocks. In reality, USS invests largely in equities which are expected to deliver superior returns. Acting on actuarial advice, the trustee company agreed to leave the shortfall to be addressed by investment performance rather than

increasing contributions at this time, but is undertaking a review, in consultation with the participating employers, of the funding of the scheme to determine whether an increase in contributions should be made in advance of the next valuation at 31 March 2008.

Equity markets have proven to be particularly volatile in the recent past but the trustee company does not intend to attempt to 'call the markets'; it is investing, over the long term, on the basis that equities will indeed provide outperformance over gilts over long periods. The USS fund is well placed to ride any short-term volatilities as it has a very positive cash flow, with contribution income and dividend receipts well in excess of the level of benefits to be paid out of the scheme each year, for the foreseeable future. As it does not have to sell investments in order to pay out benefits, temporary falls in market values are of less concern than would be the case for a mature scheme. The scheme also covers all its statutory and regulatory requirements regarding funding and one might view the covenant of the employing institutions as extremely strong. Taking these factors into account it is the trustee company's view that the funds held are likely to be sufficient to meet existing accrued liabilities.

Agreed contributions

Following the last actuarial valuation, and acting on actuarial advice, the trustee company agreed to maintain the institutions' contribution rate at 14% of pensionable payroll, pending the results of the review of the funding of the scheme referred to above.

Funding level at 31 March 2006

Since 31 March 2005 the financial security of the scheme has improved and the actuary has estimated that the funding level had increased from 77% at 31 March 2005 to 89% at 31 March 2006. This improvement in the scheme's financial security is due to the investment return on the scheme's assets since 31 March 2005 being higher than allowed for in the funding assumptions. On the FRS17 basis, the actuary estimated that the funding level at 31 March 2006 was above 100%, and he also advised that the scheme would have been more than fully funded on a technical provisions basis.

STATEMENT OF INVESTMENT PRINCIPLES

Introduction

The Pensions Act 1995 as amended by the Pensions Act 2004 and the Occupational Pension Schemes (Investment) Regulations 2005, requires trustees to prepare and keep up-to-date a written statement recording the investment policy of the trustee company. The purpose of this document is not only to satisfy the requirements of the Act but also to outline the broad principles governing the investment policy of the trustee company.

The statement has been agreed by the management committee of the trustee company on written advice from the investment committee (a sub-committee of the management committee), the scheme's external investment consultants and the scheme actuary following consultation with the participating employers or their appointed representatives.

The management committee reviews the statement at least every three years and without delay if there are any significant changes in investment policy or where the trustee company considers that a review is needed for other reasons. The investment committee monitors compliance with this statement at least annually and obtains confirmation from the investment managers that they have exercised their powers of investment with a view to giving effect to the principles contained herein as far as reasonably practicable.

Governance

The investment committee is established under the articles of association of the trustee company, and under the rules of the scheme, to advise the trustee company on all questions relating to the investment of the assets of the fund. It consists of between three and eight people of whom at least one must be a member of the management committee and up to five may be persons other than directors whom the management committee may decide to appoint because they have special skills or are able to give competent advice to the trustee company on the policy to be adopted from time to time for investment of the fund.

The management committee, as the governing body of the trustee company, retains the overall power of investment in relation to the fund but can delegate to the investment committee the power to decide the investment policy of the fund. In practice, the investment committee will generally make recommendations to the management committee, rather than decisions, on matters of strategy. This would encompass, for example, changes in the fund's investment objective, the appointment and remit of external managers, investment in new asset classes and decisions on whether to participate in new investment activities. In making its recommendations, the investment committee receives advice from its external investment consultants. All stock selection decisions are made by the individual investment managers (either internal or external) within constraints recommended by the investment committee and agreed by the management committee. The chief investment officer monitors and reports their activity to the investment committee. The internal fund managers make recommendations for the continuance or amendment of their fund's asset allocation policy on a half yearly basis for the approval of the investment committee. The investment committee also determines the appropriate allocation of cash (new money) between the different managers on a quarterly basis. The management committee believes that this structure, together with the range of expertise of its in-house staff, committee members and external managers and advisers enables the trustee company to make effective investment decisions.

Investment objective and strategy

The trustee company's duty is to act in the best financial interests of all classes of scheme member and accordingly to ensure that the assets are invested to secure the benefits under the scheme. The managers are therefore instructed to give primary consideration to the financial prospects of any investment they hold or consider holding.

The trustee company's investment objective is to maximise the long-term investment return on the assets having regard to the liabilities of the scheme and the desirability of maintaining stable contribution rates. Regard is had to the scheme's relative immaturity, strong positive cash flow, the scheme's statutory funding objective, the minimum funding requirement of the Pensions Act 1995 and the wish of the employers and the management committee to minimise the risk of higher contributions at some time in the future. At the last triennial valuation as at 31 March 2005 the scheme's funding level exceeded its minimum funding requirement level. A valuation on a technical provisions basis has not yet been carried out but the advice of the actuary is that, at the current time, the scheme is likely to be fully funded on this basis. The Pensions Regulator has published certain trigger points which he will use when monitoring schemes and their funding plans. The trustee company aims to maintain an adequate funding cushion so that the risk of deterioration of the funding level, to such an extent as to be of concern to the Regulator, is acceptable.

Investment management structure

The securities investments of the fund are currently managed by a number of discretionary specialist managers and an index tracking manager. The appointment of specialist managers helps to ensure diversification by fund management organisation and investment style and is also aimed at achieving excess return over the returns expected from the internal manager. The appointment of the index tracking manager is intended to reduce investment risk and investment management costs.

The alternative asset portfolio is managed in-house, through either direct investment or through sub-contracting the management function to specialists.

The property portfolio is managed in-house with advice received from external specialists.

The management structure is subject to review, generally every five years, by the investment committee and the management committee.

The external managers are remunerated through a combination of ad valorem fees and performance-related fees. The fee arrangements in each case are considered by the trustee company to be the best way to encourage outperformance while ensuring value for money.

Investment strategy and asset mix

The management committee believes that over the longer term equity investment will provide superior returns to other investment classes. The management structure and targets set are designed to give the fund a greater than average weighting in equities compared to the weighting generally held by other funds through portfolios that are diversified both geographically and by sector.

The management committee also believes that alternative investments, ie those investments which are not traditional fixed interest, property or mainstream quoted equities, can provide similar returns to equities whilst diversifying the sources of excess return (over fixed interest securities).

The management committee has determined the appropriate asset distribution, and permitted deviations, for the fund as:

	%	Divergence limits
UK equities	40	-10% to + 10%
Overseas equities	40	-10% to + 10%
Fixed interest	10	-5% to + 2.5%
Property	10	-5% to + 2.5%

The target for investment in alternative assets is 5% of the total fund by 2008 and is to be accommodated within the 80% allocation to equities. The rationale for moving to a higher proportion in alternative assets is the management committee's belief that they will produce equity-type returns whilst reducing risk through greater diversification.

This distribution has been agreed on the recommendation of the investment committee based on its belief that, over the longer-term, the real rates of return of each asset class will be of the order of:

Equities	4.5%
Alternative assets	4%
Property	3%
Fixed interest	2.5%
Index-linked	2%

External specialists have been appointed to manage, or advise on the management of, approximately 32% of the fund:

Global equities	19%
UK equities (index)	13%

The asset distribution of the internally managed fund is used, to the extent necessary, to balance the asset distribution of the total fund to ensure that it remains within the agreed divergence limits. The indices against which the managers are measured have been agreed with them and the managers are expected to add value by selection against the indices and by asset and sector allocation. They have been informed that USS is a risk-tolerant fund due to its conservative funding assumptions, its positive cash flow and the fact that it is relatively immature.

The objective of the index tracking fund is to match the return on the FTSE All-Share Index. This fund is managed by the internal manager acting on external advice.

The investment objective for direct property investments is to exceed the return of the Investment Property Databank (IPD) universe by 0.5% pa over rolling five-year periods.

The securities assets of the fund are allocated between the managers in an approximate ratio of:

	%
Internally managed balanced fund	65
Externally managed specialist funds	21
Index tracking	14

This ratio will fluctuate due to stock market movements and cash allocation.

The allocation of cash is reviewed and approved by the investment committee on a quarterly basis.

The asset distribution of the fund is reported to the investment committee and the management committee on a quarterly basis to ensure that the asset distribution remains within the agreed

limits. If limits are breached the chief investment officer will agree with the chairman of the investment committee the appropriate action to be taken.

No more than 4% of the total fund by market value can be invested in one company except for very large UK companies in which managers are allowed a maximum overweight position of 50% of the FTSE All-Share Index weighting with an overall cap of 10% of their part of the fund. No more than 10% of the market capitalisation of any one company (excluding collective investment schemes and companies established by the trustee company to aid the efficient administration of fund investments subject to appropriate controls) may be held without prior authority from the chairman of the investment committee. In both cases, the constraints apply as at the date of purchase.

Constraints also apply to the alternative assets portfolio, limiting the proportion of the portfolio which can be allocated to each type of asset, each individual investment and each individual manager.

The chief investment officer monitors the portfolios of all the managers to ensure that an adequate spread of investments is maintained and reports on this to the investment committee.

The external managers may not, as a rule, invest in securities not quoted on a recognised or designated investment exchange. The internally managed fund can invest in alternative assets (such as private equity, hedge funds and commodities) with a view to investing up to 5% of the total fund by 2008. Any such investments are reported to the investment committee.

Risk and return targets

The trustee company recognises that it would be possible to select investments that are similar to the estimated liability cash flows. However, in order to meet the long-term funding objective within a level of contributions that it considers the employers would be willing to make, the trustee company has agreed to take investment risk relative to the liabilities. This taking of investment risk seeks to target a greater return than the matching assets would provide whilst maintaining a prudent approach to meeting the fund's liabilities.

