USS

## Outstanding Q&As

1. Why is the USS executive persisting in rejecting the smoothing and de-risking recommendations of the Joint Expert Panel despite the widespread support for them from employers, UUK and UCU and their actuarial advisors, Aon and First Actuarial?
2. UCU and UUK along with many employers have noted that the justification provided by USS for 5% Deficit Recovery Contributions, which are a major cause for the upper "bookend" of the March 2018 valuation being so high and, thereby, of the supposed need for contingent contributions, is wholly inadequate and unconvincing. Why in the face of this highly informed criticism is the USS executive persisting with calling for these high DRCs?
3. Many have observed that in light of the strike last year, the revelations about the weaknesses of the valuation, and JEP's criticisms of USS, there is little trust of USS amongst members. Do you agree, and if so, how are you going to rebuild that trust?
4. Why will the Trustee not consider a full review of the appropriateness of Test 1?
5. Would I be penalised if I opted out of the scheme until the contribution rates become more affordable?
6. When will the results of the 2018 valuation be released?
7. Is it possible to have more visibility and influence on where investments are made? Can an ESG option be made available / become standard?
8. Will future benefits be vulnerable (i.e., might they go down), once I am retired?
    - *A large proportion of my USS pension is still based on the final salary scheme. Does this part of my pension continue to be guaranteed?*
    - *For an early career academic how likely between now and my retirement are similar changes potentially going to affect my pension contributions and retirement income?*
9. How do you justify your move away from equities (now just 41.6%) over the last ten years. Especially, when the net contributions to the fund exceed payments so cash flow is not an issue?
10. In how many years over the last ten has your investment strategy outperformed an S&P500 ETF?
11. Why "actively manage" the fund? Why not just buy shares in blue chip companies, reinvest the dividends, sit back and see the 4-5% annual growth above CPI that has been the case for the last 150 years?
12. Why do we have to contribute more than in SAUL scheme, which has also been revaluated? Why has USS performed worse than TPS and SAUL?
13. How do the benefits work if you retire in a foreign country? If someone leaves UK permanently, what happens to their deposited pot? Will they get back pension when they are 65+?
14. Have you ever had, now or in the past, a performance-related pay agreement in which salary increases and/or bonuses are contingent on de-risking the Scheme?
15. How is USS preparing for hard Brexit?
16. In September 2018 the Times Higher Education made the point that over-regulation has made it difficult for USS to fulfil its obligations to members (ie pay pensions while having enough assets to pay off all the members if the scheme were to fold). Is this overly risk averse?

17. Investment performance is important, but I wanted to ask about pension fund hidden and undeclared charges. For example, the West Midlands pension fund thought they were paying £11 million/year in fees, however, after an audit of charges in 2015 they found that they were actually paying £90 million/year. Prof Chris Sier from Newcastle University has identified many layers of intermediation which lead to these hidden charges that cause a massive reduction in value over time. Does USS know the overall cost and charges incurred of its investments and is anything being done to keep them down?
18. The governor of the Bank of England says that fossil fuel investments are likely to become stranded assets in the timescales you are talking about. How have you taken account of this in valuing your fossil fuel investments?
19. According to the USS governance framework document (annex A, p8, item 5) "the triennial actuarial valuation/investigation activities, performed by the GCEO on the request of the TB". Can the GCEO please outline exactly what this entails on his behalf and the extent of his involvement in performing the actuarial valuation activities?
20. Based on that 28.7% + 5% deficit recovery, does that mean, once it's recovered, the contributions will drop back down, and if so is there any idea when that could be? Will contributions be reduced again if the scheme performs better than predicted in future?
21. Given your understandable aversion to risk, why did you allow the employers to reduce their contributions historically?
22. Why is there no capacity for a lower level of contributions and associated lower benefits within the scheme - why is it all or nothing? Instead of being forced into paying more fees to be a part of the defined benefits pension, why is there not an option for us to move over to a defined contributions scheme as new employees starting contracts now (on the same pay scales as us) are being signed up to.
23. Are the USS trustees members of the USS pension scheme?
24. Is part of the risk analysis based on all the universities in the UK were to all collectively fold as a business concern?
25. De-risking might help secure past service benefits, but is there a danger that this puts my future pension benefits at significant risk?
26. Do you realise how un-diverse your Board and your Executive are?
27. Why has the employers' contribution of the optional additional 1% match been discontinued?
28. So the Trustee is an unelected board of 12 people who set the contribution rates?
29. Has any consideration been given to the actual affordability of the proposed future contribution?
30. When will we have a definitive decision on whether the other planned cost-sharing increases will take place?
31. You sometimes refer to/compare with RPI and at other times to CPI. Can you explain when each of these two values are used please? For example, the returns on inflation-linked UK government bonds are relative to RPI inflation rather than CPI inflation?
32. How do you justify the salaries and bonuses paid to USS staff? Are they driven by decisions that benefit you more than members?

