Employer Investment Discussion Forum

16 June 2023

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Agenda

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1. Welcome and introduction
2. Overview of the last six months
3. Investment related aspects of the 2023 valuation, timetable for VIS & SIP
4. Investment Balanced Scorecard for DB and DC, an update on our performance review and reporting
5. Responsible Investment and Carbon Net Zero update

1. Introduction and overview of the last six months

2. Investment related aspects of the 2023 valuation, timetable for VIS & SIP

Capital Market Expectations ("CMEs")

Where are the CMEs used across the valuation?

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We outline our asset class return forecasts, or ***Capital Market Expectations*** *(or "****CMEs****")*

The CMEs are used to support…

The central path of the ALM model

This allows us to construct stochastic distributions and calculate probabilistic outcomes

The self-sufficiency portfolio and discount rate

This leads to the Scheme Actuary's advice on the self-sufficiency discount rate

The Transition Risk assumption within the IRMF

This feeds into the calculations of the reliance metrics

The Valuation Investment Strategy (VIS)

This includes the component pre/post retirement portfolios via the ALM Framework

Implied prudence within the Technical Provisions

Via the distributional gap between the best estimate return and the TP discount rate

The ongoing FMP monitoring process

Allows us to monitor the funding position of the scheme relative to the planned trajectory intra-valuation

Combining CMEs into a total portfolio return

As in previous actuarial valuations, **we use the median annualised portfolio return from the stochastic ALM model**, instead of a simple weighted average of USSIM's Capital Market Expectations (CMEs).

This approach is commonly used when combining investment returns from multiple asset classes:

1. Inputs

- The **CMEs of the different asset classes** are the inputs to the process

2. Process

- The **stochastic ALM model** is the process of combining the CMEs into total portfolio returns[1]

3. Output

- The **median annualised return of the total portfolio** is the output of the process

[1]We do this by simulating the returns of the total portfolio (5,000 times) over a 30 year period (using the scenario generator's volatility and correlation characteristics) and by assuming the total portfolio rebalances on a monthly basis.

Investment inputs to the Integrated Risk Management Framework ("IRMF")

The inputs to the IRMF

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The main inputs to the IRMF are…

The trustee's risk appetite
The amount of risk the Trustee believes the employers are willing and able to support in funding the Scheme and it is prepared to use in funding of the Scheme (aka the "affordable risk capacity").

Available risk capacity
The Trustee's view of the maximum amount of risk that is supportable by the sector

Limit of reliance
The amount of reliance beyond which the Trustee would not wish to go

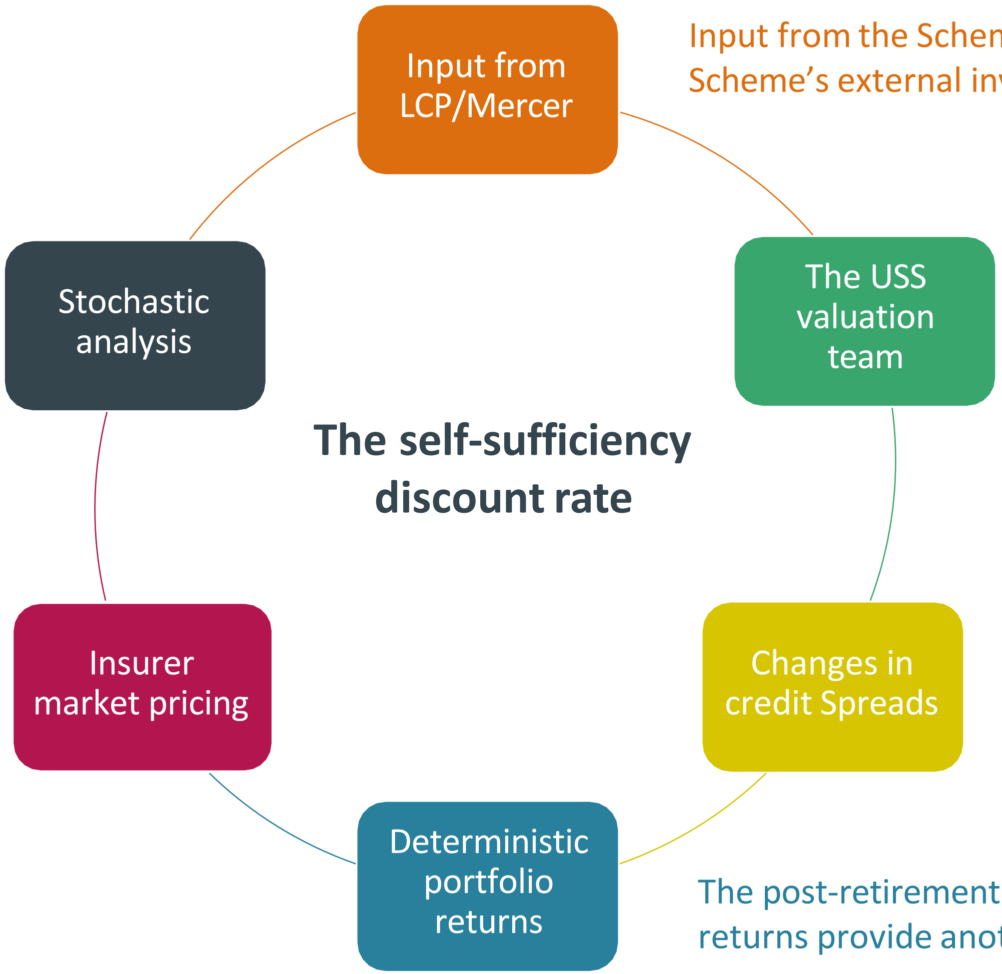
Self-sufficiency
The amount of assets required such that there is a high probability that all accrued benefits can be paid whilst demonstrating a high level of funding

