# Report & Accounts

for the year ended 31 March 2015

Universities Superannuation Scheme Ltd is the corporate trustee of one of the largest private sector pension funds in the UK with assets at 31 March 2015 of over £49 billion. It was established in 1974 and in 1975 began to manage the principal pension scheme for academic and comparable staff in UK universities and other higher education and research institutions.

The registered number of the trustee company (Universities Superannuation Scheme Ltd) at Companies House is 01167127

The reference number of the scheme (Universities Superannuation Scheme) at the Pensions Regulator is 10020100

USS

# Trustee's report

# Chairman's introduction to the trustee's report

**Professor Sir David Eastwood Chairman**

**The trustee has engaged extensively with employers and members over the reporting year, both on scheme funding matters and more generally around its pension services. There will be continued engagement throughout the forthcoming year as discussions around benefit changes are finalised and preparations are made to introduce new features to the scheme. It will be a period of substantial change; however the trustee remains committed to continuing to deliver strong investment performance and a high quality pension service.**

At the end of the financial year Sir Martin Harris, upon reaching the end of his term of office, retired as Chair of the trustee board, a position he held for nine of the 24 years he served as a Director of the trustee company. I would like to begin this year's report and accounts by expressing our thanks to Sir Martin who led the trustee board with great skill and insight, particularly through the recent economic uncertainty and the funding challenges which followed. His wisdom and guidance will be missed by us all.

Following his retirement I was appointed Chair of the board as of 1 April 2015, having been a Director of the trustee board for eight years. I appreciate that this is a crucial time for the scheme, and for its stakeholders and members, and I look forward to working with my fellow Directors and the expanded and strengthened executive team to meet the challenges of the coming year. I would also like to welcome Professor Anton Muscatelli to the trustee board. Professor Muscatelli has filled the vacancy left by Sir Martin's departure and my subsequent appointment as Chair.

Two key themes began to emerge in the work of the trustee over the previous 12 months. One is around engagement. Of course, the trustee is in close contact with a wide range of organisations throughout the higher education and related sectors. It maintains an open and thoughtful dialogue with many institutions and their representatives through the Institutions' Advisory Panels and other forums. However, these dialogues have been more extensive and detailed over this past year as the trustee concluded its assessment of the support available from employers and updated its approach to scheme funding.

On scheme funding matters, the trustee's primary duty is to ensure there are sufficient funds available to pay the pensions promised as they fall due, and its focus throughout the year has been upon gathering the information it needs to feel assured it can meet those responsibilities. This work has included updating the trustee's understanding of the employer covenant, that is the level of support available from the scheme's participating employers, and working through its funding and investment strategy to ensure it remains appropriate.

In the period since December 2013, the trustee has conducted three separate consultations with the scheme's participating employers, through Universities UK. The first consultation set out the trustee's initial conclusions following the detailed work on the employer covenant; the second considered the framework within which the trustee proposed to monitor the level of risk within the scheme; and the third was the formal consultation on the proposed assumptions underlying the triennial valuation and the updated recovery plan.

In these consultations and wider engagements, substantial input has been required from both the participating employers and from members which has largely been delivered through the respective representative bodies: Universities UK and the University and College Union (UCU). The trustee board and the executive team wish to thank those stakeholders for the time and energy they have dedicated to the scheme over the course of 2014/15. The trustee would also like to thank Sir Andrew Cubie for his leadership of the Joint Negotiating Committee (JNC) throughout the discussions which have taken place between the scheme's stakeholders around changes to the pension benefits provided by USS which resulted in the joint proposal for a new hybrid section of the scheme which was subsequently put forward for consultation with affected employees and their representatives.

The trustee will continue to progress the processes required to complete the valuation as at 31 March 2014. The valuation will be finalised in the coming months following the conclusion of the employer consultation with affected employees. We continue to have a dialogue with the Pensions Regulator on these matters and the Regulator is aware that the March 2014 valuation is not yet finalised. Further information is available in the financial performance and valuation commentary on page 14.

Engagement with employers and members, in one form or another, will continue to feature over the forthcoming year. Participating employers concluded their consultation with affected employees in May and the trustee is in the process of finalising the proposed changes to the scheme. There will be further engagement with members throughout the year both on the detail of the changes and any decisions they are required to take as a result.

The second theme to emerge over the reporting year has been around governance and particularly ensuring our structures and processes are appropriate to meet the challenges we face. One of the trustee's priorities for 2014/15 has been to consider its framework for decision-making, alongside ensuring the appropriate in-house expertise exists to continue to deliver a pensions service which is valued. During the year, there has been focus on clearly delineating the responsibilities of the trustee board and the executive, enabling the trustee board to concentrate on strategic priorities and the executive to deliver the agreed business plan through the day-to-day management of the company. As detailed in the Group Chief Executive Officer's update, the Group Executive has been strengthened both to support the continued monitoring and development of the trustee's integrated approach to scheme funding, and to ensure the executive has the right skills and experience to deliver the anticipated changes to both scheme design and operation.

The trustee company remains committed to delivering its investment strategy through an effective in-house team. The trustee favours an in-house investment operation as it allows closer alignment between the trustee and the delivery of its investment objectives. It shall therefore continue to develop the in-house team to support continued diversification of the scheme's assets. We report on investment performance and outlook in the update on pages 29 to 35.

More broadly, 2015/16 will be another exceptionally busy year for the trustee company. There is likely to be substantial operational change required to support the introduction of a new section of the scheme, and we shall continue to rely upon the inputs of employer and member representatives as we develop new features and processes. Throughout this period of change USS will continue to deliver good quality pension provision, supported by the professional, personalised service which our employers and members value.

**Professor Sir David Eastwood**
**Chairman**

# Board Members

**From top left:**
Ian Maybury
Kirsten English
Bill Trythall
Rene Poisson
Dr Angela Roger
Joseph Devlin
Michael Merton

**From bottom left:**
Professor Anton Muscatelli (inset)
David McDonnell
Professor Dame Glynis Breakwell
Professor Sir David Eastwood
Dr Kevin Carter

### Professor Sir David Eastwood - Chair
### Appointed by Universities UK

Professor Sir David Eastwood became Vice-Chancellor of the University of Birmingham in April 2009. Former posts include Chief Executive of the Higher Education Funding Council for England (HEFCE), Vice-Chancellor of the University of East Anglia (UEA) and Chief Executive of the Arts and Humanities Research Board. Before that he held a Chair in Modern History at the University of Wales Swansea, where he was also Head of Department, Dean and Pro-Vice Chancellor. He was a Fellow and Senior Tutor of Pembroke College (1988-95), and is an Honorary Fellow of St Peter's College, Oxford, from where he graduated in 1980, and of Keble College, Oxford from 2006. He became a Director of USS in January 2007.