1. **Why is the USS executive persisting in rejecting the smoothing and de-risking recommendations of the Joint Expert Panel despite the widespread support for them from employers, UUK and UCU and their actuarial advisors, Aon and First Actuarial?**

   **A:** The answer to this boils down to managing risk. The contribution rate the Trustee requires in this valuation – or indeed, in any valuation – depends on the amount of risk that is being taken: risk that the contributions will prove insufficient and higher contributions will be required later.

   Individually, each of the JEP's proposed changes is worthy of consideration, but they must be considered collectively in terms of their overall impact on the aggregate risk in the valuation – and set against a balanced judgment on an acceptable risk position.

   Four of the JEP's suggestions, namely, increasing target reliance, deferring de-risking, smoothing contribution rates and allowing for investment outperformance in the recovery plan each involve a greater dependence on uncertain investment returns, and therefore a greater risk that those returns do not materialise.

   Smoothing contribution rates over several valuations would involve paying in less than is currently required to fund the benefits being accrued, in the expectation that these will cost significantly less in future years. This has the potential to leave future generations with a significant deficit to address if our funding assumptions around future investment returns and interest rates do not come to pass; if experience is poorer than expectation.

   De-risking involves greater certainty in the funding plan and reduces the risk that we are unable to generate the cash flows required in future to pay your benefits. It comes at the cost of foregoing the likely – but not certain – higher returns of investing in 'riskier' assets. It also ensures that the amount employers might need to pay in future to secure your benefits is within their means to fund. The price of de-risking ultimately reflects the nature and the value of the promise that has been made to you, in terms of a set level of income in retirement. If we were to delay de-risking, the possibility of future shortfalls in the scheme could grow and become too great for employers to support.

   However, to date, no decision has been made on which of the changes that increase risk would be adopted – but adopting **all** of the changes proposed would fall outside the Trustee's risk appetite.

   The Trustee's approach to risk is to balance its investment strategy and its contribution strategy such that enough risk is taken in the investments to generate returns that help keep the costs down – but not so much risk that it puts the achievement of the strategy itself as a whole at risk.

   The potential consequences of taking greater risk must be quantified, and credible options for managing material downsides coming from that risk must be available. The Trustee has certain legal, regulatory and fiduciary duties to ensure that the pensions promised to members are secure and can be paid when due.

The unwelcome but incontrovertible fact is that independent, objective perspectives on this valuation have come to a conclusion that it is at the limits of the acceptable risk position.

Although it did not quantify the risks associated with its proposals, the JEP report did recognise that there were a number of different paths the Trustee could adopt which would to lead to a required contribution rate of below 30% of salary.

We do believe that a contribution rate slightly below 30% could be acceptable provided it was subject to an appropriate level of contingent support being put in place to help offset the additional risks involved should they materialise.

2. **UCU and UUK along with many employers have noted that the justification provided by USS for 5% Deficit Recovery Contributions, which are a major cause for the upper "bookend" of the March 2018 valuation being so high and, thereby, of the supposed need for contingent contributions, is wholly inadequate and unconvincing. Why in the face of this highly informed criticism is the USS executive persisting with calling for these high DRCs?**

   **A:** Closing the deficit as fast as is reasonably possible is important, as it places the scheme in a 'fully funded' position based on the current assumptions and so makes the scheme more resilient should those assumptions turn out to be inadequate. Closing the deficit more slowly is higher risk in this respect.

   It is also the case that for a 'strong' covenant, the Pensions Regulator expects to see a shorter recovery plan (though it will tolerate higher level of risk in the technical assumptions).

   Our "Technical Provisions" funding measure reflects how optimistic we believe we can afford to be in relying on uncertain investments and economic developments to fund your benefits in future – given the degree to which we can rely on your employers if experience proves to be worse than expected.

   The degree to which we are relying on uncertain forecasts and/or your employers to fund your benefits is currently at the very edge of what we believe is an acceptable level of risk, given the very nature of the promise being made to you. This must be managed effectively in order for us to have a credible and resilient plan for arriving at an acceptable level of risk in the long-term.