Transition risk
The additional amount to cover the investment and mortality risk in moving to self-sufficiency

Technical Provisions
The amount of assets required to pay benefits in full, based on an appropriate level of caution in the actuarial and investment-related assumptions

Assets
The prevailing level of Defined Benefit assets held by the Scheme

The inputs USSIM consider



Input from the Scheme Actuary and the Scheme's external investment consultant

Guidance on this work from the internal valuation team (including Funding Strategy)

This provides an indicative change in the discount rate

The post-retirement expected portfolio returns provide another indication

Indicative (pensioner buy-in) market pricing

Stochastic analysis using USSIM's CMEs

We have updated these inputs as at 31 March 2023 for the valuation.

Transition risk

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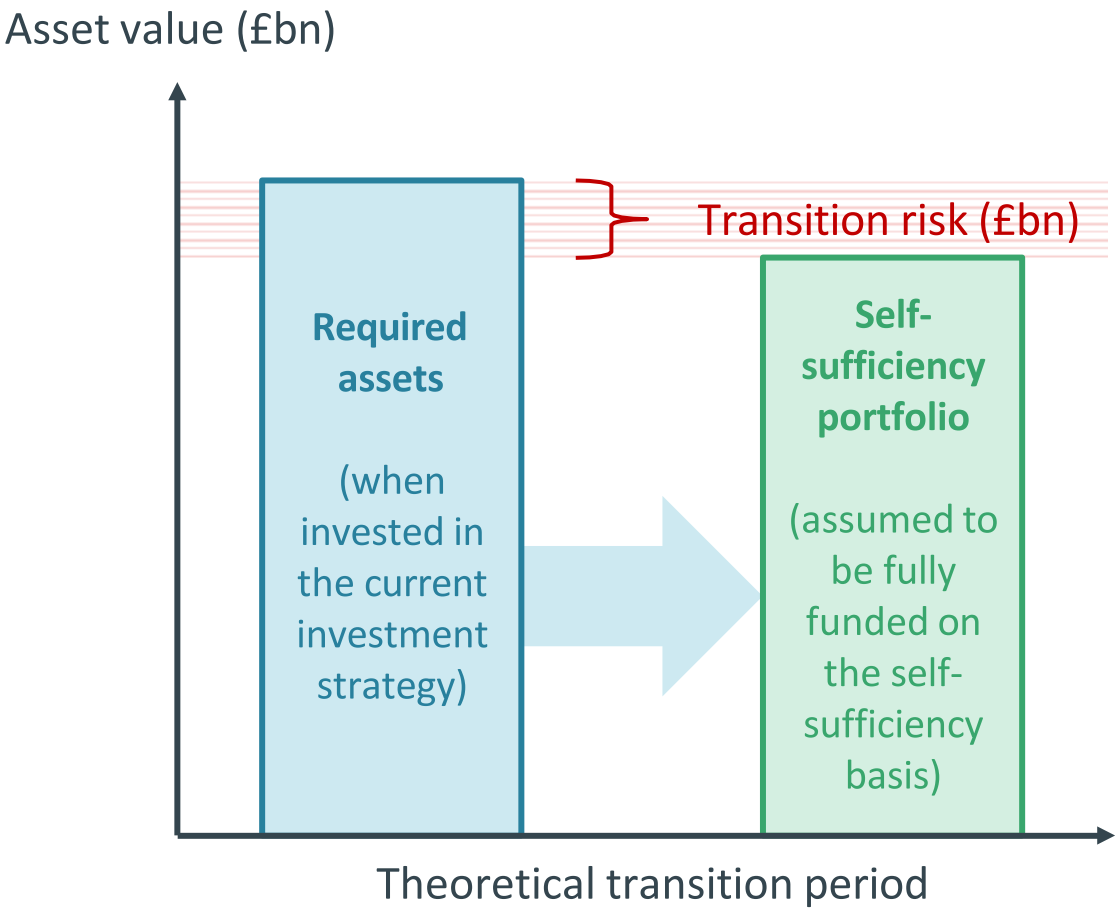
Transition risk is the additional allowance (in £ terms) required over the self sufficiency liability to protect against the risk associated with a theoretical de-risking of the current valuation investment strategy (VIS) to the self sufficiency portfolio.