Before deciding to take investment risk relative to the liabilities, the trustee company receives advice from the investment consultant and the scheme actuary, and considers the views of the employers. In particular, it considered carefully the following possible consequences:

- The assets might not achieve the excess return relative to the liabilities anticipated over the longer term. This would result in deterioration in the fund's financial position and consequently higher contributions from the employers than are currently expected.
- The relative value of the assets and liabilities will be more volatile over the short term than if investment risk had not been taken. This will increase the likelihood of there being a shortfall of assets relative to the liabilities in the event of discontinuance of the fund.

The trustee company believes that the strong positive cash flow of the scheme, the ongoing flow of new entrants into the scheme and the strength of covenant of the employers enables it to take a longer-term view of its investments. Short-term volatility of returns can be tolerated and need not feed through directly to the stability of the contribution rate.

The trustee company's willingness to take investment risk is dependent on the continuing financial strength of the employers and their willingness to contribute appropriately to the fund, the financial health of the fund and the fund's liability profile. The trustee company monitors these factors regularly with a view to altering the investment objectives, risk tolerance and/or return target should there be any significant change in any of the factors.

Having regard to the above, and after taking advice from the investment consultant and scheme actuary, the trustee company has adopted investment arrangements that it believes offer an acceptable trade-off between risk and return.

Diversification of risk

The overall investment risk to the fund is diversified across a range of different investments, which are expected to provide excess return over time, commensurate with risk.

The fund invests in, among other assets, bonds, equities, property and alternative assets such as private equity, commodities, currencies, absolute return strategies, derivatives and infrastructure.

The trustee company also monitors, analyses and responds to other risks such as regulatory risk, administrative risk, custody risk, concentration, liquidity and counterparty risk and political and country risk.

The investment portfolio has been constructed to be consistent with the investment objective, risk tolerance and excess return target of the trustee company.

Additional assets

Additional voluntary contributions (AVCs) from members to purchase additional benefits on a money purchase basis are invested separately and managed and administered externally. The appointment of AVC providers is subject to review by the management committee.

Monitoring performance

The performance of the fund and of each investment manager is measured quarterly by HSBC Bank Fund Administration against the relevant indices. The performance of the investment managers and the fund is reported quarterly to the investment committee, which reports on this each quarter to the management committee.

The performance of the property portfolio is also separately measured against the customised IPD universe. The IPD performance data is incorporated within the data provided to HSBC by USS Ltd for measurement of the performance of the whole fund against its benchmark.

The internal auditor and chief investment officer visit the external investment managers to check the quality and effectiveness of procedures on a regular basis. The internal auditor monitors the internal manager to check the quality and effectiveness of procedures on a regular basis.

Transaction costs

Each of the securities managers is required to provide a report annually to the trustee company on transaction costs incurred which provides, as a minimum, the information required by the Investment Management Association/National Association of Pension Funds Pension Fund Cost Disclosure Code.

Level of scheme maturity

Although approximately 35% of the liabilities as at the 2005 valuation were in respect of pensions in payment, the scheme is cash flow positive and does not need to realise investments to meet liabilities. The actuary has confirmed that this is likely to remain the case for the next ten years or more.

Stock lending

The trustee company is authorised by the scheme rules to participate in stock lending and has done so since 1998. It has concluded that the risks associated with stock lending in accordance with those lending programmes in which it participates, which incorporate a high level of risk mitigation, are not intrinsically different from those of other market operations and are justified in the light of the return to the scheme in terms of the annual stock lending fees capable of generation.

Any stock lending programme in which the fund participates must provide for all loans to be fully pre-collateralised and be approved by the investment committee acting on legal advice.

Responsible investment

As an institutional investor that takes seriously its fiduciary obligations to its members, the trustee company aims to be an active and responsible long-term investor in the assets and markets in which it invests. By encouraging responsible corporate behaviour, the trustee company expects to protect and enhance the value of the fund's investments in the long-term.

The trustee company therefore requires its fund managers to pay appropriate regard to relevant extra-financial factors including corporate governance, social, ethical and environmental considerations in the selection, retention and realisation of all fund investments. The management committee expects this to be done in a manner which is consistent with the trustee company's investment objectives and legal duties.

Specifically, the management committee has instructed its internal fund managers and called on its external managers to use influence as major institutional investors to promote good practice by investee companies and by markets to which the fund is particularly exposed.

The management committee also expects the scheme's fund managers, both internal and external to undertake appropriate monitoring of the policies and practices on material corporate governance and social, ethical and environmental issues of current and potential investee companies so that these extra-financial factors can, where material, be taken into account when making investment decisions.

The aim of such monitoring should be to identify problems at an early stage, and enable engagement with management to see appropriate resolution of such problems. The trustee company has required its fund managers to use voting rights as part of the engagement work they do on behalf of the beneficial owners and to ensure that voting is undertaken in a prioritised, value-adding and informed manner. Where collaboration is likely to be the most effective mechanism for encouraging company management to address these issues appropriately, the trustee company expects its fund managers to participate in joint action with other institutional investors.

The investment committee monitors this engagement on an on-going basis with the aim of maximising its impact and effectiveness. The trustee company's governance, social, ethical and environmental policies are also reviewed regularly by the management committee and, where appropriate, updated to ensure that they are in line with good practice for pension funds in particular, and institutional investors in general.

Derivatives

Each of the managers is permitted to use derivatives within limitations specified by the investment committee. The current limit is 10% of the total funds under their management although the limit for the internally managed fund can be increased to up to 15% with the prior approval of the chairman of the investment committee. In connection with transitional arrangements for a reorganisation of the fund's management, the management committee may approve a higher percentage for that limit, which will then apply in that connection for such period as that committee shall have specified. The use of derivatives is to be solely for the reduction of risk or the efficient management of the portfolio.

Underwriting

The managers are permitted to underwrite issues provided they are prepared to hold all the stock which they underwrite.

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

UNIVERSITY INSTITUTIONS

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
0100	Aberdeen	1,650	599	146
4100	Aston	600	357	127
4300	Bath	1,309	387	71
6600	Belfast	1,974	624	150
1000	Birmingham	2,755	1,072	239
4200	Bradford	886	491	100
1100	Bristol	2,666	791	153
4400	Brunel	902	328	71
7035	Buckingham	82	44	5
1200	Cambridge (University)	4,686	1,026	313
1202	Christ's	19	8	2
1204	Churchill	53	8	–
1206	Clare	19	5	–
1208	Clare Hall	10	–	1
1210	Corpus Christi	36	6	3
1212	Darwin	5	2	2
1214	Downing	38	10	3
1216	Emmanuel	22	6	1
1218	Fitzwilliam	79	7	2
1220	Girton	39	14	3
1222	Gonville & Caius	36	11	3
1224	Hughes Hall	3	2	1
1226	Jesus	20	5	2
1228	King's	30	13	2
1230	Lucy Cavendish	29	5	–
1232	Magdalene	18	6	2
1234	New Hall	60	9	4
1236	Newnham	37	19	3
1238	Pembroke	38	7	–
1240	Peterhouse	22	2	1
1242	Queens'	20	2	–
1245	Robinson	13	7	–
1246	St Catharine's	27	7	1
1255	St Edmund's	13	1	–
1250	St John's	36	9	6

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
1252	Selwyn	22	1	2
1254	Sidney Sussex	28	1	1
1258	Trinity	59	11	6
1260	Trinity Hall	20	6	5
1268	Wolfson	13	3	–
4700	City	1,222	396	99
7016	Cranfield	930	494	103
0700	Dundee	1,670	386	90
1300	Durham (University)	1,642	498	87
1301	St Chad's	2	–	–
1302	St John's	4	–	–
1303	Ushaw College	3	1	–
1500	East Anglia	1,258	434	64
0200	Edinburgh	3,672	1,034	265
1700	Essex	1,059	225	47
1600	Exeter	1,192	540	98
0300	Glasgow	2,611	918	191
0800	Heriot–Watt	793	275	51
1800	Hull	1,029	495	116
3100	Keele	966	270	60
1900	Kent	1,073	383	54
2100	Lancaster	1,293	376	79
2000	Leeds	3,367	1,124	260
2200	Leicester	1,422	411	81
2300	Liverpool	2,152	782	192
2497	London (University)	528	640	191
2408	Birkbeck	733	162	30
2401	Goldsmiths' College	602	149	12
2480	Heythrop	18	4	–
2409	Imperial Coll of Science, Technology & Medicine	3,074	1,050	262
2440	Institute of Cancer Research	223	22	4
2403	Institute of Education	458	210	49
2410	King's College London	2,741	968	231
2412	London School of Economics & Political Science	958	246	59
2434	London School of Hygiene & Tropical Medicine	535	106	32

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
2413	Queen Mary & Westfield College	1,464	558	136
2447	Royal Holloway and Bedford New College	717	267	46
2436	Royal Veterinary College	269	56	20
2428	St George's Hospital Medical School	488	83	21
2415	School of Oriental & African Studies	478	189	52
2416	School of Pharmacy	129	31	10
2417	University College	4,349	1,088	225
2484	London Business School	300	40	10
4600	Loughborough	1,393	493	128
2500	Manchester	4,751	1,754	358
1400	Newcastle-upon-Tyne	2,276	808	178
2600	Nottingham	2,829	724	165
8900	Open	5,820	1,648	204
2700	Oxford (University)	4,294	1,197	363
2701	All Souls	31	12	3
2702	Balliol	31	4	5
2703	Brasenose	20	5	3
2704	Christ Church	47	11	6
2705	Corpus Christi	15	6	2
2706	Exeter	24	5	3
2735	Harris Manchester	10	3	–
2707	Hertford	21	6	2
2708	Jesus	24	7	1
2709	Keble	35	5	–
2710	Lady Margaret Hall	23	11	3
2734	Linacre	6	3	–
2711	Lincoln	18	6	3
2712	Magdalen	38	11	5
2732	Mansfield	19	5	1
2713	Merton	37	8	3
2714	New College	44	15	4
2715	Nuffield	41	9	2
2716	Oriel	23	11	–
2717	Pembroke	17	6	4
2718	Queen's	19	9	2