### Professor Dame Glynis Breakwell
### Director - Appointed by Universities UK

Professor Dame Glynis Breakwell was appointed Vice-Chancellor of the University of Bath in 2001 having previously been Pro-Vice-Chancellor (Research) and Head of the School of Human Sciences at the University of Surrey. Dame Glynis took her PhD in Psychology from the University of Bristol and DSc from the University of Oxford where she held a Prize Fellowship at Nuffield College. Dame Glynis is an Honorary Fellow of the British Psychological Society and an Academician of the Academy of Social Sciences. She was appointed Dame Commander of the Order of the British Empire in the Queen's New Year Honours for services to higher education and in 2014 she was named in the Science Council's list of 100 leading UK practising scientists.

Dame Glynis is a Director of the Student Loans Company and Universities UK. She is also Director of the Leadership Foundation for Higher Education and a Council Member of the Economic & Social Research Council. She became a director of USS in September 2009.

### Dr Kevin Carter
### Director - Independent

Kevin Carter is Chairman of Murray International Trust PLC and a Non-Executive Director of Lowland Investment Company PLC. He is a trustee Director of the BBC Pension Trust Limited and Chairman of its investment committee, and a Director of the Centrica Combined Common Investment Fund. He is also Chairman of Hermes GPW LLP, a private markets asset manager.

He was Chief Executive of Old Mutual Asset Managers (UK) Limited from 1987 to 2000 and Chief Executive of Old Mutual Asset Managers (US) LLC from 2000 to 2001. He then became a senior investment consultant and ultimately European Head of Investment Practice at Watson Wyatt. Subsequently he joined JP Morgan in London as a Managing Director and Head of the EMEA Pension Advisory Group. He was appointed a Director of USS in September 2012.

### Joseph Devlin
### Director - Appointed by UCU

Joseph Devlin has been the Open University's Pensions Manager since 1998, having previously worked over a number of years in the private sector in the areas of actuarial, pension consultancy and administration.

Joseph has tutored for the Pensions Management Institute and International Employee Benefits Examinations. He was appointed a UCU nominated director of USS in September 2007.

### Kirsten English
### Director - Independent

Kirsten English holds several non-executive directorships including Tyman PLC and Birdstep Technology A.S and is an Advisory Board Member of Innovate Finance (the Financial Technology Industry Association).

She currently works as a consultant to private equity firms focusing on financial technology acquisitions and operational improvement in portfolio companies. She has previously held a variety of positions including Director at Terra Firma Capital Partners, CEO (Alternative Investments) at Grenfell PAI (Punter Southall Group), and Entrepreneur in Residence at Warburg Pincus. She also has 16 years' experience with Reuters, where she served as CEO for the Norwegian and Icelandic divisions and Internal Communications Director. Kirsten was co-founder and General Manager at Radianz, which sold to BT in 2005. Kirsten is a graduate of St Anne's College, Oxford and the Wharton Business School Executive Program and speaks fluent Norwegian. Kirsten joined the trustee board in May 2014.

### Dr Angela Roger
### Director - Appointed by UCU

Dr Angela Roger recently retired as a Senior Lecturer in Education at the University of Dundee. Her teaching and research interests included coaching new and experienced staff in higher education, and promoting effective and attuned communication for a range of professions.

She is a member of UCU's National Executive Committee, Honorary Treasurer of UCU and formerly a President of AUT Scotland and AUT. Angela is a former Chair of USS's Advisory Committee on which she served for eight years; and was a member of the JNC for seven years. She is also Chair of the Board of Trustees of the Teachers' Support Network, the educational charity incorporating Recourse which supports staff in further and higher education. She was appointed a Director of USS in September 2012.

### Ian Maybury
### Director - Independent

Ian Maybury joined Schroders in 2012 as the Head of Solution Management and has previously worked for Redington, Citigroup and Royal London Insurance in various actuarial and management roles. He currently combines a part time advisory role at Schroders with a portfolio of trustee, investment committee, non-executive and advisory or consultancy roles.

An experienced executive with particular expertise in investment and risk management, he has occupied a number of key trustee positions for much of his career. He took on a Defined Contribution Committee role for the Unilever UK Pension Scheme in March 2013, in addition to becoming a trustee for Royal National Institute for Blind People in October 2013. He has a keen interest in the governance of DB and DC pension schemes as well as financial services and pension regulation. He was appointed a Director of USS in November 2013.

### David McDonnell CBE
### Director - Appointed by Universities UK

David McDonnell is currently Vice Lord Lieutenant of Merseyside and Pro-Chancellor of the University of Liverpool. Until 2009 he was Global Chief Executive of Grant Thornton and in 2009/10 he served as High Sheriff of Merseyside.

David was Chairman of National Museums Liverpool for ten years until 2005, and is currently Chairman of the Arena and Convention Centre Liverpool Limited. David is an Honorary Fellow of Liverpool John Moores University and a Director of Hill Dickinson LLP and Liverpool University Press Limited. He was made CBE in 2005 and joined USS as a Director in April 2007.

### Michael Merton
### Director - Independent

An alumnus of the Senior Management Development programme at Harvard University and a Fellow of the Institute of Chartered Accountants in England & Wales, Michael Merton worked for Rio Tinto from 1976 to 2009.

At Rio Tinto, he was formerly the Group Financial Controller and member of the Executive Committee and held the position of CEO for Lihir Gold, a Rio Tinto managed operation based in Papua New Guinea and Australia, between 1997 and 2000. He fulfilled the role of CFO for some of the firm's operations in the UK, France and the USA between 1984 and 1997, and became Head of Global Business Services in 2005. Michael now acts as Chair of the J Sainsbury Pension Scheme and its investment committee, is a trustee of the HALO Trust and serves on the boards of Cape PLC and BlackRock Commodities Income Investment Trust Plc. He became a Director and Chair of the Audit Committee of USS in February 2014.

### Professor Anton Muscatelli
### Director - Appointed by Universities UK

Professor Anton Muscatelli became Principal and Vice-Chancellor of the University of Glasgow on 1 October 2009. He studied at the University of Glasgow, where he graduated with an MA in Political Economy and with a PhD in Economics.

He was a lecturer in Economics from 1984 and Daniel Jack Professor of Economics from 1992 until 2007. He was Dean of the Faculty of Social Sciences, from 2000 to 2004, and Vice-Principal (Strategy, Budgeting and Advancement) from 2004 until 2007. He was Principal and Vice-Chancellor of Heriot-Watt University from 2007 to 2009. He was appointed a Director of USS in April 2015.