- In other words, the IRMF requires that we allow for an additional allowance over self sufficiency to reflect the fact that the transition from the current investment strategy towards the self sufficiency portfolio would take some time.

- It is therefore incorporated into the IRMF metrics to determine affordability, allowing for the current investment strategy.



Investment strategy & stability modelling

Background

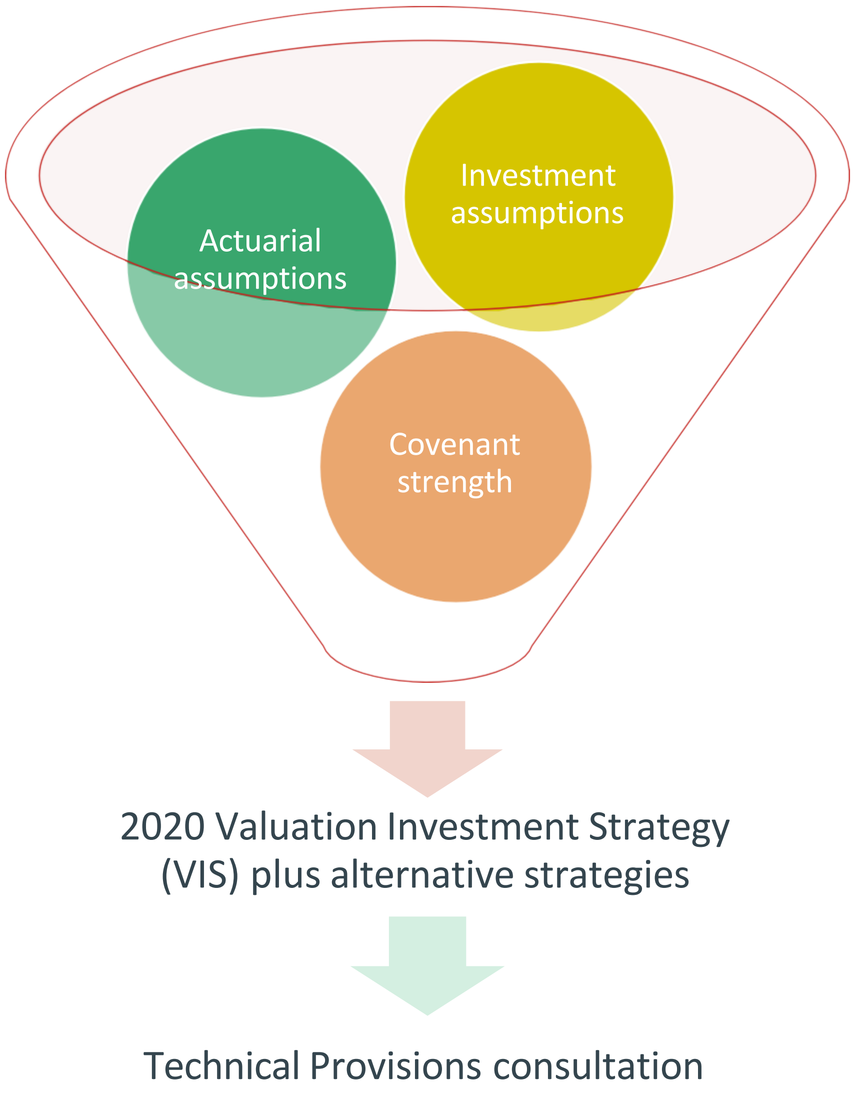
1. The 31 March 2023 valuation position will be **based on a series of input assumptions**. The assumed investment strategy will be one of these.

