

Response to Aon note on revisions to Statement of Investment Principles

We are grateful for Aon's considered comments on the Statement of Investment Principles (SIP) consultation materials (entitled '[Review of Statement of Investment Principles](#)', 19 April 2022), and the helpful way it informed the constructive feedback employers provided on important issues.

Many of the points made were requests for further information. We hope this response provides a helpful guide as to where relevant additional information has been provided outside of the SIP itself. We have also made documents easier for employers to find [on our website](#).

Where appropriate, we have also provided responses to other points made by Aon. (*Aon's wording is in black, ours is in blue.*)

Expected returns

Regarding section 1.2.4, and the process involved in how the Trustee monitors expected returns and the frequency at which this is monitored, the SIP Implementation Statement (Section 2.4 in [the 2021 statement](#)) states: *"The actual investment returns of the scheme's DB investments are monitored regularly by the Investment Committee through reporting provided by USSIM's Performance and Investment Risk (PAIR) team. In order to ensure the Implemented Portfolio remains appropriate (and is expected to deliver the appropriate long-term returns at the desired level of risk), the Trustee, with the support of the Investment Committee and USSIM, monitors changes to expected asset class and Implemented Portfolio returns at least annually."*

In practice, expected returns are reviewed by the Trustee and Investment Committee quarterly. They form part of the Monitoring and Action Framework, and the associated Financial Management Plan monitoring reports are [published](#) on the USS website.

Responsible investment

Aon: *"In 1.4.3 the SIP introduces an ambition to be net-zero by 2050. This is relatively unusual to include in a SIP. The Employers should consider whether that ambition fits with the ambition of their own organisations. For example, if the employer had an ambition to achieve this earlier or later, or had made a decision to make no such commitment, it may wish to feed that back in the consultation. The Employers many also wish to ask how progress towards this ambition will be monitored."*

- The Net Zero ambition is included in the SIP to reflect its importance to the scheme and the Trustee. Progress will be reported annually in our [TCFD reporting](#) (our latest report is due to be published alongside the 2022 Report and Accounts) and Implementation Statement (which is included in our annual Report and Accounts).

Aon: *"In a number of places the SIP refers to the fact that the Trustee expects its external managers to take action with respect to integrating ESG/stewardship into their investment processes, although there is no indication as to how the scheme's external managers would know that this is expected of them. We would consider it best practice for the SIP to include more explicit engagement/communication with external managers as well as detail as to how this is monitored."*

- This is addressed with external managers during the initial due diligence before investment and as part of the ongoing manager monitoring.
- Further details have since been set out in Principle 8 of the [2022 Stewardship Code report](#) and are also given in the Implementation Statement (Section 5.2 in the [2021 statement](#)).

Responsible investment (continued)

Aon: “When referring to ESG as a financially material concern, the SIP wording limits the Trustee’s consideration of these factors to actions taken by the scheme’s investment managers. The Employers could seek clarity as to the extent to which ESG related factors would feature in asset allocation decisions.”

- Further details have since been set out in our latest [Stewardship Code report](#):
 - “With an investment horizon stretching many decades, the Scheme is not only exposed to current risks, but also to risks into the future. As such, we recognise that certain issues pose macro, market wide or systemic risks and these need to be addressed just as much as more immediate issues. The Scheme assesses these major macro, market wide or systemic risks in a number of ways. We recognise that certain issues could affect our asset allocation and to assess the implications of these, we have developed and investigated a set of plausible scenarios based on some of these issues.”
 - These scenarios are detailed in the Stewardship Code report.
- USSIM has already taken action to mitigate the transition risks by moving away from standard equity benchmarks (including the introduction of a **‘climate tilt’** within the Global Developed Markets Equity mandate) and considering a global climate-transition aware benchmark for asset allocation decisions.
- In 2022, USSIM plans to undertake a number of initiatives to determine how it can create a more climate-resilient portfolio going forward. These include:
 - assessing how it can better integrate climate risk in the investment decision-making process;
 - incorporating climate scenarios in the asset allocation framework and the valuation best estimate assessment;
 - setting carbon footprint targets for our investment mandates;
 - improving both internal and external climate-related reporting.
- Going forward, the Trustee has put in place a new framework with USSIM, which is based on a range of investment objectives and risk limits, including assessment of USSIM’s progress with respect to its further integration of ESG factors (including reporting and stewardship) and USSIM’s progress towards Net Zero. Progress will be reported in next year’s Stewardship Code Report and Implementation Statement.

Aon: “The changes in section 1.4.4 seem sensible, but the Employers could ask for greater detail on how this is monitored.”