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
2736	Regent's Park	2	–	–
2719	St Anne's	32	11	1
2720	St Antony's	31	10	1
2737	St Benet's Hall	–	–	–
2721	St Catherine's	34	9	2
2722	St Edmund Hall	12	3	1
2723	St Hilda's	33	15	1
2724	St Hugh's	24	9	1
2725	St John's	47	8	1
2726	St Peter's	27	4	2
2727	Somerville	35	10	–
7028	Templeton	6	20	3
2728	Trinity	15	3	1
2729	University	30	9	4
2730	Wadham	13	7	7
2733	Wolfson	10	5	4
2731	Worcester	19	10	1
2800	Reading	1,691	582	141
0400	St Andrews	982	276	65
4800	Salford	1,079	544	107
2900	Sheffield	2,945	813	162
3000	Southampton	2,761	732	131
0500	Stirling	813	262	48
0600	Strathclyde	1,908	612	168
4000	Surrey	1,432	490	85
3200	Sussex	1,017	461	94
6800	Ulster	1,720	467	98
3900	Wales (University)	59	24	4
3300	Aberystwyth	675	306	79
3400	Bangor	832	373	85
3500	Cardiff	2,686	786	203
3800	Lampeter	116	50	14
3600	Swansea	1,251	416	101
5000	Warwick	1,867	424	90
5200	York	1,601	317	70
	Old university institutions total	**111,509**	**35,673**	**7,981**

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
	New universities admitted for limited membership only			
8160	Abertay	4	–	–
8420	Bolton	1	–	–
8100	Bournemouth	6	2	–
8080	Brighton	39	1	–
8430	Canterbury Christ Church	–	–	–
8350	Central England	13	–	–
8150	Central Lancashire	15	2	–
8110	Coventry	37	1	–
8060	De Montfort	10	4	–
8010	Glamorgan	15	1	–
8400	Glasgow Caledonian	–	–	–
8210	Greenwich	4	–	–
8040	Hertfordshire	2	–	–
8050	Huddersfield	19	–	–
8170	Kingston	6	–	–
8190	Lincoln	26	1	–
8300	Liverpool Hope University College	4	–	–
8270	Liverpool John Moores	14	–	–
8240	London Metropolitan	26	1	–
8280	Luton	10	–	–
8140	Manchester Metropolitan	25	1	–
8090	Nottingham Trent	13	6	–
8120	Oxford Brookes	27	–	–
8250	Paisley	2	1	–
8070	Plymouth	33	5	–
8290	Queen Margaret University College	9	–	–
8370	Roehampton	11	1	–
8220	Sheffield Hallam	16	1	–
8020	South Bank	35	4	–
8320	Sunderland	12	–	–
8340	Swansea Institute of Higher Education	10	–	–
8330	Teeside	2	–	–
8030	Thames Valley	7	4	–
8380	University College Falmouth	4	–	–

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
8360	University College Worcester	2	–	–
8180	University of Wales Institute, Cardiff	10	–	–
8130	Westminster	21	–	–
8410	West of England	–	–	–
8450	Winchester	7	–	–
8390	Wolverhampton	–	–	–
	New university institutions total	**497**	**36**	**–**
	All university institutions total	**112,006**	**35,709**	**7,981**

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

NON-UNIVERSITY INSTITUTIONS

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
7224	AGCAS	13	–	–
7221	Al-Maktoum Institute	5	–	–
7252	Amaethon Ltd	1	–	–
7010	Animal Health Trust	47	10	1
7080	Arable Group	5	5	1
7040	Arthritis Research Campaign	1	3	–
7275	Arts and Humanities Research Council	–	–	–
7190	Ashridge (Bonar Law Memorial) Trust	199	4	–
7178	Assessment and Qualifications Alliance	24	36	8
7011	Association of Commonwealth Universities	35	32	8
7244	Association of University Teachers	75	15	5
7255	Aston Academy of Life Sciences	3	–	–
7108	Aston Techn Planning & Management Services Ltd	–	–	1
7067	Beatson Institute for Cancer Research	87	3	2
7084	BLCMP (Library Services) Ltd	1	4	1
7037	Brewing Research International	40	14	5
7206	Bristol Zoo Gardens	1	–	–
7012	British Glass Manufacturing Confederation	–	8	–
7030	British Institute in Eastern Africa	4	1	–
7091	British Institute of Archaeology at Ankara	1	2	–
7112	British Institute of International & Comp Law	4	1	–
7097	British Psychological Society	2	2	–
7087	British School at Athens	6	2	1
7092	British School at Rome	3	–	–
7033	British School of Archaeology in Iraq	1	–	–
7050	British Universities Sports Association	–	1	–
7122	Burden Neurological Institute	6	–	–
7116	Cambridge Crystallographic Data Centre	44	4	–
7060	Cancer Research UK	2	10	2
7153	CASE (Europe)	2	1	–
7197	Centre for Migration Studies	1	–	–
7286	Challenge Fund Trading Company Limited	2	–	–
7015	College of Estate Management	23	31	7
7191	Connect - The Communications Disability Network	16	–	–
7110	Council for British Research in the Levant	1	–	–

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

NON-UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
7265	Council for Christ Col and Universities	3	–	–
7216	Courtauld Institute of Art	68	3	3
7188	Cranfield Aerospace Limited	16	6	–
7251	Cranfield Impact Centre Ltd	–	–	–
7219	Cranfield Innovative Manufacturing Ltd	8	1	–
7098	Culham Institute	1	–	–
7145	Dartington Hall Trust	13	1	–
7217	Duke Corporate Education Ltd	6	–	–
7253	East Malling Research	98	–	–
7241	Economic Research Institute of Northern Ireland Ltd	8	–	–
7159	EDEXCEL	–	–	–
7164	Edinburgh Business School	24	3	–
7032	Edinburgh University Students' Association	62	25	2
7182	EDUSERV	22	3	–
7266	EDUSERV Technologies Ltd	37	–	–
7229	Energy Consortium (Education)	2	–	–
7139	Engineering Development Trust	17	10	–
7257	ESCP-EAP European School of Management	9	–	–
7212	EUSPEN Ltd	3	–	–
7089	Ewing Foundation	3	2	–
7239	Facial Surgery Research Foundation	1	–	–
7283	Florida State University IPA UK	–	–	–
7214	Forum for European Philosophy	–	–	–
7175	Freshwater Biological Association	9	1	–
7041	Geographical Association	6	3	–
7246	Graduate Prospects	–	–	–
7152	Gray Laboratory	24	4	–
7176	HEFCE	1	–	–
7025	Henley Management College	246	41	6
7237	Henley Management College (Trading) Ltd	1	–	–
7230	Heriot-Watt University Students Association	3	–	–
7258	Higher Education Academy	82	–	–
7157	Higher Education Careers Service Unit	4	6	–
7186	Higher Education South East	8	–	–
7135	Higher Education Statistics Agency Ltd	17	2	2

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

NON-UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
7053	History of Parliament Trust	26	5	–
7143	Homerton College	23	4	1
7254	Horticultural Research International Ltd	205	3	–
7170	Hull University Union	10	2	–
7259	INNOS Ltd	13	–	–
7236	Institute for Criminal Policy Research	11	–	–
7029	Institute for Employment Studies	5	11	–
7017	Institute of Development Studies	119	34	8
7056	Institute of Food Science & Technology	2	–	–
7231	Interactive University	7	–	–
7207	International Extension College	4	1	–
7124	International Institute of Biotechnology	1	–	–
7132	International Society (Manchester)	2	1	–
7149	International Students House	3	–	–
7147	JNT Association	45	9	1
7054	Joint Library of Hellenic & Roman Societies	–	1	–
7066	Journal of Endocrinology Ltd	–	1	–
7189	Kelvin Nanotechnology Ltd	2	–	–
7226	Kidscan Ltd	2	–	–
7240	Leadership Foundation for Higher Education	11	1	–
7177	Learning from Experience Trust	–	–	–
7208	LeNSE Ltd	2	–	–
7271	LHASA Limited	36	–	–
2482	Lister Institute of Preventive Medicine	–	5	3
7247	Liverpool Associates in Tropical Health	–	–	–
7277	Liverpool University Press	–	–	–
7168	London Mathematical Society	2	–	–
7179	London School of Jewish Studies	2	1	–
7235	London Universities Purchasing Consortium	3	–	–
7117	Ludwig Inst for Cancer Research - Middlesex Branch	21	5	–
7215	Manchester Medical Society	2	–	–
7090	Marie Curie Cancer Care	44	3	4
7125	Marine Biological Association of the United Kingdom	36	–	–
7094	MIRA Ltd	36	52	8
7096	Modern Humanities Research Association	5	1	–