2. It is proposed that **the valuation outcome must be allowed to fully emerge** before changes to the strategy should be implemented. The **TP consultation** will however make assumptions on the investment strategy, and show sensitivities around it.

3. We expect that **the current VIS agreed at the 2020 valuation will be the central strategy** for the TP consultation.

4. We will also develop sensitivity analysis (using a range of other strategies) for the TP consultation, to help stakeholders understand the impact of a change to the investment strategy.

5. The final investment portfolio (2023 VIS) will be considered once the TP consultation is complete and the valuation outcome is clearer (and will be accompanied by separate advice from USSIM)



Many inputs will feed into the TP consultation and the selection of the new Valuation Investment Strategy (VIS) for 2023

Why use the current VIS for the central strategy?

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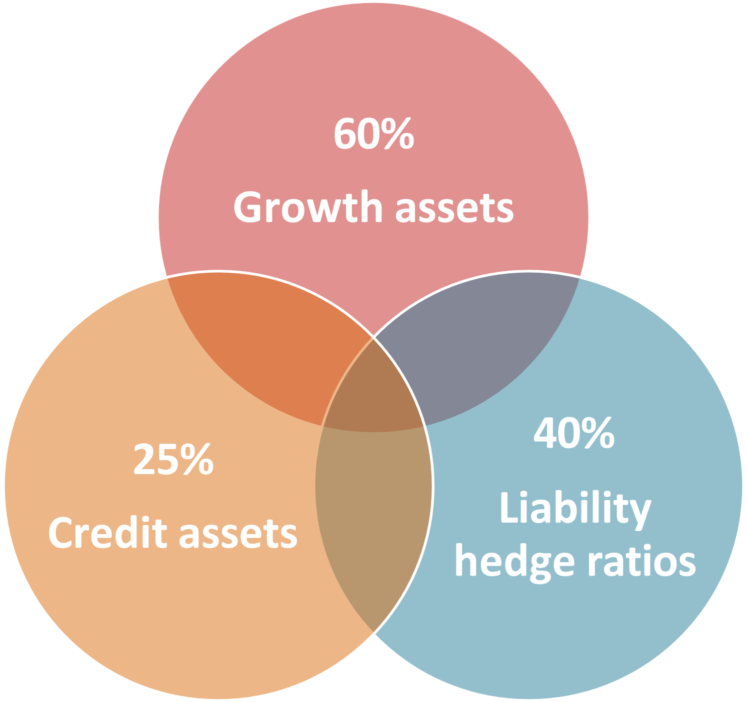
The current VIS[2]:

1. Was the strategy agreed at the last actuarial valuation, which reflects the Trustee's current investment risk appetite.

2. Is consistent with the Trustee's current Statement of Investment Principles (SIP).

3. Is broadly consistent with USSIM's current investment strategy (under the new investment framework)[1].



[1]The major difference between the current VIS and USSIM's implemented portfolio is USSIM's substantial (35-40%) allocation to illiquid investments.
[2]Please note, the percentages to growth and credit assets are capital allocation weights. However, the liability hedge ratios are not capital weights, they reflect the extent to which the strategy is protected from interest rate and inflation shocks, and are calculated on a self-sufficiency basis.

A range of investment strategies could be considered

We propose to use the current VIS as the baseline for the TP consultation. We plan to illustrate the ability of other investment strategies (around the VIS) to support the TPs and to consider scheme stability.

1. **The proposed range is simplified and illustrative in nature** (e.g. it does not allow for an updated Trustee investment risk appetite, covenant strength or actuarial advice).

2. We propose to use this range to help the IC, Trustee and stakeholders gain an **insight into the sensitivity** of the decision on investment strategy as part of the actuarial valuation.