   Contributions to a recovery plan can be lower if the Trustee takes more risk: in allowing a longer period of deficit recovery OR in assuming investment returns above the level built into the base funding assumptions. The Trustee is not saying it cannot take this risk, but it needs greater support from employers in order to do so.

   The potential consequences of taking greater risk must be quantified, and credible options for managing material downsides coming from that risk must be available. The Trustee has certain legal, regulatory and fiduciary duties to ensure that the pensions promised to members are secure and can be paid when due.

   The Pensions Regulator gave the following guidance on recovery plans in its latest Annual Funding Statement: "Our data indicates that the median recovery plan length to be seven years, so we take the view that the schemes with strong covenants should generally have recovery plan lengths which are significantly shorter than this."

3. **Many have observed that in light of the strike last year, the revelations about the weaknesses of the valuation, and JEP's criticisms of USS, there is little trust of USS amongst members. Do you agree, and if so, how are you going to rebuild that trust?**

   **A:** The 2017 and 2018 valuations have both generated a lot of interest, opinions and challenges. We fully appreciate that the outcomes are unwelcome and understand the impassioned response this has generated: pensions are a huge component of everyone's sense of security for their futures, and a very big part of a good employment package.

   You are relying on us to get this right, in the face of significant economic uncertainty, and that is a profound responsibility in which we take great care, pride and professionalism in delivering. This demands that we look at these issues objectively and honestly, that we do not to ignore them, wish them away, or kick them down the road in belief that things will improve.

   As a result we have endeavoured to oversee the most transparent valuation process of any UK pension scheme. We are not aware of a better example of a trustee volunteering the level of technical detail we have provided.

   However, valuations are technical and complex issues. We have tried to make our position clear to members in as accessible a format as possible, but we appreciate we need to do more to engage meaningfully with members on these issues. The recent webinar is just one example of how we are trying to do this, as is the new content we've provided on the 2018 valuation section of the USS website.

   Given that some level of judgement is involved, we would expect, and are happy to receive, robust challenge when difficult conclusions are reached. Some observers have, however, focused on just one part of the overall picture in reaching their conclusions, and this has led to some poorly informed, imbalanced commentary on the Trustee's approach.

   It is clearly important for members to understand the complex, multifaceted issues we are trying to manage, and consider the Trustee's perspective amongst often polarised and polemic opinions.

   The difficult truth is that there are no easy answers to the challenges we face in ensuring the promises made to you – promises that you and your dependents will rely upon in retirement and at critical life events – can be kept in the face of current economic and political conditions and uncertainty. (Paul Johnson, of the Institute for Fiscal Studies, gave a presentation at the Pensions and Lifetime Savings Association's Investment Conference 2019, covering some of these challenges. You can watch it here: https://youtu.be/XjCAqLnsRHI)

   The independent judgement of the Trustee is a critical part of the checks and balances of running a mutual pension scheme. The Trustee has no other agenda than to ensure that the benefits promised to you, its members, can be paid as they fall due. This should give members confidence that balanced, considered decisions are being made in their interests.

**4. Why will the Trustee not consider a full review of the appropriateness of Test 1?**

**A:** A lot of the criticisms of Test 1 have arisen because it is misunderstood, and because some observers have focused solely on what is just one part of the overall picture.

Test 1 is essentially USS's version of the capital adequacy tests that banks and insurance companies are required to satisfy in order to conduct their business and protect their customers. If USS did away with Test 1, we would be obliged to replace it with some other form of capital adequacy test, to protect our members should investment outcomes turn out to be much lower than expected.

The Trustee's construction of Test 1 has not been a constraint on the valuation, as the employers' expressed views on risk appetite at the 20 year funding horizon has been more conservative than the Trustee's view on capacity for risk.

However, as the regulator has pointed out, a construction such as Test 1 remains appropriate. It reflects the fundamental characteristic of defined benefit pension plans as a promise of certainty, in terms of the payments that must be made to beneficiaries in retirement.

When it comes to assessing the amount we are relying on employers, we benchmark the risks against what is known as the "self-sufficiency measure".

Self-sufficiency is based on the 'guaranteed' cash flows available from low risk investments, and is the value of assets we would need to hold in order to have a greater than 95% chance that all the benefits members have earned to date can be paid when due, without any further contributions.

In other words, this is the funding level we would need to achieve in the absence of further support from employers.

We do not target this level of funding (nor do we target the asset mix it would require) precisely because we have the active support of your employers and believe we can have confidence in that support over many decades into the future.