### Rene Poisson
### Director - Independent

Rene Poisson retired after a 30 year career with JP Morgan latterly as Managing Director and Senior Credit Officer for Europe, Middle East and Africa. Over the last 15 years he has been a trustee of JP Morgan's London Office Retirement Plan and, is currently Chair of the board and investment sub-committee of JP Morgan's UK Pension Plan. He is also Chair of the Advisory Committee for Rothschild and of the Independent Governance Committee of Standard Life Assurance PLC and Director of the Standard Life Master Trust. Rene is a Director and Chair of the Remuneration Committee of Stemcor as well as a patron of the Disability Challengers Charity. He was appointed a Director of USS in November 2012.

### Bill Trythall
### Director - Appointed by UCU

Bill Trythall has retired after nearly 40 years teaching History at the University of York. He has had a long involvement in USS, including over 20 years on the Joint Negotiating Committee, and many years as an AUT Director of the trustee company up to 2005.

He sits on the committee of the Association of Member Nominated Trustees and on a panel of pension scheme trustees advising DWP. He is a former national President of AUT and was subsequently a trustee of the union and of its staff pension fund. He was appointed Pensioner Director in October 2009.

# Membership of Committees

The Directors and committee members who held office during the year, or prior to the approval of these financial statements are set out below.

## Board

*Appointed by Universities UK*
Professor Sir David Eastwood (Chair from 1 April 2015), Sir Martin Harris (Chair until 31 March 2015), Professor Dame Glynis Breakwell, Professor Anton Muscatelli (from 1 April 2015), Mr David McDonnell
*Appointed by the University and College Union (UCU)*
Mr Joseph Devlin, Dr Angela Roger, Mr Bill Trythall
*Appointed by the board (Independent)*
Dr Kevin Carter, Ms Kirsten English, Mr Rene Poisson, Mr Ian Maybury, Mr Michael Merton

## Policy Committee

*Appointed by the board*
Professor Dame Glynis Breakwell (Chair from 1 April 2015), Professor Sir David Eastwood (Chair until 31 March 2015), Mr Joseph Devlin, Mr Rene Poisson, Mr Bill Trythall, Dr Kevin Carter

## Rules function of the Policy Committee

*Appointed by the board*
Mr Brendan Mulkern (Chair), Mr Bill Trythall, Mr Cliff Vidgeon

## Investment Committee

*Appointed by the board*
Dr Kevin Carter (Chair), Professor Dame Glynis Breakwell, Sir Martin Harris (until 31 March 2015), Professor Sir David Eastwood (from 1 April 2015), Professor Anton Muscatelli (from 1 April 2015), Ms Angela Docherty (until 24 September 2014), Mr David McDonnell, Mrs Virginia Holmes, Mr Ian Maybury, Ms Sarah Bates, Dr Angela Roger

## Audit Committee

*Appointed by the board*
Mr Michael Merton (Chair), Mr Gordon Coull, Mr Joseph Devlin, Ms Kirsten English, Mr David McDonnell, Sir Martin Harris (until 31 March 2015)

## Remuneration Committee

*Appointed by the board*
Mr Rene Poisson (Chair), Mr David McDonnell, Professor Dame Glynis Breakwell, Mr Joseph Devlin

## Governance & Nominations Committee

*Appointed by the board*
Mr David McDonnell (Chair), Professor Sir David Eastwood, Dr Angela Roger, Mr Bill Galvin, Ms Kirsten English

## Advisory Committee

*Appointed by Universities UK*
Dr Antony Bruce, Mr Denis Linfoot, Mr Cliff Vidgeon (Chair from 1 July 2014)
*Appointed by UCU*
Ms Pauline Collins (Chair until 30 June 2014), Mr Gordon Watson, Dr Marion Hersh, Mr David Goode (until 30 June 2014)

## Joint Negotiating Committee

*Independent Chair*
Sir Andrew Cubie
*Appointed by Universities UK*
Dr Anthony Bruce, Mr Phil Harding, Mr John Neilson, Mr Will Spinks, Mr Cliff Vidgeon
*Appointed by UCU*
Dr Jimmy Donaghey, Mr Roger Brooks, Ms Geraldine Egan, Dr Marion Hersh, Mr Gordon Watson

# Group Chief Executive Officer's update

**Bill Galvin**
**Group Chief Executive Officer**

**The Group Executive is focussed on delivering a good quality product and service that is highly valued by employers and members. A substantial investment in our in-house capabilities notably in risk management, change delivery and institution liaison has put the executive on a sound footing as we prepare to deliver the substantial changes put forward by our stakeholders.**

In April 2015 the scheme reached an important anniversary – 40 years in operation – a milestone of which we are all immensely proud. When the scheme began it had just 13,000 members and £10 million in assets, it has grown and is now one of the largest open pension schemes in the UK. In the year to 31 March 2015, assets under management grew to £49 billion and membership reached a new peak of almost 323,000. The Career Revalued Benefits (CRB) section now accounts for more than one third of total active membership.

Periodically the trustee surveys employers and members to seek their views on various aspects of USS and its approach. In the year to 31 March 2015 we asked both our participating employers and the membership about their experiences of USS. The results are described in more detail on page 13, however, it is worth highlighting that the response from employers and members alike was broadly positive and demonstrated that our service continues to be valued. This reflects particularly well on our member focussed service delivery teams, and on those who administer USS pensions on our behalf from within our participating employers. We shall continue to seek feedback as we deliver the proposed new section of the scheme and develop our future service proposition.

Our goal is to exceed the expectations of members and institutions and we shall continue to invest in the people and technology that will make that happen. We have made a number of new appointments to help improve the services we provide bolstering the teams that focus on risk, product strategy, institution liaison and financial management. During the year I was joined in the Group Executive by Jeremy Hill, as Group General Counsel, by Guy Coughlan, as Chief Financial Risk Officer, by Kevin Smith as Chief Service Delivery Officer and by Jennifer Halliday as Chief Financial Officer. These are important additions to the leadership of the organisation, and together with Roger Gray, Brendan Mulkern and Howard Brindle, complete a Group Executive team with the capability and capacity to run one of the largest private sector pension schemes in the UK and to deliver the changes outlined by our stakeholders in the recent strategic discussions on risk, funding and benefit structures.