We are working on the suite of risk, return and stability metrics for each of these strategies:

The portfolios underpinning this range are indicative in nature and are intended to assist stakeholders understand the sensitivity of the valuation outcome to the investment strategy decision.
Analysis of the final 2023 VIS will take place later in the year post the TP consultation and as part of the stability workstream

3. Investment Balanced Scorecard for DB and DC, an update on our performance review and reporting

A recap of the Investment Framework

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The new Investment Framework for DB and DC takes a more holistic approach to both risk management and the assessment of USSIM's investment management performance.

The rationale of the Investment Framework was to:

1. Remove the **disproportionate focus** on the Reference Portfolios (for risk and return purposes)

2. **Better align** USSIM efforts to the trustee's wider objectives and investment policies and make USSIM **more accountable** for the trustee's wider DB and DC goals

3. Introduce a **multi-faceted view of risk** through Key Risk Indicators (in line with the trustee's Risk Appetite Statements).

The Investment Framework includes Investment Key Risk Indicators for risk management and an investment balanced scorecard for assessing USSIMs investment performance

What does the investment balanced scorecard look like?

The investment balanced scorecard takes a balanced view of investment performance against the backdrop of USSIM's investment objectives and the interests of the scheme's members and employers.

There are investment balanced scorecards for both DB and DC.

Both scorecards use the same high-level categories, but have different underlying metrics.

1. **INVESTMENT RETURN**
2. **INVESTMENT RISK**
3. **ACTIVE MANAGEMENT**
4. **PORTFOLIO RESILIENCE**
5. **RESPONSIBLE INVESTMENT**
6. **INVESTMENT ADVICE**

USSIM is assessed by the IC on a scale of:

- *Very Good*
- *Good*
- *Average*
- *Poor*
- *Very Poor*

The metrics for the DB scorecard

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1. INVESTMENT RETURN

a. Realised return

i. Versus required return
ii. Versus expected returns

b. Funding measures

i. Probability of Technical Provisions full-funding
ii. Evolution of Technical Provisions funding level
iii. Evolution of Self-Sufficiency funding level

2. INVESTMENT RISK

a. Deficit risk

i. A projection of the Scheme's affordability
ii. Self-sufficiency liability hedge ratios
iii. Asset liability volatility and Value at Risk 95

b. Long-term hedging attributes

i. The contribution from longer-term inflation sensitive assets

3. ACTIVE MANAGEMENT

a. Asset allocation

i. Return versus market comparators

b. Public markets

i. Return over benchmarks
ii. Information ratio
iii. Number of mandates to have outperformed

c. Private markets

i. Return over benchmarks
ii. Quality and quantity of matching assets originated
iii. Number of mandates to have outperformed

4. PORTFOLIO RESILIENCE

a. Liquidity

i. The probability of running out of cash
ii. The probability of running out of collateral

b. Counterparty risk

i. The probability of losing 0.5% of Scheme NAV from a counterparty default

5. RESPONSIBLE INVESTMENT

a. Net zero ambition

i. An assessment of how USSIM is delivering versus the Scheme's net zero ambition

b. ESG integration

i. An assessment of how USSIM is integrating ESG factors (including reporting and stewardship)

6. INVESTMENT ADVICE

a. IC assessment of USSIM advice

i. The annual IC advice survey
ii. A qualitative assessment by the IC

How is investment performance assessed?

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Performance is assessed by the Investment Committee with input from USSIM, trustee executives and external advisors from Mercer (for DB) and LCP (for DC).

The assessment considers many aspects of investment performance, using a range of metrics considering changing market conditions and trustee requirements.

The metrics are either calculated or overseen by the independent risk and performance function under the Chief Risk Officer, who also provides input into the IC discussion.

4. Responsible Investment and Net Zero update

We have set an ambition for our investments to be Net Zero by 2050, if not before.

We believe climate change presents a significant financial risk. Our primary duty is to make sure we can pay our members' pensions when due. Responsible investments that provide good returns and help tackle climate change can play an important part in this.

- We will focus on encouraging governments and the businesses in which we invest to transition to Net Zero.
- Divestment will not address the climate challenge.
- We need a seat at the table to influence and drive change.

Our progress so far

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We've set interim targets as milestones in our journey to Net Zero

We've introduced a 'climate tilt' to our portfolio

We've announced a new £500m Sustainable Growth mandate

We've invested more than **£1.9bn** in renewable energy and clean technology

We will continue to engage with governments and companies to bring about change

Find out more in our Task Force on Climate Related Financial Disclosures (TCFD) report

uss.co.uk/how-we-invest/responsible-investment