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

NON-UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
7268	Myscience Co Ltd	–	–	–
7222	National Centre for Business and Sustainability	2	–	–
7018	National Inst of Economic & Social Research	19	9	3
7268	National Science Learning Centre	19	–	–
7272	Ner Yisrael Educational Trust	1	–	–
7205	North East Wales Institute	6	–	–
7073	Northern College	31	8	2
7269	Northern Consortium UK Ltd	5	–	–
7146	Northern Ireland Council for Postgraduate Medical & Dental Education	4	2	–
7115	Northern Ireland Economic Research Centre	–	1	4
7048	Numerical Algorithms Group Ltd	34	11	2
7155	Nuffield Trust	4	5	–
7183	NYU in London	5	–	–
7242	The Office for the Independent Adjudicator for Higher Education	12	–	–
7209	Open College Network Anglia	8	–	–
7284	Open College Network Eastern Region	3	–	–
7260	Open University Children's Centre	18	–	–
7261	Open University Student's Association	15	2	–
7058	Open University Worldwide	48	11	–
7023	Overseas Development Institute	61	10	–
7174	Oxford Cambridge & RSA Examinations	177	14	2
7031	Oxford Centre for Hebrew & Jewish Studies	8	1	1
7118	Oxford Centre for Islamic Studies	8	1	–
7163	Oxford Policy Institute	1	–	–
7287	Oxford Said Business School	–	–	–
7104	Pain Relief Foundation	1	–	–
7243	Picker Institute Europe	1	–	–
7075	Policy Studies Institute	37	16	4
7162	Quality Assurance Agency	58	13	3
7264	Queen Victoria Blond McIndoe Research Foundation	5	–	–
7234	Rambert School of Ballet and Contemporary Dance	5	–	–
7052	Reading University Students Union	–	1	–
7203	Regional Studies Association	3	–	–
7156	Regulatory Policy Institute	1	–	–

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

NON-UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
7238	Rhodes Trust	4	–	–
7123	Richmond College	40	9	–
7185	Royal Academy of Dance	1	–	–
7160	Royal Academy of Music	2	–	–
7218	Royal Agricultural College	1	–	–
7181	Royal College of Music	2	–	–
7081	Royal College of Paediatrics and Child Health	4	1	–
7020	Royal College of Surgeons of England	147	31	9
7021	Royal Geographical Society	2	3	1
7077	Royal Institution	12	5	1
7158	Royal Northern College of Music	5	–	–
7064	Royal Society	–	–	–
7070	Royal Society of Edinburgh	3	2	–
7022	Ruskin College	44	22	6
7105	School Mathematics Project	2	2	–
7130	Scottish Association for Marine Science	72	2	2
7232	Scottish Further Education	1	–	–
7262	Shared Care Network	12	–	–
7196	Sheffield University Enterprises Ltd	5	–	–
7199	Smith Institute	7	–	–
7274	Society for Experimental Biology	4	–	–
7169	Society of Antiquaries of London	9	2	–
7131	Southern Universities Management Services	14	3	–
7180	Standing Conference of Principals Ltd	4	–	–
7220	Stockholm Environment Institute	4	–	–
7042	Strangeways Research Laboratory	11	11	2
7187	Technology Innovation Centre	1	–	–
7273	The Biochemical Society	1	–	–
7282	The Educational Competences Consortium Ltd	2	–	–
7270	The Northern Consortium	2	–	–
7134	The Prince's Foundation	1	2	–
7280	The Young Foundation	16	7	–
7138	Thrombosis Research Institute	15	2	–
7109	Trade Union Research Unit Ltd	–	1	–
7173	Trinity College of Music	46	3	–

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

NON-UNIVERSITY INSTITUTIONS continued

No.	Name	MEMBERS	PENSIONERS Pensioner Members	Spouses, Dependants and Dependent Children
7263	UC (Suffolk) Ltd	–	–	–
7204	UHI Millenium Institute	7	–	–
7250	UK Biobank Ltd	18	–	–
7210	UKCOSA	15	–	–
7285	UK Socrates-Erasmus Council	12	–	–
7166	UMIST Ventures Ltd	3	–	–
7106	Universities and Colleges Admissions Service	20	16	5
7150	Universities and Colleges Employers Association	9	1	–
7121	Universities UK	47	9	2
7194	University College Northampton	4	–	–
7184	University Council for the Education of Teachers	3	1	–
7171	University of the Arts London	10	1	–
7049	University of Leicester Student's Union	1	3	1
7256	University of Sheffield Union of Students	4	–	–
7202	University of Wales, Newport	1	–	–
9999	USS Ltd	151	30	6
7227	Warren House Group at Dartington	14	–	–
7065	Wildfowl & Wetlands Trust	1	7	2
7148	Witan Hall (incorp Gyosei International College in the UK)	10	4	1
7142	WP Management Ltd	3	–	–
7027	York Archaeological Trust	3	2	–
7223	York Health Economics Consortium Ltd	7	–	–
7195	Yorkshire Universities	6	–	–
7076	Zoological Society of London	41	11	–
–	Withdrawn institutions	–	95	12
	Non-university institutions total	**3,623**	**833**	**151**
	All institutions total	**115,629***	**36,542**	**8,132**

*Included in this figure (but counted once only) are 2,295 members who have more than one appointment.

The number of members in the scheme and the number receiving pension and annuity benefits at the end of the year are as follows:

SUMMARY OF MOVEMENTS during the year ended 31 March 2006

Members		University Institutions	Non-University Institutions	Totals
Total members at 1 April 2005		106,564	3,402	109,966
New members		17,945	719	18,664
Retirements	- Ill-health	101	4	105
	- Other	1,744	32	1,776
Deaths		81	2	83
Leavers and withdrawals	- Refunds	1,689	65	1,754
	- Deferred/undecided	8,408	276	8,684
	- Retrospective*	589	10	599
Total members at 31 March 2006		111,897	3,732	115,629

*Retrospective withdrawals are members who withdrew from USS within three months of the date of joining the scheme with retrospective effect to the date of commencing employment at a USS institution.

In addition USS Ltd was notified during the year of 3,916 employees who became eligible to join the scheme but elected not to do so.

Pensioner Members	University Institutions	Non-University Institutions	Totals
Total pensioners at 1 April 2005	33,715	779	34,494
Mergers			
New pensioners	2,754	80	2,834
Deaths	760	26	786
Total pensioners at 31 March 2006	35,709	833	36,542

In addition at 31 March 2006, there were 7,259 pensions being paid to spouses and dependants and 873 annuities being paid to dependent children. Deferred pensioners not yet receiving a pension totalled 66,065.

Ex-spouse participants

At 31 March 2006, 226 ex-spouse participants have benefits within the scheme in their own right as a result of pension sharing, of whom 16 are now in receipt of their pension and are included in the pensioner member summary above.

FUND ACCOUNT for the year ended 31 March 2006

	Note	2006 £m	2005 £m
Contributions and Benefits			
Contributions receivable	3	842.1	783.7
Premature retirement scheme receipts		25.9	32.2
Transfers in	4	145.8	230.1
		1,013.8	1,046.0
Benefits payable	5	789.8	742.1
Payments on account of leavers	6	38.0	57.9
Administration costs	7	11.8	9.1
		839.6	809.1
Net additions from dealings with members		174.2	236.9
Returns on investments			
Investment income	8	686.9	587.6
Change in market value of investments	9	5,722.2	1,485.0
Investment management expenses	10	(20.7)	(15.9)
Net returns on investments		6,388.4	2,056.7
Net increase in the fund during the year		6,562.6	2,293.6
Fund at start of year		21,739.7	19,446.1
Fund at end of year		28,302.3	21,739.7

The notes on pages 63 to 69 form part of these financial statements.

STATEMENT OF NET ASSETS as at 31 March 2006

	Note	2006 £m	2005 £m
Investments			
Securities	12	25,163.2	19,036.6
Pooled investment vehicles securities	13	610.0	461.4
Pooled investment vehicles property	13	1,014.1	97.7
Property	14	1,042.3	1,701.9
Cash deposits		300.1	280.6
Other investment balances	15	116.3	105.1
		28,246.0	21,683.3
Net current assets	16	56.3	56.4
Total net assets, representing the fund balance		28,302.3	21,739.7

The financial statements on pages 61 to 69 were approved by the trustee, Universities Superannuation Scheme Limited, on 27 July 2006 and were signed on its behalf by:

Martin Harris
Chairman

T H Merchant
Chief Executive

The notes on pages 63 to 69 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 March 2006

1. Basis of preparation

The financial statements have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 and with the guidelines set out in the Statement of Recommended Practice (SORP) "Financial Reports of Pension Schemes" except that transactions and fund values in respect of money purchase additional voluntary contributions have not been disclosed in the fund account and the net assets statement on the grounds that the amounts involved are not material when compared to the scheme as a whole. However, details of AVC transactions are included in note 3 to the financial statements.

The financial statements summarise the transactions of the scheme and deal with the net assets at the disposal of the trustees. They do not take account of obligations to pay pensions and benefits which fall due after the end of the scheme year. The actuarial position of the scheme, which does take account of such obligations, is dealt with in the statements by the actuary on pages 75 and 76 and these financial statements should be read in conjunction with it.

2. Accounting Policies

A summary of the significant accounting policies which have been applied consistently by the scheme is set out below.

Contributions & Benefits

Contributions represent the amounts returned by the participating institutions as being those due to the scheme in respect of the year of account. The responsibility for ensuring the accuracy of contributions rests with institutions which, under the terms of the trust deed regulating USS, are ultimately responsible for ensuring the solvency of the scheme. Receipts under the premature retirement scheme and benefits payable are accounted for in the period in which they fall due.

The principal scheme benefits are provided under the main section. The supplementary section, which is funded by a contribution of 0.35% of salary from the members, provides additional benefits payable when a member retires on the grounds of ill-health or incapacity or dies in service.

Investment income

Investment income is brought into account on the following bases:

(a) Dividends, tax and interest from securities, on the date that the scheme becomes entitled to the income;

(b) Interest on cash deposits, as it accrues;

(c) Property rental income, as it accrues;

(d) Interest on advances for property developments, which is treated as investment income in the fund account and forms part of the cost of the relevant development, as it accrues until the earlier of the development becoming a completed property or the contracted purchase price being reached.