The trustee board has, over the course of the year, continued to delegate authority to the executive, and to establish appropriate governance and information flows to assure delivery. One major step towards greater delegation to the executive is the introduction of the reference portfolio approach; a truly ground-breaking framework for investment governance in the scheme. USS is amongst the first pension schemes in the UK to adopt this approach; it is used by only a small number of major funds globally. The reference portfolio approach gives considerable flexibility to the in-house investment team to manage the fund's investments to meet certain risk and return criteria. It is one of the trustee's key beliefs that a well-run and appropriately governed internal investment capability is the best way for the trustee company to meet its long term investment objectives in an aligned and cost-effective manner. Further information on this new approach can be found on pages 29 to 35 of the investment report where we also report the trustee company's investment performance and related activities including the significant engagement activity carried out by our in-house responsible investment team on matters such as climate risk, good governance and executive remuneration.

The coming year will undoubtedly be a challenging one for the trustee and the executive team; the proposed changes to future benefits provided by USS will change the way the company operates and our interactions with employers and members. To this end, the trustee has agreed the business plan for 2015/16, which allows further investment in the executive's operational capacity in order to support the anticipated changes to the scheme and to our service. We shall continue to draw upon our knowledge of the higher education and related sectors, and the strong connections we have with employers and members, to develop our service to meet future requirements. We will work closely with our participating institutions to guide members through these changes.

I am confident that we will rise to these challenges: we have the right people and processes in place to deliver a new section of the scheme, and an updated service proposition for the participating employers. We will continue to provide members with very positive retirement outcomes, now and in the future.

**Bill Galvin**
**Group Chief Executive Officer**

# Principal officers & advisors

The principal officers and advisors of the trustee company are:

### Group Chief Executive Officer
Bill Galvin

### Chief Investment Officer
Roger Gray

### Chief Financial Officer
Jennifer Halliday

### Chief Policy & External Affairs Officer
Brendan Mulkern

### Chief Service Delivery Officer
Kevin Smith

### Group General Counsel
Jeremy Hill

### Chief Operating Officer
Howard Brindle

### Chief Financial Risk Officer
Guy Coughlan

### Actuary
Ali Tayyebi of Mercer,
Birmingham
B1 2LQ

### Solicitors
DLA Piper UK LLP,
Liverpool
L2 ONH

### Independent Auditors
Grant Thornton UK LLP,
Royal Liver Building
Liverpool
L3 1PS

### Bankers
Barclays Bank Plc,
Manchester
M2 1HW

# Review of the year & future developments

The following report provides a detailed review of the scheme's performance in the year, and the significant projects undertaken. Key highlights for the year ended 31 March 2015 were:

- A continued increase in membership from over 316,000 to almost 323,000, an increase of 2%.
- An increase in the fund's assets from £41.5 billion to £49.0 billion (excluding AVCs).
- Extensive dialogue with members and institutions and their representatives to support the scheme funding approach.
- Introduction of the reference portfolio framework (explained further on page 30).
- Positive feedback from employers and members on the quality of USS services.
- Improved governance structures and a strengthened executive team.

The accounts for the scheme are set out on pages 54 to 77 and have been prepared in accordance with the regulations made under Section 4(1) and (6) of the Pensions Act 1995.

In the year to 31 March 2015, the fund's assets have increased by £7.5bn (excluding AVC's) not least as a result of exceptionally strong investment performance in the year. A detailed update on investment performance and on the changes to our investment approach which have been implemented in the year are available in the investment report on pages 29 to 35. USS continues to be one of the largest private sector pension schemes in the UK, and one of the few pension schemes in the private sector which continues to have defined benefit pension provision at its heart.

Even with strong investment performance the scheme's deficit has increased and scheme funding matters have dominated the year. Following significant discussion and consultation around the level of risk carried by the scheme and the related implications for funding, the trustee has progressed the the valuation process alongside the stakeholders' continuing discussions around the future USS pensions offering as set out in the financial performance and valuation section on pages 14 to 16.

An important element of that pensions offering is the service we provide to both employers and members. Engagement both directly with employers and members and via their respective representative bodies has featured heavily over the course of the year as we seek to understand, at a more granular level, which aspects of our service are most valued and where improvements can be made.

During the year we have also sought to strengthen our governance arrangements and processes. We have made a number of changes to the board and committees as well as key appointments to the group executive to ensure the trustee company remains well-positioned to be able to continue to deliver a quality pensions product and first rate pensions service. Further detail on board and committee changes is set out on pages 7 to 9 and the executive appointments are detailed in the Group Chief Executive's update.

## Membership


The membership of the scheme has continued to grow and as at 31 March 2015 stood at 322,779, an increase of 2% on the previous year (31 March 2014: 316,440). The chart shows that over the last five years the total number of members has increased by 16.3%. More details are given in the detailed membership update on page 50 to 53.

During the year the trustee surveyed both employers and members to understand which elements of the service they value, where improvements could be made and how it can develop to meet future requirements. The results from the active member survey were encouraging; around 75% were satisfied with the timeliness and responsiveness of the service they received and reported that the information provided to them by USS was both clear and concise, 71% stated that they would recommend the service to a colleague. For employers the number was slightly higher with 80% stating that they would recommend our service. This is good progress towards the trustee's mission to be the pension service of choice for the higher education sector for the long-term.

The survey also helped to identify and confirm the areas for improvement, for example seeking more effective use of electronic communication and digital processes. These areas shall be explored further as an improved pensions administration technology is developed, and more broadly as work continues to refine the trustee company's proposition for employers and members.

# Financial performance and valuation

## Integrated funding approach

The trustee's integrated approach to scheme funding involves consideration of a number of key elements including the employer covenant, investment strategy, funding strategy, and the contributions paid to cover the cost of the current benefit arrangements. The trustee considers each of these elements and the interactions between them when making judgements around the future funding approach required to meet its principal objective which is to pay the benefits promised as they fall due.

This integrated approach informs the ongoing assessment that the trustee makes of the level of risk which is sustainable in its investment of the scheme's assets, when balanced against the profile of the scheme's liabilities and the level of support available to the scheme from the sponsoring employers.

Over the course of the year the trustee has progressed its review of scheme funding, in conjunction with its consideration of the outcome of the actuarial valuation as at 31 March 2014. This approach ensures the key fundamentals for scheme funding are updated and continue to be appropriate. Importantly, following the granular assessment of the support available from the employers – the covenant – completed by EY, the trustee company's independent covenant assessors, the trustee has updated its understanding of the risk tolerance of participating employers. EY's work confirmed a strength and resilience within the scheme's sponsoring employers which supports a reasonable reliance by the trustee company on employers within the higher education and related sectors. This is important as the amount of support available to the scheme from the employers affects how much risk the trustee can reasonably take in delivering the benefits. Risk is inherent in the funding of the scheme, in particular in the investment of the fund's assets, and has an impact on the contribution requirements associated with providing a particular level of benefits.