But the self-sufficiency deficit is a measure of the reliance we ultimately place on your employers to fund your benefits if our experience of investing in high growth, but less certain investments, turns out significantly worse than expected. In this regard, it is an important point of reference in terms of confidence in the ability to fund benefits – and both the Pensions Regulator and the Join Expert Panel agree that it is an appropriate consideration.

At the time of the 2018 valuation (31 March 2018), the distance to funding your benefits on a self-sufficiency basis was more than £20bn.

By contrast, our Technical Provisions measure reflects how optimistic we believe we can be in relying on uncertain investments and economic developments to fund your benefits in future – given the degree to which we can rely on your employers if experience proves to be worse than expected. At the time of the 2018 valuation, the Technical Provisions deficit was much lower than the self-sufficiency deficit.

We have received representations to change our approach based on a suggestion that if we were to smooth expected returns from the assets in our current allocation, over 20 years, we would be likely to meet one of the requirements for our scheme funding target – that we should be within an acceptable distance from the self-sufficiency metric.

Unfortunately, this is a one-dimensional analysis of a multi-faceted problem that, critically, takes our assumptions about future investment returns and interest rates for granted. This is not a simple mathematical equation or spreadsheet analysis, it is taking a considered view of the risks across the piece (as we covered in the webinar), the dispersion of potential outcomes, and the resilience of the scheme today and in the future, in reaching balanced judgements.

We have published a note on our website on this suggestion, and a more technical response, as well. In summary, the challenges with this are that:

- If benefits are underfunded in the earlier years and the Trustee's funding assumptions, especially as regards interest rates and uncertain investment returns, do not come to fruition, then a deficit could be created that might not be recoverable.
- The future is inherently uncertain, and a shock in the short-term could be catastrophic to such a strategy. The scheme is not starting from a strong position, and we need to be more resilient as regards the potential for short-term economic shocks to our funding level.
- The position of the scheme in year 20, even if all went to plan, would continue to be highly volatile, and the sector might not be able to manage such high levels of volatility from payroll contributions at that point.

If there *was* such a simple solution as has been suggested – that could fulfil the duties of the Trustee; that could be acceptable to our scheme actuary and the Pensions Regulator; that would secure your benefits with a high degree of confidence – we would almost certainly grab it with both hands.

5. **Would I be penalised if I opted out of the scheme until the contribution rates become more affordable?**

   **A:** If you opted out of the scheme or made an election for enhanced opt out (EOO), you will be entitled to deferred benefits from the USS Retirement Income Builder (the defined benefit section of the scheme). The benefits you'd already earned at that point would be protected by law and cannot be changed retrospectively but you (and your employer) would no longer be adding to these benefits (meaning your final pension would be lower than it would otherwise be) and if you do opt out (as opposed to taking EOO) then you would no longer have the reassurance provided by the scheme's additional benefits, described in the webinar, covering for example death in service, death in retirement or incapacity. Any USS Investment Builder (defined contribution) funds you have built up will continue to be invested and administered for you, and you will still be able to manage these investment as usual, but you would not be able to contribute further.

6. **When will the results of the 2018 valuation be released?**

   **A:** The statutory deadline for completing the valuation is 30 June 2019 and the Trustee is working with its stakeholders to meet this deadline. We will continue to keep members informed of key developments.

7. **Is it possible to have more visibility and influence on where investments are made? Can an ESG option be made available / become standard?**

   **A:** ESG considerations form a key part of all our investment decisions. The Trustee is responsible for all investment decisions regarding the defined benefit fund (the USS Retirement Income Builder) and selects the range of funds made available through the defined contribution section of the scheme (the USS Investment Builder).

   We have provided members with distinct ethical fund options in the defined contribution section of the scheme (the USS Investment Builder). Members can choose the USS Ethical Lifestyle Option (if you want us to manage your savings for you) or the USS Ethical Equity or Sharia fund (if you want to manage the investments yourself).

   We have provided wider commentary on our position on this important issue, which you can read on the following link. Please also see Question 18 for related matters:
   USS's approach to Responsible Investment
   The divestment debate

8. **Will future benefits be vulnerable (i.e., might they go down), once I am retired?**
- **A large proportion of my USS pension is still based on the final salary scheme. Does this part of my pension continue to be guaranteed?**
- **For an early career academic how likely between now and my retirement are similar changes potentially going to affect my pension contributions and retirement income?**

**A:** Benefits *already* earned by both active and deferred members are protected by law and the scheme rules. Similarly, benefits already being paid to retired members would not be affected by any changes arising from a valuation.