Property

A completed property is one that has received an architect's certificate of practical completion and which is substantially let. If a property has a certificate of completion but is not substantially let, it is included as a completed property, provided it is outside the period of contractors' liability for defects and no further building works are expected. Developments in progress include any property which is not a completed property.

Rates of exchange
Assets and liabilities denominated in overseas currencies are translated into sterling at the rates of exchange ruling at the balance sheet date and any exchange movements on translation are included in the fund account as part of the change in market value of investments.

Transfers
Transfers to and from the fund are accounted for on the basis of amounts received and paid during the year.

Investments
Investments are included in the statement of net assets at current value at the year end.

The current values are as follows:

(a) Quoted Securities – at closing prices; these prices may be last trade prices or mid market prices depending on the convention of the stock exchange on which they are quoted;

(b) Property – on the basis of open market value;

(c) Pooled investment vehicles – at unit prices or values based on the market valuation of the underlying assets.

Changes in current values are shown as movements in the fund account in the year in which they arise.

3. Contributions

	2006 £m	2005 £m
Main section		
Employers' contributions	554.4	518.1
Members' basic contributions	238.6	222.8
Members' additional voluntary contributions	35.3	29.9
	828.3	770.8
Supplementary section		
Members' contributions	13.8	12.9
	842.1	783.7

Additional voluntary contributions referred to above represent contributions made to purchase additional pensionable service under the rules of the scheme.

Money purchase additional voluntary contributions
A money purchase additional voluntary contribution facility is administered by the Prudential Assurance Company Limited.

Individual members'contributions are deducted from their salaries and paid direct to the Prudential by the institutions. The contributions are invested through the Prudential on behalf of the individuals concerned to provide additional benefits within the overall limits laid down by the Inland Revenue. The contributions paid and the investments purchased are not included in the accounts.

The value of the accumulated additional voluntary contributions at the end of the year, together with a summary of the movements during the year, is as follows:

	2006 £m	2005 £m
Value at the start of the year	175.2	153.4
Contributions from members	19.7	19.9
Transfers in	2.5	1.9
Income from interest and bonuses	7.7	8.7
Payouts to members	(10.0)	(8.7)
Value at the end of the year	195.1	175.2

4. Transfers in

	2006 £m	2005 £m
Individual transfers in	141.5	105.8
Group transfers in	4.3	124.3
	145.8	230.1

5. Benefits payable

	2006 £m	2005 £m
Main section		
Pensions	653.8	607.3
Lump sums on or after retirement	115.7	114.8
Lump sums on death in service	11.5	11.1
	781.0	733.2
Supplementary section		
Pensions	8.4	7.9
Lump sums on or after retirement	0.2	0.7
Lump sums on death in service	0.2	0.3
	8.8	8.9
	789.8	742.1

6. Payments on account of leavers

	2006 £m	2005 £m
Individual transfers to other schemes	34.6	54.6
Payments for members joining state scheme	1.5	1.5
Refunds to members leaving service	1.9	1.8
	38.0	57.9

7. Administration costs

In accordance with the trust deed, the costs of managing and administering the scheme, incurred by the trustee company, are chargeable to USS. Details are given in the financial statements of the trustee company (Universities Superannuation Scheme Limited: Registered No. 1167127).

8. Investment income

	2006 £m	2005 £m
Dividends from UK equities	298.3	258.1
Net property income	78.7	78.7
Income from pooled investment vehicles	2.6	2.9
Dividends from overseas equities	207.1	160.9
Income from UK fixed interest securities	57.8	55.7
Income from overseas fixed interest securities	23.2	17.1
Interest on cash deposits	10.7	10.2
Other income	8.5	4.0
	686.9	587.6

9. Change in market value of investments

The changes in the market value of investments are shown below.

	Market value 2005 £m	Purchases during the year at cost £m	Proceeds of sales during the year £m	Changes in value during the year £m	Market value 2006 £m
Securities	19,036.6	12,983.0	(12,141.6)	5,285.2	25,163.2
Pooled investment vehicles - securities	461.4	375.6	(436.9)	209.9	610.0
Pooled investment vehicles - property	97.7	870.2	(2.0)	48.2	1,014.1
Property	1,701.9	229.3	(1,074.8)	185.9	1,042.3
Cash deposits	280.6	26.5	–	(7.0)	300.1
	21,578.2	14,484.6	(13,655.3)	5,722.2	28,129.7
Other investment balances	105.1				116.3
Total	21.683.3				28,246.0

Changes in the value of investments comprise both realised gains/(losses) on investments sold during the year and unrealised gains/(losses) on investments held at the year end.

During the year three properties totalling £840m were transferred to separate property unit trusts in exchange for units in the unit trusts. The acquisition of these units is included above as part of the purchases of pooled investment vehicles - property.

Within cash deposits at 31 March 2006 are £444.6m of forward currency assets together with related liabilities of £446.8m. Forward currency transactions have been used to hedge part of the currency risk relating to overseas fixed interest and equity investments.

10. Investment management expenses

Investment management expenses comprise all costs directly attributable to the scheme's investment activities, including the operating costs of the London Investment Office and the costs of management and agency services rendered by third parties. Details are given in the financial statements of the trustee company (Universities Superannuation Scheme Limited: Registered No. 1167127).

11. Taxation

UK tax

USS is an exempt approved scheme under the Income & Corporation Taxes Act 1988 and is therefore not normally liable to UK income tax on income from investments directly held nor to capital gains tax arising from the disposal of such investments.

Overseas tax

Investment income from overseas investments may be subject to deduction of local withholding taxes. Where no double taxation agreement exists between the UK and the country in which the income arises, the tax suffered is deducted from the income to which it relates.

12. Securities

	2006 £m	2005 £m
Quoted		
UK equities	10,197.2	8,226.2
Overseas equities	13,039.0	9,103.4
UK fixed interest - public sector quoted	144.7	222.4
UK fixed interest - other	982.7	924.8
Overseas fixed interest - public sector quoted	779.0	459.9
Overseas fixed interest - other	20.6	99.9
	25,163.2	19,036.6

13. Pooled investment vehicles

	2006 £m	2005 £m
Securities		
Managed funds	334.7	252.8
Unit trusts	275.3	208.6
	610.0	461.4
Property		
Unit trusts	896.3	32.7
Property companies	6.2	2.2
Limited partnerships	111.6	62.8
	1,014.1	97.7
	1,624.1	559.1

14. Property

	2006 £m	2005 £m
UK completed properties	976.0	1,577.9
UK developments in progress	66.3	124.0
	1,042.3	1,701.9
Properties analysed by type:		
Freehold	912.4	1,600.3
Leasehold	129.9	101.6
	1,042.3	1,701.9

The completed properties and developments in progress have been valued on the basis of market value as at 31 March 2006 for accounts purposes by Drivers Jonas acting as independent valuers and by Colliers Conrad Ritblat Erdman as at 31 March 2005. The valuations have been undertaken in accordance with the RICS Appraisal & Valuation Standards.

15. Other investment balances

	2006 £m	2005 £m
Amount due to stockbrokers	(180.0)	(79.2)
Amount due from stockbrokers	160.9	68.4
Dividends and accrued interest	135.4	115.9
	116.3	105.1

16. Net current assets

	2006 £m	2005 £m
Current assets		
Contributions due from institutions:		
- employers' contributions	55.6	53.4
- members' basic contributions	21.1	19.2
- members' additional voluntary contributions	2.1	2.0
Other debtors	15.4	23.4
Cash at bank and in hand	9.8	20.4
	104.0	118.4
Current liabilities		
Rents & service charges received in advance	10.8	16.7
Property revenue expenses payable	0.7	0.9
Amount due on property purchases	3.1	1.5
Benefits payable	23.6	37.0
Taxation creditor	1.5	1.6
Other creditors	0.8	0.9
Due to USS Ltd	7.2	3.4
	47.7	62.0
	56.3	56.4

Contributions due at the year end have been paid to the Scheme subsequent to the year end in accordance with the Schedule of Contributions.

Benefits payable include £5.2m (2005: £22m) in respect of certain benefits for early leavers which have been underpaid. These had been calculated based on the scheme's normal retirement age but, following a ruling by the High Court, it has now been established that they should have been calculated based on each individual's contracted retirement age. Of the opening balance of £22m, £11.8m was paid in the year and £5m written back to benefits payable, leaving a closing balance of £5.2m.

17. Securities on loan

Securities have been lent to the counterparties in return for fee income earned by the scheme. Security for these loans is obtained by holding collateral in the form of cash, equities, government bonds and letters of credit.

	2006 £m	2005 £m
Value of stock on loan at 31 March	3,455.0	271.0
Value of collateral held at 31 March	3,609.7	285.1

The fund changed its main lending agreement in March 2005 to lend most of its internally managed European stocks exclusively to one borrower for a fixed percentage fee. This increased the total income from securities lending and the value of stock on loan. As at 31 March 2005, the value of stock on loan had been significantly reduced in anticipation of the transfer to the new borrower.

18. Financial commitments

	2006 £m	2005 £m
Property		
Contracts placed but not provided for	108.1	77.0
Securities		
Forward commitments for unpaid calls on securities and underwriting contracts	11.9	4.1

19. Self investment

The scheme had no employer related investments during the year.

20. Related party transactions

The only related party transactions are between the scheme and its trustee company and certain employees of the trustee company through their membership of the Scheme. The trustee company provides administration services, the cost of which includes directors' emoluments as detailed in note 5 of the trustee company accounts, and investment management services to the scheme, charging £11.8 million and £20.7 million respectively, with a balance due from the scheme of £7.2 million as at 31 March 2006.