Having updated its assessment of the amount of support available from the employers, the trustee considered the appropriate level of risk it should take. After careful consideration and following advice, as well as taking into account feedback from the scheme's stakeholders, the trustee developed a funding framework which enables it to monitor the scheme's reliance on the employer covenant within its overall integrated approach to scheme funding. In broad terms, the trustee believes the amount of risk taken should be proportionate to the amount of support available from the scheme's participating employers, and specifically that there should be no increase in the reliance placed on the covenant over time. Indeed, it is the trustee's view that, with the right economic conditions, and following appropriate dialogue, opportunities should be taken over the years ahead to reduce the amount of risk within the scheme and therefore its reliance on the covenant. This view has informed the trustee's investment strategy, and its assessment of the returns it can expect from its investments over time, which in turn informs the funding requirements.

## Employer covenant

The trustee, as part of its ongoing management of the scheme, adopts a system of regular monitoring of the covenant. This includes a formal assessment, when appropriate, and at least every three years to precede the full valuation of the scheme. The trustee's ongoing monitoring of the covenant takes into account a number of key indicators related to institution financing including:

| |
|---|
| Student numbers |
| Income |
| Operating costs |
| Capital expenditure |
| Change in value of net assets |
| Standing in world rankings of large institutions |

These indicators, amongst others, are reviewed by the trustee, drawing upon the latest knowledge and insight from the Higher Education Funding Councils, and other employer representative bodies. Key changes in any of these indicators or any other factors affecting the employers' ability to support the scheme will be discussed with Universities UK to further understand the potential impact upon scheme funding.

## Triennial valuation

Every three years the trustee must commission an actuarial valuation of the scheme. This involves detailed consideration by the trustee board, supported by the scheme actuary, of member data, of demographic and behavioural patterns, of movements within the membership, and of financial information regarding the fund and its investments. The valuation process also looks at the wider economic landscape, and brings together the analysis of scheme experience and the likely pattern of future changes in the membership, with the economic prospects for the scheme and for its investments. The trustee board gathers this information in order to be able to propose and, after consultation, adopt, prudent assumptions to determine the value of the scheme's liabilities at the valuation date. These liabilities are referred to formally as the scheme's 'technical provisions'.

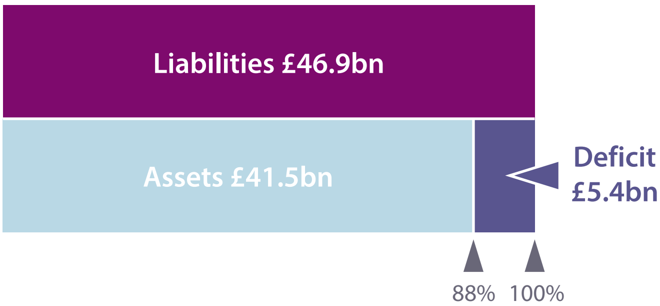
The trustee and the scheme actuary completed their review of the factors which influence scheme funding in the autumn of last year. In October 2014 participating employers were consulted, through Universities UK, on the adjustments to the assumptions underlying the technical provisions.

This consultation confirmed the cost of providing the current USS benefits. In January 2015 the employer and member representatives put forward a joint proposal to change future benefit arrangements. Employers began a consultation with affected employees and their representatives on the detail of this proposal on 16 March 2015. At the time of approving this year's report and accounts, the process following this consultation remains ongoing and the triennial valuation cannot be completed until the outcome of that process and the final form of changes to future benefit arrangements is decided upon.

## Funding position

The trustee has provided an estimate based on its updated assumptions for the technical provisions, and assuming that the proposed changes to employer and member contribution rates are implemented as described in the employer consultation materials and a new section of the scheme is introduced. Importantly, this estimate, which is illustrated below would change if there were material modifications to the proposed benefit changes.

On the basis described above, the funding level of the scheme as at the valuation date of 31 March 2014 would have been:




For further information about the scheme's funding position please refer to the summary funding update on pages 79 to 83.

## Recovery plan

In 2011, in accordance with the scheme-specific funding regime for defined benefit pension schemes, and after formal consultation with Universities UK, the employers' representative body, the trustee put in place a 10-year recovery plan to respond to the deficit reported in that year's triennial valuation. It involved the employers continuing to pay a contribution of 16% of salaries for the first six years of a 10-year plan, with an allowance for an additional contribution of 2% above the then future cost of accrual for the remaining four years. In addition to these contribution requirements, the plan also assumed an additional 0.51% per year investment return, over and above the underlying prudent investment return assumption.

This recovery plan has been reviewed and updated and employers were consulted, through Universities UK, on the revised draft recovery plan in the autumn of 2014. The updated recovery plan will be finalised and published as part of the formal actuarial valuation once the changes to future benefit arrangements have been decided upon and future contribution rates have been confirmed.

In particular, the trustee considered the appropriate length of the recovery plan given EY's findings that generally there was good visibility of the covenant for a period of 20 years. The trustee does not believe that the recovery plan should be extended to the full length of the covenant horizon but is content for it to be lengthened from the 10 years allowed for in the 2011 recovery plan.

The additional assumed outperformance to be included in the updated recovery plan will be aligned to the reduction in investment risk – and therefore the discount rate – which the trustee proposes to implement gradually over a period of 20 years. It is the trustee's intention that the additional assumed outperformance available on the fund's assets during the recovery period will be 50% of the difference between the assumed discount rate for the technical provisions and the best estimate return from the investment strategy.

The updated recovery plan has been compiled with care, taking into account the economic circumstances of the scheme, the strength of the sponsoring employers and their capacity to meet deficit contributions, as well as the trustee board's investment strategy and beliefs.

## Operating costs

The operating costs for the year amounted to £96.1m (2014: £83.4m), representing an overall increase of 15% compared to the previous year as shown in the table below:

| | 2015 £'000 | 2014 £'000 | Increase/(Decrease) £'000 | Variance % |
|---|---|---|---|---|
| Personnel costs | 44,121 | 35,096 | 9,025 | 26 |
| Premises costs | 3,480 | 3,516 | (36) | (1) |
| Investment costs | 28,607 | 25,765 | 2,842 | 11 |
| Other costs | 19,886 | 19,026 | 860 | 5 |
| | 96,094 | 83,403 | 12,691 | 15 |

The trustee remains focused upon delivering outstanding core business performance for the benefit of members and institutions whilst also providing value for money. The vision and strategy requires us to manage the costs efficiently without impairing the service we deliver. The trustee has therefore invested in its people and processes over the year to 31 March 2015 and an analysis of the increase in personnel costs is provided on page 26. In order to control costs over the long-term we must incur some additional costs currently to deliver against our strategic priorities. The proposed introduction of a new section of the scheme, and the required adjustments to the service provided by the trustee company will require further investment over the 2015/16 period.