The shape of benefits *yet to be earned* are subject to discussions of the Joint Negotiating Committee.

9. **How do you justify your move away from equities (now just 41.6%) over the last 10 years. Especially, when the net contributions to the fund exceed payments so cash flow is not an issue?**

**A:** It is important to note that we have diversified our allocation over the past 10 years to include a significant element of alternative assets – our Private Markets allocation. You can read more about this here: An alternative approach to funding pensions?

This allocation, together with our property holdings, means that the scheme's exposure to equity-like return-seeking assets today is actually more than 60%.

Ultimately, the overall balance of our implemented portfolio reflects the fundamental characteristic of a defined benefit pension: a promise of certainty, in terms of the payments that must be made to beneficiaries in retirement.

That certainty needs to be delivered with a high degree of probability but also at a manageable cost, which can be a difficult balance to strike.

There are some things we know for certain today – the value of the assets we hold, how much 'risk free' investment costs – but we need to understand what the likely path and distribution of returns from other, less certain, assets might be if we are to rely on them to fund your benefits.

The balance of risk versus certainty – relative to the size of the scheme now and in the future, and the size of the payroll supporting it – is key to securing the benefits members will rely upon in retirement, and this is reflected in our asset allocation and funding plan.

As an aside, the historical performance of financial markets is no guarantee of future performance. Paul Johnson, of the Institute for Fiscal Studies, gave a presentation at the Pensions and Lifetime Savings Association's Investment Conference 2019 that provided some context on this point. You can watch it here: https://youtu.be/XjCAqLnsRHI

10. **In how many years over the last 10 has your investment strategy outperformed an S&P500 ETF?**

    **A:** Our analysis shows USS outperformed the S&P 500 (in pounds sterling terms) in three of the last 10 calendar years (2009, 2012 and 2017).

    However, investing solely in the S&P500 would introduce substantially greater downside risk as regards our liabilities. This is a critical consideration. The fundamental characteristic of a defined benefit pension is a promise of certainty, in terms of the payments that must be made to beneficiaries in retirement. That certainty needs to be delivered with a high degree of probability and, as trustee, we have certain legal, regulatory and fiduciary duties in this regard which influences the amount of risk taken in the investment strategy.

    It is also worth noting that the last 10 years covers a period following a large equity market correction, and extending the comparison to 12 years, for example, would provide a different picture.

    Finally, the historical performance of financial markets is no guarantee of future performance. Paul Johnson, of the Institute for Fiscal Studies, gave a presentation at the Pensions and Lifetime Savings Association's Investment Conference 2019 that provided some context on this point. You can watch it here: https://youtu.be/XjCAqLnsRHI

11. **Why "actively manage" the fund? Why not just buy shares in blue chip companies, reinvest the dividends, sit back and see the 4-5% annual growth above CPI that has been the case for the last 150 years?**

    **A:** Firstly, the historical performance of financial markets is no guarantee of future performance. Paul Johnson, of the Institute for Fiscal Studies, gave a presentation at the Pensions and Lifetime Savings Association's Investment Conference 2019 that provided some context on this point. You can watch it here: https://youtu.be/XjCAqLnsRHI

    Secondly, our active management of the DB fund added £1.7bn of value to the fund over the five years to 31 March 2018 – relative to a passive benchmark – and that is *net* of the associated investment costs that have been independently benchmarked as being more than £60 million a year lower than funds of a similar size and complexity.

    So it adds value, and helps to lower the contributions otherwise required of members and employers. Active management also allows us to benefit from our Private Markets programme, and ensures the scheme is investing within the risk appetite of the Trustee and its sponsoring employers. This last point is important as it protects the security of the benefits that have been promised to our members, which they will rely upon retirement.

**12. Why do we have to contribute more than in SAUL scheme, which has also been revaluated? Why has USS performed worse than TPS and SAUL?**

**A:** Comparisons of the costs and performance of different defined benefit pension funds are far from straightforward. The profile of a scheme's membership, the relative maturity of a scheme, and the range and type of benefits provided all influence the cost of a £1 of pension. Similarly, investment policies may be set in different contexts and their relative performance will therefore differ across different periods.

The cost of benefits is influenced by a number of underlying factors that might not be immediately apparent at face value. There can be differences in the make-up of the membership – analysis of scheme-specific experience shows that USS members live significantly longer than an average member of the UK population. There will be differences in benefits provided, such as the level of death in service and incapacity benefits, and inflation protection. Small differences here can add up to big differences overall to the contribution rate required to fund a scheme's benefits.