STATEMENT OF TRUSTEE'S RESPONSIBILITIES in respect of the financial statements

The audited financial statements are the responsibility of the trustee, Universities Superannuation Scheme Limited. Pension scheme regulations require the trustee to make available to scheme members, beneficiaries and certain other parties, audited financial statements for each scheme year which:

- show a true and fair view of the financial transactions of the scheme during the scheme year and of the amount and disposition at the end of the scheme year of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the scheme year, and
- contain the information specified in the Schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including a statement whether the financial statements have been prepared in accordance with the Statement of Recommended Practice "Financial Reports of Pension Schemes".

The trustee has supervised the preparation of the financial statements and has agreed suitable accounting policies, to be applied consistently, making any estimates and judgements on a prudent and reasonable basis. The trustee is also responsible for making available each year, commonly in the form of a trustee's annual report, information about the scheme prescribed by pensions legislation, which it should ensure is consistent with the financial statements it accompanies.

The trustee also has certain responsibilities in respect of contributions which are set out in the statement of trustee's responsibilities accompanying the trustee's summary of contributions.

The trustee has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to it to safeguard the assets of the scheme and to prevent and detect fraud and other irregularities, including the maintenance of appropriate internal controls.

Signed on behalf of the trustee on 27 July 2006

Martin Harris
Chairman

T H Merchant
Chief Executive

STATEMENT OF TRUSTEE'S RESPONSIBILITIES in respect of contributions

The trustee is responsible under pensions legislation for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions showing the rates of contributions (other than voluntary contributions) payable towards the scheme by or on behalf of the employer and the active members of the scheme and the dates on or before which such contributions are to be paid. The trustee is also responsible for keeping records of contributions received in respect of any active member of the scheme, and for ensuring that contributions are made to the scheme in accordance with the schedule of contributions.

Trustee's summary of contributions payable under the schedule in respect of the scheme year ended 31 March 2006

This summary of contributions has been prepared by and is the responsibility of the trustee. It sets out the employer and member contributions payable to the scheme from 1 April 2005 to 30 January 2006 under the schedule of contributions certified by the actuary on 20 May 2003 and subsequently in accordance with the schedule of contributions certified by the actuary on 31 January 2006 in respect of the period 31 January 2006 to 31 March 2006. The scheme auditor reports on contributions payable under the schedule in their auditors' statement about contributions.

Contributions payable under the schedule in respect of the scheme year

	£m
Employer	
Normal contributions	553.5
Special contributions	0.9
Additional contributions	25.9
Member	
Normal contributions	250.3
Additional contributions	2.1
Contributions payable under the schedule (as reported on by the scheme auditor)	832.7

Reconciliation of contributions payable under the schedule to total contributions payable to the scheme in respect of the scheme year

	£m
Contributions payable under the schedule	832.7
Contributions payable in addition to those payable under the schedule (and not reported on by the scheme auditor): Member additional voluntary contributions (excluding those paid to the Prudential)	35.3
Total contributions (including premature retirement scheme receipts) reported in the financial statements	868.0

In addition to the total contributions reported in the financial statements, there were £19.7m additional voluntary contributions paid by members to the Prudential. Details are included in note 3 to the financial statements.

Signed on behalf of the trustee on 27 July 2006

Martin Harris
Chairman

T H Merchant
Chief Executive

INDEPENDENT AUDITORS' REPORT to the trustee of the Universities Superannuation Scheme

We have audited the financial statements of the Universities Superannuation Scheme for the year ended 31 March 2006 which comprise the fund account, the net assets statement and the related notes. These financial statements have been prepared under the accounting policies set out therein. This report is made solely to the scheme trustees, as a body in accordance with the Pensions Act 1995 and Regulations made thereunder.

Our audit work has been undertaken so that we might state to the scheme trustees those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the scheme trustees, as a body for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of trustees and auditors

As described in the statement of trustees' responsibilities on page 70, the scheme trustees are responsible for obtaining an annual report, including audited financial statements prepared in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements show a true and fair view and contain the information specified in the Schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. We also report to you if, in our opinion, we have not received all the information and explanations we require for our audit.

We read the trustees' report and other information contained in the annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by or on behalf of the trustees in the preparation of the financial statements, and of whether the accounting policies are appropriate to the scheme's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements:

- show a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the financial transactions of the scheme during the scheme year ended 31 March 2006 and of the amount and disposition at that date of its assets and liabilities (other than liabilities to pay pensions and benefits after the end of the scheme year); and
- contain the information specified in Regulation 3 of, and the Schedule to, the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995.

KPMG LLP
Chartered Accountants
Registered Auditor

27 July 2006

INDEPENDENT AUDITORS' STATEMENT ABOUT CONTRIBUTIONS

made under Regulation 4 of The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, to the trustee, of the Universities Superannuation Scheme.

We have examined the summary of contributions payable under the schedule of contributions to the Universities Superannuation Scheme in respect of the scheme year ended 31 March 2006 which is set out on page 71.

This statement is made solely to the scheme's trustee, in accordance with the Pensions Act 1995 and Regulations made thereunder. Our work has been undertaken so that we might state to the scheme's trustee those matters we are required to state to it in an auditors' statement about contributions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the scheme's trustee, for our work, for this statement, or for the opinions we have formed.

Respective responsibilities of trustee and auditors

As described on page 71, the scheme's trustee is responsible, under the Pensions Act 2004, for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions which sets out the rates and due dates of certain contributions payable towards the scheme by or on behalf of the employer and the active members of the scheme. The trustee has a general responsibility for procuring that contributions are made to the scheme in accordance with the schedule of contributions.

It is our responsibility to provide a statement about contributions paid to the scheme and to report our opinion to you.

We read the trustee's report and other information in the annual report and consider whether it is consistent with the summary of contributions. We consider the implications for our statement if we become aware of any apparent misstatements or material inconsistencies with the summary of contributions.

Basis of statement about contributions

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to give reasonable assurance that contributions reported in the summary of contributions have been paid in accordance with the relevant requirements. For this purpose, the work that we carried out included examination, on a test basis, of evidence relevant to the amounts of contributions payable to the scheme and the timing of those payments. Our statement about contributions is required to refer to those exceptions which come to our attention in the course of our work.

Statement about contributions payable under the schedule

In our opinion contributions for the scheme year ended 31 March 2006 as reported in the summary of contributions and payable under the schedule have been paid from 1 April 2005 to 30 January 2006 in accordance with the schedule of contributions certified by the actuary on 20 May 2003 and subsequently in accordance with the schedule of contributions certified by the actuary on 31 January 2006.

KPMG LLP
Chartered Accountants

27 July 2006

ACTUARIAL STATEMENT made for the purposes of Regulation 14 of the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996.

Name of scheme: **Universities Superannuation Scheme**
Effective date of valuation: **31 March 2005**

1. Compliance with minimum funding requirement

In my opinion, on the effective date the value of the assets of the scheme exceeds 120% of the amount of the liabilities of the scheme.

2. Valuation principles

The scheme's assets and liabilities are valued in accordance with section 56(3) of the Pensions Act 1995, the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 and the mandatory guidelines on minimum funding requirement (GN27), prepared and published by the Institute of Actuaries and the Faculty of Actuaries.

Mercer Human Resource Consulting Limited
Manchester M2 4DW
December 2005

E S Topper
Fellow of the Institute of Actuaries

Note:
The valuation of the amount of the liabilities of the Scheme does not reflect the cost of securing those liabilities by the purchase of annuities, if the Scheme were to have been wound up on the effective date of the valuation.

ACTUARIAL STATEMENT made for the purposes of Regulation 30 of the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996.

Name of scheme: **Universities Superannuation Scheme**
Effective date of valuation: **31 March 2005**

1. Security of prospective rights

In my opinion, the resources of the scheme are likely in the normal course of events to meet in full the liabilities of the scheme as they fall due. This statement assumes the scheme continues and does not mean that should the scheme wind up there would be sufficient assets to provide the full accrued benefits.

I have made assumptions consistent with market values, prospective investment returns and economic conditions at the effective date. Variations in markets may mean divergence from those assumptions and changes in values of assets such that this statement would no longer be true unless different assumptions are made or contributions increased at or before the next valuation. The institutions' abilities to meet future contribution requirements are outside the scope of my investigation. In giving this opinion, I have assumed that the following amounts will be paid to the scheme:

Description of contributions

Employer contributions:	14% of Salaries per annum
Member contributions:	6.35% of Salary per annum

Subject to review at future actuarial valuations.

2. Summary of methods and assumptions used

Valuation method		Projected unit
Investment return	- past service	4.5% per annum
	- future service	6.2% per annum
Salary growth		3.9% per annum
Pension increases		2.9% per annum

Further details of the methods and assumptions used are set out in my actuarial valuation addressed to the Trustee dated December 2005.

Mercer Human Resource Consulting Limited
Manchester M2 4DW
December 2005

E S Topper
Fellow of the Institute of Actuaries

FIVE YEAR SUMMARY - FUND ACCOUNTS for years ended 31 March

	2006 £m	2005 £m	2004 £m	2003 £m	2002 £m
Contributions and benefits					
Contributions	842	784	698	661	611
PRS receipts	26	32	36	40	38
Transfers in	146	230	110	115	106
	1,014	1,046	844	816	755
Benefits payable					
Pensions	662	615	562	524	488
Lump sums	128	127	122	121	122
Transfers out	36	56	43	41	54
Refunds	2	2	2	2	2
	828	800	729	688	666
Investment income (net of investment management costs)	666	572	542	541	463
Administration costs of the trustee (excluding investment management costs)	11.8	9.1	9.3	7.6	5.8
Changes in value of investments	5,722	1,485	3,215	(5,036)	(629)
Investments of the fund (restated) (at current values) at 31 March					
Securities	25,163	19,037	16,876	12,914	16,890
Pooled investment vehicles	1,624	559	539	477	566
Property	1,043	1,702	1,553	1,650	1,667
Life assurance policies	–	–	4	15	183
Cash deposits	300	281	350	396	486
Other investment balances	116	105	88	86	99
	28,246	21,684	19,410	15,538	19,891

Membership numbers at 31 March	2006	2005	2004	2003	2002
Contributing members	115,600	110,000	103,100	98,400	95,700
Pensioners	44,700	42,200	39,200	37,000	35,100
Deferred pensioners	66,100	62,700	56,700	51,400	49,500
	226,400	214,900	199,000	186,800	180,300

REPORT OF THE DIRECTORS for the year ended 31 March 2006

The directors submit their report and the accounts for the year ended 31 March 2006.