The trustee also plans to continue to develop the in-house investment team and the related monitoring and governance arrangements so that it is best-placed to deliver above benchmark performance. The trustee company delegates implementation of its investment strategy to USSIM Ltd which provides in-house investment management and advisory services. The trustee favours in-house provision and will only seek external investment management if the skills required are not available internally and are too costly to develop in a timely fashion. This approach ensures that the trustee company remains cost effective compared to global pension schemes of a similar size and scale. In 2013, the latest year for which figures are available, investment costs were approximately £20m less than the industry benchmark for a scheme of the size and asset mix held in the fund.

Operating costs for USS Investment Management Limited (USSIM Ltd) are recharged to the trustee company in accordance with the Investment Management and Advisory Agreement (IMA), such that it does not make a profit or a loss. These costs are included within the costs shown in the table above and contribute £51.1m to the £96.1m shown.

# Regulatory developments

The trustee dedicates significant time and resource to engaging with regulators and policy makers on issues which may have material impact on the scheme and upon the trustee company. When implementing new regulations we aim to do so with as little disruption as possible to members and institutions and where possible have produced briefing materials to assist institutions – as far as we reasonably can – with any new legal requirements they need to meet in relation to the scheme.

## IORP Directive II

A draft pensions directive (formally known as the Institutions for Occupational Retirement Provision (IORP) directive) was released in March 2014 by the European Commission and is in the process of being considered by the European Parliament and Council.

The draft directive proposes new governance requirements for risk management, internal audit, trustees, member communications and retains the additional funding and regulatory requirements for cross-border schemes (USS is not a cross-border scheme). Whilst the trustee welcomes certain principles within the directive (such as improved member communications), some concerns have been raised that a number of the proposed reforms could prove to be an expensive administrative burden with potentially only limited practical benefits. The next milestone in the consideration of the draft directive is a report from the European Parliament due to be issued in July 2015.

The estimated date for implementation of the directive at a national level is the end of 2016/start of 2017.

Separately, the European insurance and pensions regulator – EIOPA - continues its work on potential additional capital requirements for pension schemes. The trustee shall continue to engage with regulators and policy makers in Europe as these important issues are given further consideration. This will involve responding to the latest consultation issued by EIOPA on capital requirements.

## Financial Reporting Standards

The Financial Reporting Council (FRC) has issued new financial reporting standards for application in the United Kingdom and Ireland. The new accounting framework replaces the UK Generally Accepted Accounting Principles (UK GAAP) and fundamentally reforms financial reporting with three new financial reporting standards:

- FRS 100 Application of Financial Reporting Requirements;
- FRS 101 Reduced Disclosure Framework; and
- FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland

The new standards align UK GAAP more closely with international accounting standards and will be applicable from next year and will therefore apply to the scheme's 31 March 2016 financial statements. One of the most significant changes under FRS 102 is the requirement to include within the scheme's financial statements substantial new disclosures, in particular in respect of the nature and extent of investment risk, including the exposures to credit and market risks and the objectives, policies and processes for their management.

The new accounting framework recognises Statements of Recommended Practice (SORPs) under FRS 100. The pension SORP was revised in November 2014 and covers the specific requirements for pension schemes established by FRS102 as well as other requirements which are expected to apply to pension schemes. Work is well progressed to implement FRS 102 across all group entities which report under UK accounting standards.

FRS 102 also brings in a requirement for sponsoring employers to recognise a liability for contributions which are made to fund a pension deficit in defined benefit multi-employer schemes. This will be the first time such a liability will need to be formally measured, recognised and disclosed on the individual balance sheets of some of the scheme's participating employers. The financial statements will also need to include a description of the extent to which one institution can be liable for other institutions' obligations under the terms and conditions of the multi-employer scheme and explain how that obligation / liability has been determined.

The trustee company, working with the British Universities Finance Directors Group ('BUFDG') and its Financial Reporting Group, issued a template example of how deficit contribution liability could be calculated in order to assist institutions as they prepared their own accounts. This template example will be updated and re-issued following the completion of the actuarial valuation later in the year.

### Auto enrolment

The trustee has continued to provide ongoing support to institutions as they respond to legislation which requires all employers to automatically enrol eligible employees into a workplace pension. The date upon which an institution is required to meet these obligations is referred to as its 'staging date' and it varies according to the number of people an institution employs. The staging date for USS's largest participating institutions was 1 March 2013 and many of these larger institutions are now approaching their first re-enrolment (which must take place every three years). The majority of institutions will have completed the auto-enrolment process by October 2015, the full roll out – including smaller employers – will not be completed until 1 February 2018.

## Taxation changes

### Annual and Lifetime Allowance

With effect from the 2015/16 tax year the Lifetime Allowance (LTA) for pension savings will be £1.25million (reduced from £1.5 million for the 2013/14 tax year). The lifetime allowance will fall to £1 million from 6 April 2016. The Annual Allowance (AA) for the 2015/16 tax year is £40,000.

The trustee is not registered to provide financial advice (including tax advice) but recognises that it is important to provide appropriate information to those members who may be affected by these new limits. The trustee will continue to provide reasonable information to those members it considers might be affected by the LTA and AA. In the last few days prior to the approval of this report, the Government has announced plans to gradually reduce the annual allowance from £40,000 to £10,000 for those earning more than £150,000 from April 2016.

### Contracting out changes

The Government is legislating to replace the current two-tier state pension with a single state pension to be introduced from 6 April 2016. This change means the earnings-related state second pension will cease to exist. This change will affect both employers and members of USS, as the vast majority of participating employers currently offer members – through USS – the opportunity of 'contracting out' of paying into the state second pension, thereby reducing the amount of National Insurance (NI) paid by both employer and employee in return for a reduced state second pension (to reflect the benefits earned within USS).

The ending of the state second pension will affect individuals in different ways depending on their specific circumstances. In the long-term, the Government predicts that the majority of people will benefit from this change. However, both scheme members and participating employers will, from 6 April 2016, be required to pay increased national insurance contributions at the standard rate (as opposed to the 'discounted' contracted out rate). It is estimated that this equates to approximately 1.4% of eligible salary for members.

Based on current information it is estimated that our participating institutions will see their NI contributions increase by 3.4% on earnings above £5,564 - there is no upper earnings limit for employers. This equates to approximately 2.2% of USS payroll for employers.