There can also be notable differences in the investments and investment strategies that fund defined benefit pension schemes that can give rise to differences in past and expected future investment performance. For example, a scheme that hedged to a greater extent than USS, and/or elected to de-risk its investment strategy, over the last four years will have seen its investments performing relatively better – but this would also lead to an increase in the expected cost of funding benefits in future.

While we have gradually increased our liability-hedging assets, it would not have been realistic – given market capacity issues – for a scheme of our size to have approached full hedging of our liabilities, even if our sponsoring employers said they wanted us to pursue such an approach. Employers have been clear in the past, when we consulted on our statement of investment principles, that they supported a gradual shift in portfolio risk, rather than a short-term hedging strategy.

USS has been consistent with the investment strategies consulted upon with employers – and has performed well: In the five years to 31 March 2018, our investment team outperformed its passive benchmark to the tune of £1.7bn – that's value they have directly added to the fund, net of investment costs independently benchmarked as £60m a year cheaper than our peer funds have achieved. This has directly contributed to lower scheme costs for employers and members.

But, the challenges we face in meeting the cost of funding defined benefits are the same for every pension scheme. For example, the Teachers' Pension Scheme – which is backed by the UK government – is unfunded, meaning its pensions are paid for directly by today's taxpayers and it is significantly increasing the payroll contributions required to fund its pensions to avoid future unsustainable claims on taxpayer support.

13. **How do the benefits work if you retire in a foreign country? If someone leaves the UK permanently, what happens to their deposited pot? Will they get back pension when they are 65+?**

    **A:** USS has members who live all over the world to whom it pays pensions on a monthly basis. If you live overseas, you might have to pay UK tax on your pension as well as tax in the country you live in depending on your tax residency status and any tax arrangements between the UK and that country. If you are planning on moving overseas, you must tell HMRC so that you pay the correct level of tax. As tax laws are different in each country, it's always best to seek independent financial advice if you're unsure.

14. **Have you ever had, now or in the past, a performance-related pay agreement in which salary increases and/or bonuses are contingent on de-risking the Scheme?**

    **A:** No. Page 19 onwards of the 2018 Annual report & Accounts provides a detailed overview of the scheme's remuneration arrangements.

15. **How is USS preparing for hard Brexit?**

    **A:** As negotiations are ongoing, and the terms of the UK's exit from the EU have not been agreed, we can't say with any certainty what the impact of Brexit will be. However, we're taking a pro-active approach to planning and detailed work is being undertaken to prepare for the potential implications. You can find out more here.

16. **In September 2018, THE made the point that over-regulation has made it difficult for USS to fulfil its obligations to members (i.e. pay pensions while having enough assets to pay off all the members if the scheme were to fold). Is this overly risk averse?**

    **A:** The scheme is required by law to compare the value of the assets it holds with the level of assets it believes it would need to pay the pensions promised to date. We believe that this is a sensible requirement, and consider the comparison on a number of measures. Having this as our funding target (on the 'Technical Provisions' measure – see Question 4) reduces the extent to which the payment of pensions are reliant on future contributions, as well as limiting the extent to which funding problems could materialise in future.

    We also consider the "self-sufficiency measure" which, as we covered in the webinar, is the value of the assets we would need to hold in order to have a greater than 95% chance that all the benefits members have earned to date can be paid when due. In other words, this is the funding level we would need to achieve in the absence of the support of employers. This is not our funding target but a level which we want to be within reach of in case experience proves to be significantly poorer than expectation. Because defined benefit pensions are promises, we have to ensure we are sufficiently prudent for the benefits to be paid when they fall due even if experience is worse than we expect.

**17. Investment performance is important, but I wanted to ask about pension fund hidden and undeclared charges. For example, the West Midlands pension fund thought they were paying £11 million/year in fees, however, after an audit of charges in 2015 they found that they were actually paying £90 million/year. Prof Chris Sier from Newcastle University has identified many layers of intermediation which lead to these hidden charges that cause a massive reduction in value over time. Does USS know the overall cost and charges incurred of its investments and is anything being done to keep them down?**

**A:** USS has a very high level of focus on the costs of our investment activities and we have chosen an in-house investment operating model that gives us i) very high levels of transparency on these costs and ii) much lower costs than our peers (as independently benchmarked).

The investment costs of members' defined contribution funds (in all but one of the fund options available) are currently paid for by your employers. The investments costs for the defined benefit fund are detailed in the 2018 Report & Accounts, and show how "embedded" costs (the majority of external management and performance fees, notably from private equity and hedge fund managers, are embedded fees deducted from the value of the assets that they are managing) are accounted for as "investment costs as a proportion of assets under management".