Principal activity

The company, which is limited by guarantee and does not have a share capital, was established to undertake and discharge the office of trustee of any superannuation scheme but in particular to act as the trustee of the Universities Superannuation Scheme (USS).

Operating costs and review of activities

The operating costs for the year amounted to £32,462,000 this amount being recoverable from USS. This compares with £25,061,000 for the year ended 31 March 2005 and represents a 30% increase in administration costs and a 30% increase in investment management costs. The increase in administration costs is due almost entirely to the payment of the Pension Protection Fund levy for the first time this year totalling £2,551,000. The levy was introduced by the Pensions Act 2004. Excluding this amount, administration costs increased by approximately 1%. The increase in investment costs is due partly to increases in the base fees of the external managers, which are linked to market values (the value of the fund rose 30% during the year), and to the performance fee for one of the managers whose performance significantly exceeded target.

There have been major legislative changes during the year to implement the government's radical revisions to the occupational pension scheme environment. Internal preparations have been undertaken to ensure that the trustee company is in a position to administer benefits in accordance with the new tax regime from 6 April 2006 (A-day) and key decisions have been taken on the extent to which the new flexibilities might be adopted within the USS rules (within the existing funding constraints). Staff have received internal training on the new arrangements, the pensions administration software has been updated to reflect the key changes in the legislation, and internal processes have been revised. A new *Guide for Members* has also been prepared, and has been distributed at the end of March 2006, and affected members have received detailed communication material. There have also been numerous regulations arising from the Pensions Act 2004 and the trustee company has been active during the year in considering various issues which arise from these new provisions and ensuring, as far as possible, that the fund is not disadvantaged by the regulations.

The officers carried out a review during the year of the potential systems to replace the scheme's existing pensions administration software, the Universal Pensions Management System (UPM) from Comino and in July 2005 the trustee company decided that Comino's replacement software, UPM version 2, was the best solution for the company's business needs. Following a detailed feasibility study and extensive contractual negotiations, the project to replace the pensions administration system commenced in February 2006 and the application was successfully implemented onto our test environment in March. The new system is expected to go live during 2007/08.

Fixed assets

The details of movements in fixed assets are set out in Note 13 to the accounts.

Directors

The directors of the company during the year were as follows:

Sir Graeme Davies, *chairman*
Sir Martin Harris, *deputy chairman*
A S Bell (to 31.7.2005)
Professor John Bull
M Butcher
S Egan (from 1.2.2006)
D Guppy (from 1.9.2005)
Mrs V Holmes (from 1.9.2005)
H Jacobs
Lady Merrison
Sir Howard Newby (to 31.1.06)
M S Potts
Professor Charles Sutcliffe
J W D Trythall (to 31.8.05)
Baroness Warwick of Undercliffe

Sir Graeme Davies retired as chairman on 31 March 2006 and was replaced as chairman by Sir Martin Harris on 1 April 2006. Professor Bull became deputy chairman on 1 April 2006.

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the operating costs of the company for that period. In preparing those financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditors

The auditors, KPMG LLP, have indicated their willingness to continue in office and a resolution concerning their reappointment will be proposed at the annual general meeting.

By order of the board

I M Sherlock
Secretary

27 July 2006

STATEMENT OF OPERATING COSTS for the year ended 31 March 2006

	Note	2006 £000	2005 £000
Personnel costs			
Employees' emoluments	4	8,067	7,375
Directors' emoluments and expenses	5	427	438
Recruitment, training and welfare		433	310
		8,927	8,123
Premises costs			
Rent, rates, service charges and utilities		1,568	1,557
Depreciation and maintenance		286	277
		1,854	1,834
Investment costs			
Securities management	6	10,357	6,215
Property management		1,608	1,690
Custodial services		1,396	1,376
Legal costs - property management		521	331
- securities management		103	31
Property valuation		124	134
Investment performance measurement		79	77
Costs met by third parties	7	(11)	(77)
		14,177	9,777
Other costs			
Pension Protection Fund Levy		2,551	–
Computer and information services costs	8	2,499	2,598
Professional fees	9	1,480	1,420
Travel and car costs		510	466
Institution liaison and member communication		309	250
Telephones and postage		298	254
Office equipment		281	263
Printing and stationery		185	149
Insurances		144	194
Pensions Regulator Levy		133	–
Pensions Act Levy		–	108
FSA membership		61	77
Auditors' remuneration	10	53	51
Sundry expenditure		54	51
Profit on disposal of fixed assets		(23)	(1)
Costs met by third parties	7	(1,031)	(553)
		7,504	5,327
Total operating costs	12	32,462	25,061

A separate statement of total recognised gains and losses has not been presented as all gains and losses are included in the Statement of Operating Costs.

The notes on pages 83 to 89 form part of these financial statements.

BALANCE SHEET as at 31 March 2006

	Note	2006 £000	2005 £000
Assets			
Fixed assets			
Tangible fixed assets	13	1,204	1,589
Current assets			
Debtors	14	8,126	4,348
Cash at bank and in hand		3	3
		8,129	4,351
Total assets		9,333	5,940
Liabilities			
Creditors - amounts falling due within one year	15	9,333	5,940
Total liabilities		9,333	5,940

The notes on pages 83 to 89 form part of these financial statements.

The financial statements on pages 80 to 89 were approved by the board of directors on 27 July 2006 and were signed on its behalf by:

Martin Harris
Chairman

John Bull
Deputy Chairman

CASH FLOW STATEMENT for the year ended 31 March 2006

	Note	2006 £000	2005 £000
Operating activities			
Cash received from USS		28,713	23,518
Operating costs paid	16	(28,332)	(23,048)
Net cash inflow from operating activities		381	470
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(457)	(502)
Sale of tangible fixed assets		76	33
		(381)	(469)
Increase in cash		–	1

The notes on pages 83 to 89 form part of these financial statements.

NOTES TO THE ACCOUNTS for the year ended 31 March 2006

1. The company, which is limited by guarantee and does not have a share capital, has no beneficial interest in the investments and other assets held in its name but not included in its balance sheet, since it holds these as the trustee of USS.

2. Format of accounts

A Profit and Loss Account is not presented with these accounts as such a statement is inappropriate to the operations of the company. The costs incurred and the method by which they are recovered are therefore set out in the Statement of Operating Costs.

A separate note of historical cost profits and losses is not required as the accounts are prepared under the historical cost convention.

3. Accounting policies

Accounting convention

The accounts are prepared under the historical cost convention and on the accruals basis and comply with applicable Accounting Standards in the United Kingdom which have been consistently applied.

Depreciation of fixed assets

Depreciation is calculated so as to write off the cost of fixed assets on a straight line basis over the expected economic lives of the assets concerned. The principal annual rates used for this purpose are:

	%
Office equipment	15
Alterations to rented premises	20
Computer equipment	20 and 33 ⅓
Motor cars	25
Computer software	33 ⅓

Operating leases

Rental costs under operating leases are charged on a straight line basis over the lease term in the Statement of Operating Costs.

Pensions

USS Ltd participates in the Universities Superannuation Scheme (USS), a defined benefit scheme which is externally funded and contracted out of the State Second Pension (S2P). The assets of the scheme are held in a separate trustee-administered fund. USS Ltd is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis and therefore, as required by FRS 17 "Retirement benefits", accounts for the scheme as if it were a defined contribution scheme. As a result, the amount charged to the income and expenditure account represents the contributions payable to the scheme in respect of the accounting period.

4. Employees' emoluments

	2006	2005
The average weekly number of persons employed by the company during the year (excluding directors) was	173	158
Staff costs for the above persons were:	£000	£000
Wages and salaries	6,508	5,874
Pension costs (superannuation contributions)	723	679
Social security costs (national insurance contributions)	637	539
Restructuring costs	199	283
	8,067	7,375

Emoluments of the chief executive	2006 £000	2005 £000
T H Merchant	218	198

The emoluments of the chief executive are shown on the same basis as for higher paid staff. USS Ltd's pension contributions for the chief executive amounted to £14,784 (2005: £14,280).

Remuneration of other higher paid staff, excluding employer's pension contributions but including benefits in kind:

	2006	2005
£70,001 - £80,000	5	7
£80,001 - £90,000	6	2
£90,001 - £100,000	3	2
£100,001 - £110,000	2	1
£110,001 - £120,000	2	5
£120,001 - £130,000	5	1
£130,001 - £140,000	1	–
£140,001 - £150,000	1	–
£160,001 - £170,000	–	1
£170,001 - £180,000	1	–
£200,001 - £210,000	–	1
£340,001 - £350,000	1	–
£390,001 - £400,000	1	–
£430,001 - £440,000	–	1

The salary figures above include bonus payments for the investment staff, totalling £751,269 (2005: £463,392), which relate directly to their contribution to fund out-performance. Both the bonus scheme and the annual outcome are reviewed by the remuneration committee.