## Principal risks and uncertainties

The scheme's principal risks and uncertainties are assessed by reference to their potential to threaten the ability of the trustee to deliver its strategic objectives. Risks can arise as a result of internal or external factors and can adversely impact the scheme's funding, solvency and operations. The table below sets out those principal risks, the potential impact and the mitigation in place.

| Risk | Potential Impact | Control/mitigation | Key performance indicator for 2015 |
|---|---|---|---|
| **Funding Risk** | | | |
| Significant increase in the scheme's net pension liability and/or significant deterioration in the ability of employers to make contributions to fund the deficit. | The potential inability of the trustee to secure the benefits for members. This may lead to the requirement to substantially increase contributions and/or reduce future benefits. | Regular monitoring of the funding level, covenant strength and liability. Analysis of the sources of changes in both the liability and the deficit. | At 31 March, the funding ratio stood at 86% with a deficit of £8.3bn. See page 81. |
| **Investment Performance Risk** | | | |
| A prolonged period of inadequate investment performance, or a sharp fall in the value of investments. | A significant further increase in the deficit. This may lead to the requirement to substantially increase contributions and/or reduce future benefits. | A documented, structured and effective investment process, run by experienced investment professionals, incorporating robust controls and diligent oversight. The investment portfolio is well diversified across a range of asset classes and risk factors. Further information with more detailed commentary on investment risks can be found in the Statement of Investment Principles. | Investment returns exceeded the target set at the start of the financial year. For further information see the investment report on page 29. |
| **Pension Service Risk** | | | |
| Pension service delivery fails to meet requisite quality standards. | The failure of operational processes leads to sub-optimal outcomes for the scheme's members/beneficiaries. This may lead to reputational damage. | Robust operational controls and regular monitoring of processes across all service delivery areas. | Improving trends in the operational management metrics from within the service delivery team and the results of stakeholder engagement activity. |
| **Business Change Risk** | | | |
| Failure to deliver strategic business change effectively, especially in relation to planned scheme changes. | Change programmes miss deadlines, are poorly implemented and/or lead to low quality outcomes. This leads to increased costs, unfavourable member experience and reputational damage amongst key stakeholders. | Business change governance is closely monitored and controlled by the Business Change team and overseen by the group executive, with specific change initiatives having their own project teams. | Successful implementation of major change programmes in 2014/15. Satisfactory results of change assurance activity. |

| Risk | Potential Impact | Control/mitigation | Key performance indicator for 2015 |
|---|---|---|---|
| **People Risk** | | | |
| Failure to attract and retain sufficient people with the necessary skill sets or develop appropriate management structures and business culture. | This may jeopardise key elements of the scheme's strategic objectives, lead to poor investment performance, increased incidence of operational error and failure, and ultimately result in reputational damage with key stakeholders. | The trustee has consistently sought to recruit and retain an excellent team. This is supported by regular performance and remuneration reviews with reference to appropriate benchmarks, training and development programmes, and employee satisfaction reviews. During the year, we have invested in the performance management review process to further strengthen this control. | There has been continued investment in the human capital of the organisation as seen by the increase in average annual staff numbers from 348 to 379. Total joiners were 79 and total leavers were 56. More information regarding employees is set out on page 22. |
| **Regulatory Risk** | | | |
| The product and service offering is impacted adversely by changes to pension policy, legislation or regulation. The trustee fails to adopt and apply effective oversight, legal and regulatory compliance arrangements. | Potential for change to adversely impact the scheme's product offering, give rise to additional costs and lead to operational complexity. Failure to respond to such changes in an appropriate and timely manner could lead to fines, compensation costs and censure, as well as damage to stakeholder relationships and reputation. | Dedicated professionals focussed on assessing existing and emerging regulatory initiatives. Application of structured change management methodology for the implementation of necessary changes. Ongoing compliance training, advisory and monitoring activity in the relevant business divisions. | Satisfactory completion of all education and awareness activity by relevant staff. No incidence of substantial or notifiable breaches. The most relevant new or evolving areas of legislation, including the accounting and taxation developments are summarised on pages 18 to 19. |

The scheme is supervised in terms of its conduct of operations and financial reporting by the Pensions Regulator and the investment management subsidiary is regulated by the Financial Conduct Authority (FCA). Significant effort is taken into ensuring that the scheme and its subsidiaries are effectively managed, with a strong governance framework and emphasis on regulatory compliance.

The trustee board's approach to risk management is set out in the risk governance policy which defines its risk appetite, the risk universe (summarising the potential full population of risks to which the scheme is exposed) and the relevant governance arrangements. Risks are assessed against the approved risk appetite and where necessary, appropriate remedial action is taken. Agreed actions are tracked and monitored through to eventual resolution.

The trustee oversees a 'three lines of defence model' whereby risks are identified and managed by the 'first line' business unit. The assessment and mitigating controls are overseen by the 'second line' compliance and risk functions. During the year, the risk function has been strengthened with the appointment in January 2015 of a new Chief Financial Risk Officer and the establishment of an expanded Group Risk function. Together with a new team under the Group General Counsel, this has significantly bolstered the second line of defence. Assurance over the effectiveness of these second line controls is provided by the 'third line' Internal Audit function. Risk reporting is provided to the executive team, the respective legal entity boards and also their sub-committees. The internal audit reporting is provided to the executive team and to the audit committee which reports to the trustee board.

# Strategy and outlook for 2015/16

The trustee's strategy for 2015/16 focusses on three key pillars:

| | | |
|---|---|---|
| **Development of the pension offer for employers and members** | **Enhancement of our service to the members and employers, including the in-house investment services to continue to build superior investment performance** | **Development of the governance framework** |

With the anticipated conclusion of the stakeholders' discussions around future benefit arrangements, the trustee will progress the introduction of the proposed changes which potentially include a new defined contribution section of the scheme as a specific pensions product offered by the trustee thereby creating a hybrid DB/DC scheme. In addition to enacting the required rule changes to deliver this new section, which in itself is a significant task, the trustee is also considering how the new section of the scheme will be delivered to both employers and members – essentially how the trustee will support employers and members going forward, and the necessary elements of our service proposition. Key to this is the trustee's mission to be the pension service of choice for the higher education sector. It is therefore important that the overall USS proposition continues to develop to suit the evolving requirements of employers and members both now and in the future. This work will involve substantial engagement with the scheme's stakeholders to understand their requirements and ensure that our services continue to be some of the best available.