This shows that our active in-house management of the fund (circa 75% of assets are now managed internally) has reduced the level of embedded costs significantly over time: from 33 basis points* in 2013/14 to 20 basis points in 2017/18. Overall investment costs have reduced from 47bps to 31 basis points in that time.
(*One basis point is equal to 0.01% of the fund value)

**18. The Governor of the Bank of England says that fossil fuel investments are likely to become stranded assets in the timescales you are talking about. How have you taken account of this in valuing your fossil fuel investments?**

**A:** USS has undertaken carbon footprinting of its public equities portfolio for a number of years, and is a signatory to the Montreal Pledge. The scheme has also undertaken carbon footprinting for a range of other asset classes in order to identify the potential climate and carbon related risks across its portfolios. Such cross-fund footprinting is rare, and the methodologies for this undertaking is still under development. In order to encourage this, USS has worked with a number of European pension funds to publish a document outlining the Group's views on the challenges facing the process and what can be done to address them. This document, "If carbon footprinting is the answer, then what is the question? A group of asset owners reflect on current practice in carbon reporting", can be found here:

We've also provided detailed commentary and case studies on the issue of climate change on our website:
Climate change
The divestment debate
Shell announces new climate change policy following collaboration with leading investors

19. **According to the USS governance framework document (annex A, p8, item 5) "the triennial actuarial valuation/investigation activities, performed by the GCEO on the request of the TB". Can the GCEO please outline exactly what this entails on his behalf and the extent of his involvement in performing the actuarial valuation activities?**

    **A:** The terms of reference in the USS governance framework document are worded in short hand to acknowledge that while the Trustee Board retains overall oversight of the scheme, day-to-day management has been vested by the Trustee Board in the GCEO, which allocates specific responsibilities to its Executive team and advisers. Therefore, in practice, the GCEO and its team will work with the appointed Scheme Actuary in performing the triennial actuarial valuation/investigation activities and reporting to the Trustee Board. A key duty of the Scheme Actuary is to advise the Trustee Board of the funding position of the scheme. In particular, at least once every three years, the Trustee Board asks the Scheme Actuary to complete an actuarial valuation of the Scheme. Decisions in relation to the valuation are taken by the Trustee Board.

20. **Based on that 28.7% + 5% deficit recovery, does that mean, once it's recovered, that the contributions will drop back down, and if so is there any idea when that could be? Will contributions be reduced again if the scheme performs better than predicted in future?**

    **A:** Should future experience be in line with the central expectations of the Trustee, then the cost of pensions in future will fall due to improving investment returns and paying off the deficit. The Trustee cannot fully take account of these expectations, because if they were not to occur, the scheme would potentially be in an unsustainable position.

21. **Given your understandable aversion to risk, why did you allow the employers to reduce their contributions historically?**

    A: We have addressed this issue on our website – and you can read our full response here: Historical contributions

22. **Why is there no capacity for a lower level of contributions and associated lower benefits within the scheme - why is it all or nothing? Instead of being forced into paying more fees to be a part of the defined benefits pension, why is there not an option for us to move over to a defined contributions scheme as new employees starting contracts now (on the same pay scales as us) are being signed up to.**

    **A:** The Trustee has no preference as to the benefits provided to you by the scheme; this is a matter for the Joint Negotiating Committee (which is made up of an equal number of employer (UUK) and member (UCU) representatives, with an independent Chair). The Trustee's role is to determine the contribution rate required for a given set of benefits, and it has no other agenda than to ensure that the benefits promised to you, via the JNC, can be paid as they fall due.

23. **Are the USS Trustees members of the USS pension scheme?**

    **A:** Board members who are employed by a participating institution will be eligible to be members of the scheme. The vast majority of employees at the Trustee Company are members of the scheme.

24. **Is part of the risk analysis based on all the universities in the UK collectively folding as a business concern?**

    **A:** No – but USS is a so-called “last man standing” scheme, so the effect of the pension liabilities of financially weaker employers potentially falling to other employers to fund is a key consideration. Ultimately, our concern is the collective ability of sponsoring employers to fund the benefits promised to members and that the costs of doing so do not have such an impact on the finances of employers that it weakens, or puts at risk, the very support we rely upon.