- This has since been covered in Principle 2 of the USS [2022 Stewardship Code report](#):
 - “The Board agrees the responsible investment strategy and formally reviews the RI Team’s activities annually, signing off key focus areas and policies. This includes reviewing the effectiveness of our stewardship processes and whether our resourcing, expertise and approach are appropriate to managing our members’ assets and meeting their needs. The Board is supported in this assessment by both the scheme’s Investment Committee, which reviews RI activities biannually, and by specialist external advisors.”
 - “This is set out in the Implementation Statement (Section 5 in the [2021 statement](#)): ‘The Trustee Board agrees the RI strategy, and formally reviews the RI team’s activities annually, signing off key focus areas and policies. The Investment Committee receives reports from USSIM on a semi-annual basis so that it can assure the Trustee Board that the Statement is being effectively implemented.’”

Responsible investment (continued)

Regarding section 1.4.7.2 and Aon's comment on non-financial factors, the Implementation Statement (Sections 1.6 and 1.7 in the [2021 statement](#)) includes the following commentary:

- *"The Trustee received updated legal advice on this area, www.uss.co.uk/how-we-invest/responsible-investment, and there were no circumstances over the past twelve months where the Trustee (or USSIM on its behalf) could take into account non-financial factors (the circumstances being those as described above) within its investment decision-making. The Trustee's process for engagement with members is set out in more detail in below..."*
- *"As part of this engagement, the Trustee invites views from members and beneficiaries on non-financial matters. For example, non-financial matters include (but are not limited to) ESG issues and ethical matters. To the extent permitted by its fiduciary duties, there are some circumstances where the Trustee will take account of member views on non-financial matters in relation to the selection, retention and realisation of investments."*

Aon: *"In 1.4.10 we note that the references to PRI and the Stewardship Code have been deleted. The Employers may want to investigate whether this means that the Trustee no longer commits to these, or whether they are set out elsewhere."*

- [Explicit references to PRI and the Stewardship Code have been removed \(to allow for either changing name and/or form in future\), but current commitments are unchanged and will be reported as required.](#)
- [In addition, the Implementation Statement \(Section 5 in the \[2021 statement\]\(#\)\) states: "The Trustee will undertake its decision making in a manner which is consistent with the Trustee's investment objectives, its legal duties and other relevant commitments e.g. the UN-backed Principles for Responsible Investment \(UNPRI\) and the UK Stewardship Code."](#)

Aon: *"In 1.4.12 we note that the last line about the Trustee reviewing its ESG policy regularly has been deleted. There is no requirement to state this, but it would be best practice to do it and we assume the Trustee does do this, so the Employers could query why this has been removed."*

- [Following feedback from the consultation, the Trustee has restored the following wording: "The Trustee's ESG related policies are also reviewed regularly by the trustee Board and updated as required to ensure that they are in line with good practice."](#)
- [Regular review of ESG policy is important for the Trustee. It is also covered in the \[Implementation Statement\]\(#\) and Principle 2 of the \[Stewardship Code report\]\(#\): "The Board agrees the responsible investment strategy and formally reviews the RI Team's activities annually, signing off key focus areas and policies. This includes reviewing the effectiveness of our stewardship processes and whether our resourcing, expertise and approach are appropriate to managing our members' assets and meeting their needs. The Board is supported in this assessment by both the scheme's Investment Committee, which reviews RI activities biannually, and by specialist external advisors."](#)

Performance measurement

Aon: *“In section 1.5, which sets out the policy on arrangements with managers, we note that the SIP contains details of monitoring the performance of USSIM. However, it offers no detail as to how the performance of individual direct investments managed by USSIM are reviewed. The Employers may wish to clarify particularly how USSIM’s management of illiquid direct investments is reviewed.”*

- USSIM regularly provides reporting to both the Investment Committee and Trustee Board on all mandates, which includes internal and external as well as public and private mandates.
- The Implementation Statement (Sections 1.3 and 1.5 in the [2021 statement](#)) includes the following:
 - *“The Trustee appoints USSIM to implement the scheme’s investment strategy within the terms of the Investment Management and Advisory Agreement (the IMAA). USSIM manages assets directly on behalf of the Trustee as well as having the delegated authority to appoint, monitor and change the Trustee’s external asset managers. The Trustee has various methods for overseeing the services of USSIM and USSIM provides regular reporting on its performance.”*
 - *“The Investment Committee meets regularly (10 times in the scheme year 2020-21) to review investment strategy proposals and regular reporting by USSIM on its ongoing investment management activities. Regular reviews of the investment strategy, including the overall and individual mandate investment performance, are also completed. It is a standing agenda item on each Investment Committee to report on the tactical asset allocation decisions made by USSIM during the period.”*

Asset allocation

Aon: *“We are concerned about the lack of detail in section 2.2.2, which covers the policy on the balance between investments.*

“The SIP is generally quite detailed and yet only covers the investment strategy in relatively vague terms. This approach means the Trustee can in theory make quite big changes to the asset allocation with no need to consult with the Employers since the wording here is so broad. Given the amount of detail in the SIP, we recommend including a table showing the targets and ranges for the VIS.”