5. Directors' emoluments and expenses

	2006 £000	2005 £000
Fees	371	356
Employer's costs - national insurance contributions	40	38
Expenses	16	44
	427	438

Directors are remunerated on a basis which is approved by the Joint Negotiating Committee and is in accordance with the contribution which they make to the work of USS Ltd and their legal responsibilities.

No pension contributions are made on behalf of directors. As at 31 March 2006 six of the directors are members of USS either as pensioners or through their employment with the institutions.

Directors' fees charged to the accounts reflect small differences between the amounts accrued in the accounts at each year end and the amounts paid. Actual emoluments paid to each director in respect of each of the last two years were as follows:

	2006 £000	2005 £000
Sir Graeme Davies (chairman)	45	43
H Jacobs	71	53
Professor John Bull	32	20
Sir Martin Harris (deputy chairman)	31	27
M S Potts	30	28
Professor Charles Sutcliffe	27	25
Lady Merrison	25	23
Baroness Warwick of Undercliffe	24	22
V Holmes	18	–
A S Bell	16	47
J W D Trythall	16	39
M Butcher	13	5
D Guppy	11	–
Sir Howard Newby	10	11
S Egan	2	–
C D Donald	–	12
	371	355

6. Securities management

	2006 £000	2005 £000
External manager base fees	7,674	6,131
External manager performance fees	2,338	–
Professional fees	345	84
	10,357	6,215

7. Costs met by third parties

Costs met by third parties represent the amount paid by certain stockbrokers for the purchase of equipment and services for USS Ltd for investment management purposes out of the commission paid to them by USS.

8. Computer and information services costs

	2006 £000	2005 £000
Investment information services	1,154	1,109
Computer running costs	622	617
Software depreciation	312	448
Investment accounting services	260	243
Hardware depreciation	129	170
Computer bureau fees	22	11
	2,499	2,598

9. Professional fees

	2006 £000	2005 £000
Actuarial	791	656
Legal	376	488
Committee members (other than directors)	111	114
Taxation	57	70
Member medicals	50	37
Public relations	17	15
Pensioner mortality check	–	7
Salary surveys	19	–
Other	59	33
	1,480	1,420

10. Auditors' remuneration

	2006 £000	2005 £000
USS	48	46
USS Ltd	5	5
	53	51

Remuneration of the company's auditors (KPMG LLP) for provision of services other than for the audit of USS and USS Ltd was £3,500 for advice on taxation and £4,000 for actuarial training (2005:£6,800 for advice on taxation, £8,354 for recruitment advice and £2,534 for a project management course).

11. Value Added Tax

USS Ltd is registered for Value Added Tax activities and recovers a proportion of the input tax on administrative expenditure directly attributable to the scheme's investment activities.

12. Total operating costs - recoverable from USS

	2006 £000	2005 £000
Investment management costs	20,661	15,930
Other administration costs	11,801	9,131
	32,462	25,061

Investment management costs are those costs which are directly attributable to investment activities and include relevant personnel, premises and other costs.

Included in operating costs is a charge for depreciation of £789,000 (2005: £918,000) as set out in note 13.

All of the operating costs are recoverable from USS, which at 31 March 2006 had total assets in excess of £28 billion.

13. Tangible fixed assets

	Alterations to Rented Premises £000	Computer Equipment £000	Computer Software £000	Office Equipment £000	Motor Cars £000	Total £000
Cost						
At 1 April 2005	2,105	1,680	1,959	1,486	459	7,689
Additions	–	97	210	43	107	457
Disposals	–	–	–	–	(193)	(193)
At 31 March 2006	2,105	1,777	2,169	1,529	373	7,953
Accumulated Depreciation						
At 1 April 2005	1,707	1,542	1,535	1,121	195	6,100
Charge for year	164	129	312	91	93	789
Disposals	–	–	–	–	(140)	(140)
At 31 March 2006	1,871	1,671	1,847	1,212	148	6,749
Net Book Value						
31 March 2006	234	106	322	317	225	1,204
Net Book Value						
31 March 2005	398	138	424	365	264	1,589

14. Debtors - amounts falling due within one year

	2006 £000	2005 £000
Due from USS	7,177	3,428
Prepayments	922	893
Other debtors	27	27
	8,126	4,348

15. Creditors - amounts falling due within one year

	2006 £000	2005 £000
Accrued expenditure	5,606	2,824
Other creditors	3,122	2,677
Taxation and social security	605	439
	9,333	5,940

16. Reconciliation of operating costs paid

	2006 £000	2005 £000
Operating costs - recoverable from USS	32,462	25,061
Increase in creditors	(3,393)	(779)
Profit on sale of tangible fixed assets	23	1
Depreciation	(789)	(918)
Increase/(decrease) in debtors (excluding USS)	29	(317)
Operating costs paid	28,332	23,048

17. Operating lease commitments

USS Ltd is committed to making future annual payments under operating leases which expire as follows:

	2006 £000	2005 £000
Less than one year	10	10
Between two and five years	13	9
Over five years	1,211	1,211

The payments relate to ongoing rent, rates and equipment leasing commitments in respect of USS Ltd's offices in Liverpool and London.

18. Pension costs

The company participates in the Universities Superannuation Scheme (USS), a defined benefit scheme which is externally funded and contracted out of the State Second Pension (S2P). The assets of the scheme are held in a separate trustee-administered fund. The company is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis and therefore, as required by FRS17 'Retirement benefits', accounts for the scheme as if it were a defined contribution scheme. As a result, the amount charged to the income and expenditure account represents the contributions payable to the scheme in respect of the accounting period.

The latest actuarial valuation of the scheme was at 31 March 2005. The assumptions which have the most significant effect on the result of the valuation are those relating to the rate of return on investments (i.e. the valuation rate of interest) and the rates of increase in salary and pensions. In relation to the past service liabilities the financial assumptions were derived from market yields prevailing at the valuation date. It was assumed that the valuation rate of interest would be 4.5% per annum, salary increases would be 3.9% per annum (plus an additional allowance for increases in salaries due to age and promotion in line with recent experience) and pensions would increase by 2.9% per annum. In relation to the future service liabilities it was assumed

that the valuation rate of interest would be 6.2% per annum, including an additional investment return assumption of 1.7% per annum, salary increases would be 3.9% per annum (also plus an allowance for increases in salary due to age and promotion) and pensions would increase by 2.9% per annum. The valuation was carried out using the projected unit method.

At the valuation date, the value of the assets of the scheme was £21,740 million and the value of the past service liabilities was £28,308 million indicating a deficit of £6,568 million. The assets therefore were sufficient to cover 77% of the benefits which had accrued to members after allowing for expected future increases in earnings.

The actuary also valued the scheme on a number of other bases as at the valuation date. Using the Minimum Funding Requirement prescribed assumptions introduced by the Pensions Act 1995, the scheme was 126% funded at that date; under the Pension Protection Fund regulations introduced by the Pensions Act 2004 it was 110% funded; on a buy-out basis (ie assuming the Scheme had discontinued on the valuation date) the assets would have been approximately 74% of the amount necessary to secure all the USS benefits with an insurance company; and using the FRS17 formula as if USS was a single employer scheme, the actuary estimated that the funding level would have been approximately 90%.

The institution contribution rate required for future service benefits alone at the date of the valuation was 14.3% of pensionable salaries but the trustee company, on the advice of the actuary, decided to maintain the institution contribution rate at 14% of pensionable salaries.

Surpluses or deficits which arise at future valuations may impact on the institution's future contribution commitment. An additional factor which could impact the funding level of the scheme is that with effect from 16 March 2006, USS positioned itself as a "last man standing" scheme so that in the event of the insolvency of any of the participating employers in USS, the amount of any pension funding shortfall (which cannot otherwise be recovered) in respect of that employer will be spread across the remaining participant employers and reflected in the next actuarial valuation of the scheme.

The next formal triennial actuarial valuation is due as at 31 March 2008. The contribution rate will be reviewed as part of each valuation.

The total pension cost for the company was £723,034 (2005: £678,904). The contribution rate payable by the company was 14% of pensionable salaries.

19. Related party transactions

There are no related party transactions other than transactions between the trustee company and the scheme. The trustee company provides administration and investment management services to the scheme charging £11.8 million and £20.7 million respectively, with a balance due from the scheme of £7.2 million at 31 March 2006.

20. Special purpose companies

USS Ltd owns the share capital of a number of special purpose companies to aid the efficient administration of fund investments. Their results have not been consolidated with USS Ltd because they are considered to be assets of the fund. Full details of these companies may be obtained by writing to the Company Secretary of USS Ltd, Mr Ian Sherlock, at Royal Liver Building, Liverpool L3 1PY.

INDEPENDENT AUDITORS' REPORT

to the members of Universities Superannuation Scheme Limited

We have audited the financial statements of Universities Superannuation Scheme Limited for the year ended 31 March 2006 which comprise the Statement of Operating Costs, the Balance Sheet, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities on page 79, the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion :

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2006 and of its result for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the committee reports is consistent with the financial statements.

KPMG LLP
Chartered Accountants
Registered Auditor

Date: 27 July 2006

NOTES

Sir Martin Harris
Chairman

CHAIRMEN OF PRINCIPAL SUB-COMMITTEES

Virginia Holmes
Investment Committee

Professor John Bull
Finance & General Purposes Committee and Nominations Committee

Dr Christine Challis
Audit Committee

H R Jacobs
Remuneration and Rules Committees

Sir Kenneth Berrill
Joint Negotiating Committee

Dr Angela Roger
Advisory Committee

PRINCIPAL OFFICERS

Brendan Mulkern Pensions Policy Manager
Bernadine Steventon Pensions Operations Manager
Peter Moon Chief Investment Officer
Iain Hall Head of IT
Tom Merchant Chief Executive
Colin Busby Communications Manager
Ian Sherlock Company Secretary
Colin Hunter Chief Financial Officer

USS