25. **De-risking might help secure past service benefits, but is there a danger that this puts my future pension benefits at significant risk?**

    **A:** De-risking involves greater certainty in the funding plan and reducing the risk that we are unable to generate the cash flows required in future to pay your benefits. It also ensures that the amount employers might need to pay in the future to secure your benefits is within their means to fund. The price of de-risking ultimately reflects the nature and the value of the promise that has been made to you, in terms of a set level of income in retirement.

26. **Do you realise how un-diverse your Board and your Executive are?**

    **A:** We fully appreciate the value of diversity in all its forms in running a successful business and this is reflected in our recent voting policy and in our own recruitment processes. Like most firms in our industry, we are on a journey as far as our Executive level is concerned but we take this seriously. For example, read about our new Chief Pensions Officer Helen McEwan.

    As a long-term investor with a long-term focus, executive and senior management roles are, typically, long-standing appointments. Once we have the right people in place, we want them to stay and low turnover at the senior level of the business is a welcome trend. This is likely to restrict the pace of change we can achieve on this important issue.

    So we will: look to develop from within by identifying and supporting a diverse range of internal candidates for senior roles, opportunities in the leadership team as well as succession planning; provide as flexible and accommodative working conditions as possible for all employees, and; consult with employees at USS to investigate what more we can do to develop action plans on this issue.

27. **Why has the employers' contribution of the optional additional 1% match been discontinued?**

    **A:** This was one of the steps prescribed under the cost-sharing rules. You can read more about this here: https://www.uss.co.uk/glossary#Glossary_TheMatch

28. **So the Trustee is an unelected board of 12 people who set the contribution rates?**

    **A:** USS is supported by a Corporate Trustee, USS Limited. The Board of the company is made up of 12 people appointed by UUK, UCU and by the Board itself.

    The constitution of the Board is entirely in accordance with the articles of association.

    Backgrounds of the current directors of the Trustee Company include the higher education sector, financial services, investments, pension administration, financial technology and other areas.

    The Trustee's conclusions are thoroughly reviewed by independent third parties, and reflect its legal responsibilities and regulatory obligations.

29. **Has any consideration been given to the actual affordability of the proposed future contribution?**

    **A:** The Trustee has been mindful of affordability concerns in implementing the cost-sharing rule by agreeing to phase in the required contribution increase in three stages over the course of 2019 and 2020.

    Ultimately, this question is for our stakeholders on the Joint Negotiating Committee: if the Trustee concludes that the aggregate contribution rate needs to increase, as has happened, the JNC decides how that increase should be addressed, either through contribution increases for members, employers or both, and/or changes to benefits such that the contribution increases are mitigated.

    If the JNC cannot reach an agreement – as was the case with the 2017 valuation – the scheme rules (which are shaped by the JNC itself) dictate that the increase in contribution is split on a 65:35 basis between employers and members respectively.

    We are looking at data collected from members who opt out. If affordability is a demonstrable concern, this will be reported to our stakeholders on the JNC to inform their decisions.

30. **When will we have a definitive decision on whether the other planned cost-sharing increases will take place?**

    **A:** The increases we've already announced will be required until such time as the 2018 valuation is completed. The statutory deadline for completing the 2018 valuation is 30 June 2019 and the Trustee is working with its stakeholders to meet this deadline.

    The outcome of the 2018 valuation could result in the later increases required under the 2017 valuation being mitigated, or avoided. We will continue to keep members informed of key developments.

31. **You sometimes refer to/compare with RPI and at other times to CPI. Can you explain when each of these two values are used please? For example, the returns on inflation-linked UK government bonds are relative to RPI inflation rather than CPI inflation?**

    **A:** Your benefits will increase broadly in line with the CPI measure of inflation, so this is the measure that's critical to the Trustee. Financial instruments like government bonds are priced relative to RPI.

    We make an allowance for this by applying an assumption as to how we expect the two measures to correspond over time.

32. **How do you justify the salaries and bonuses paid to USS staff? Are they driven by decisions that benefit you more than members?**

    **A:** The market rate for recruiting in the investment management and financial services sectors is higher than other sectors. USS seeks to have the appropriate competencies required to run the scheme expertly on behalf of members, and we seek to pay fairly in this context and attract staff who are proud to work for USS and the purpose it serves. That said, we do not seek to compete directly with other asset managers.

    By taking the majority of our investment services in-house, we are saving more than £60 million a year compared to our peers (see Question 17). Over the five years to 31 March 2018, our investment team added £1.7bn of value to the scheme (net of costs) over a 'passive' strategy.

    This demonstrates that these highly-skilled individuals add a great deal of value to the scheme, in return for what is the "market rate" in their chosen field.