- As noted in the SIP, and in order to ensure the SIP remains up to date, the current composition of the VIS can be found [here](#).
- Following feedback from the SIP consultation, the Trustee has added a section to the [VIS composition document](#) on the ranges around the VIS in which USSIM, its investment manager, can invest.
- It is anticipated, where reasonably practicable to do so, that any proposed changes to the VIS will be discussed with stakeholders at the engagement events that we are introducing, specifically the quarterly briefing update meetings and the biannual investment discussion forum meetings.

Risk

Regarding section 2.3, in respect of Aon's comment on longevity risk, the Implementation Statement (Section 2.5 in the [2021 statement](#)) includes the following: *"The Trustee and the Investment Committee assess the key risks relevant to the DB Section, including asset-liability, market, credit, longevity, currency, liquidity and operational risks, as well as the variability of returns of the scheme's investments relative to the Reference Portfolio and the strength of the employer covenant. The integration of these investment-related risks is assessed, managed and advised upon by USSIM, particularly as they relate to strategic asset allocation and investment strategy."*

Aon: *"The SIP states that the Trustee maintains appropriate levels of currency hedging, but offers no detail as to what the levels of currency hedging are, or how the Trustee determines that this is appropriate. The Employers may wish to understand the Trustee policy in this area, particularly in the current market environment as overseas currency exposure (expressed in GBP terms) are particularly volatile given the current macro environment and geopolitical risks."*

- Until recently, the Trustee's currency policy was set in conjunction with USSIM. This policy is now delegated to USSIM and monitored by the Investment Committee and Trustee Board.

Aon: *"Referring back to our earlier comment about the presence of US TIPS in the liability hedging assets, it could be worth including this as a risk, along with comments on how this is managed."*

- This feedback has been incorporated in the updated SIP.

Defined Contribution

Aon: *"In section 3.3, which covers the policy on risk for the DC assets, this is brief compared to what we normally see for hybrid schemes. The Employers could ask for more detail on the DC risks and how they are managed especially given that the DC section has even greater prominence as part of the overall pension saving solution from 1 April 2022."*

- While there are more members joining the DC section from 1 April 22, the Trustee believes the risks are unchanged. More detail on how the DC risks are managed is included in the Implementation Statement (Section 3.5 of the [2021 Statement](#)).

Investment Beliefs

Aon: *"Belief 2 includes the following: "The right decisions need to be made by the right people in a timely manner within requisite controls, reporting, review, oversight and regulatory compliance arrangements." This is a sensible belief, but the Employers could ask for greater detail and transparency...to see that this is happening in practice...in particular, what limits apply to USSIM."*

- Further details on the relationship with USSIM are included in the Implementation Statement (Section 1.3 of the [2021 Statement](#)). In addition, the ranges around the VIS in which USSIM can invest are set out in the [VIS composition document](#).

Investment Beliefs (continued)

Aon: “Belief 8 states that “Risk that is not sufficiently compensated should generally be avoided, hedged or diversified.” It mentions inflation and longevity as the main risks. And yet, longevity is not hedged and inflation will only be 40% hedged. This implies that the Trustee expects these risks to be compensated. This is also relevant to belief 3, where inflation and longevity are not given as risk premia expected to generate returns. The Employers could ask the Trustee to expand on this.”

- Following feedback from the consultation, the Trustee has amended the wording for the belief to be “Risk that is not sufficiently compensated should generally be avoided, hedged or diversified, taking into account the materiality of the risk, implementation and the cost”.
- The Trustee believes that this hedging is best directed at the interest rate and inflation risks associated with the liabilities for several reasons. Most importantly, these risks account for approximately two-thirds of the total financial risk to the deficit whereas the risks associated with growth assets account for only one-third. This is discussed in detail in the documentation provided as part of the SIP Consultation (see the [webinar presentation](#) and the [VIS Questions and Answers](#) document).
- Belief 8 does not imply that “the Trustee expects these risks [inflation and longevity risks] to be compensated”. The expected cost of hedging is factored into the expected return of the VIS and this cost is considered in the round against the amount of risk reduction provided. It is important to strike an appropriate balance between the cost of hedging and the risk it is intended to manage. There are also constraints (relating to the availability of collateral) on the amount of hedging that can be implemented given the allocation to growth assets.

Aon: “The Trustee has deleted the reference to volatility measures in belief 8. If they are just looking at the volatility of the assets, we regard it as positive that the Trustee is removing this measure (as it doesn’t reference the liabilities). However, it may be useful for the Employers to ask if the Trustee is introducing a new measure to monitor risk within the portfolio.”

- The investment strategy for the DB section aims to achieve an appropriate balance between generating returns and managing risks, while maintaining consistency with the DB section’s Integrated Risk Management Framework (IRMF) and the Trustee’s risk appetite.
- This means that the Trustee, in conjunction with the Investment Committee, will be measuring and monitoring a range of asset-liability risk measures including asset-liability volatility and downside risks.