An important part of the overall proposition is the investment management and advisory services provided by USSIM Ltd. One of the trustee's key investment beliefs is that a well-run and appropriately governed internal investment team is the best way for it to meet its long term investment objectives in a cost-effective manner. This was the basis for developing the reference portfolio approach and delegating more granular strategic asset allocation and implementation to the internal team. Further information about the reference portfolio framework is available on page 30 of the investment report. A key strand of work for 2015/16 will be to refine the governance structures and ensure the delegation framework is applied effectively with appropriate monitoring and controls.

The trustee shall continue to develop the in-house investment team and related support functions. With increased delegation to the investment management team, there may be a requirement for additional resources in the allocation, co-ordination and control functions. There may also be a need to further diversify the capabilities of the team to ensure it is able to deliver sustained outperformance for the benefit of the scheme and its members. More information is available in the investment report on pages 29 to 35.

The trustee will also make a significant investment in its operational capability over 2015/16. The implementation of the new section of the scheme is a substantial operational challenge for both the trustee company and the participating employers. In preparation for implementing the proposed changes the trustee has analysed its current infrastructure, technology and business processes. This analysis has indicated that there would be significant challenges in adapting the current pensions administration technologies to deliver the type of future benefit structure currently being consulted upon. Over the course of 2015/16 the trustee shall therefore be working with employer representatives to develop and implement a new pensions administration platform to support the delivery of the new benefit structure (as finalised by the scheme's stakeholders). The new platform will form part of our ongoing product and service proposition for employers and members, supporting improved processes and developing an enhanced online service for employers, as well as improving the depth and breadth of management information available and enabling a new web-based member portal. In doing so, the trustee will retain and develop those elements of the current service which are most valued by employers and members and in particular respond to the feedback received in surveys completed earlier in the year in which those stakeholders identified more effective use of electronic communications and digital processes as areas for improvement. More generally, survey data has consistently shown that it is the knowledge and experience of our employees which differentiates the service provided by the trustee company. This knowledge and experience will continue to be valued and the trustee company shall continue to deliver vital support to employers and members through these changes and beyond.

In addition to developing technologies and processes to support the proposed changes to future benefit arrangements, the trustee company will continue to invest in the service delivery team. It has initiated an 18 month programme of activity to enhance management information systems, develop talent and improve caseload management practices. The primary objective is to improve the effectiveness and quality of the service to employers and members. One aspect of this work is to consider the full process for members, and not just the USS component; the trustee is liaising closely with employers to develop its plans in this area and to better understand current process challenges. Members' views will also be gathered and considered as part of this work.

The trustee board remains dedicated to delivering pensions services which meet the needs of employers and members and will continue to seek their views on a broad range of matters related to the pensions proposition. This includes fulfilling its commitment to seek members' views on non-financial, investment-related matters, as part of a broader survey of views, to be carried out following the completion of the processes related to future benefit changes.

The trustee company has consistently sought to recruit and retain an excellent team and this has contributed to the successful delivery of a high quality pension service and strong investment performance. It is the executive team's belief that by focussing on clear communication, the organisation at all levels will remain empowered and engaged to deliver the strategic objectives over the long term.

As we note on page 20, the trustee company has recently invested in a performance management framework to align what is measured to what it believes matters, and to provide clarity and linkage with the revised remuneration arrangements referred to on page 26. From January 2015, changes to the compensation model have altered the weight of performance assessment with an increased focus on qualitative and non-investment measures, including the expected values and behaviours.

As outlined in the GCEO's update on page 10, the group executive has been strengthened. During the year, this expanded leadership team, has sponsored a number of employee initiatives, including:

- Review of the support available to the group executive team, making new appointments throughout the organisation where required;
- The Management Development Programme. This nine-month programme brings together executive and trustee board mentors with high-performing employees. The programme includes a team-based activity designed to develop collaboration, communication skills and to develop innovation and problem solving skills;
- Establishing a culture working group to embed the values and behaviours expected on a day to day basis which will be rolled out further in the coming year;
- Development of recruitment activity. Agencies acting on our behalf are briefed about the cultural values of the organisation which is embedded throughout the recruitment and induction process. This process has been reviewed and improved in the current year;
- Employee suggestions. Employees are invited to make suggestions to the executive team and updates on actions taken as a result are provided regularly. More recently, suggestions can be submitted through the intranet. This approach ensures that all employees have a voice in how the organisation operates and are empowered to identify areas which can be improved.

In addition, a series of regular 'Town Hall' and 'Hot Topic' communications serve to update employees on key events and priorities in the organisation. The GCEO and the CEO of USSIM Ltd lead these sessions and employees are invited to share questions and comments.

As explained further on page 92 the trustee company is committed to the principles of equal opportunities and eliminating discrimination in every aspect. In terms of the composition of the workforce, the trustee company collects data on gender and age profiles. For employees with a permanent employment contract the composition at 31 March 2015 was as follows:

- 44.0% were female and 56.0% were male; and
- the average age was 39 years.

# Governance

## Directors/board membership

Universities Superannuation Scheme (USS) is managed by the trustee in accordance with the scheme's Trust Deed and Rules. The trustee company is Universities Superannuation Scheme Limited, a company established as the corporate trustee of the scheme.

Under the trustee company's articles of association, the trustee board (the board) consists of between 10 and 12 non-executive directors comprising:

| |
|---|
| Four directors nominated by Universities UK |
| Three directors nominated by the University and College Union (UCU), one of whom is the pensioner director |
| Between three and five independent directors appointed by the board |

There have been a number of changes in board membership this year; Sir Martin Harris completed his term of office and stepped down as Chair of the board on 31 March 2015. Professor Sir David Eastwood now serves as the Chair of the board and Professor Anton Muscatelli joins the board as a director (both appointments effective as of 1 April 2015).

## Responsibilities of the board and executive

The board is responsible for the effective governance and oversight of the scheme to ensure that the promised benefits are paid to all beneficiaries in accordance with the trust, and in accordance with governing legislation and regulatory guidance. In order to do this the board must ensure that:

| |
|---|
| USS is adequately funded |
| Its investment strategy is appropriate for the scheme's liabilities, having regard to the support available from the scheme's sponsoring employers |
| It provides effective trusteeship in accordance with applicable law and regulation, ensuring that it has the necessary skills and takes specialist advice where appropriate |
| Its scheme management, administration and investment services are delivered at a level with which the members and participating institutions are content, and reflect appropriate value for money |

The board is responsible for strategic decision-making and is focussed on providing frameworks and establishing principles to support effective executive decisions. The GCEO implements the board's strategy and delivers its business plan through the day to day management of the trustee company. The GCEO has established a group executive team to support him in the delivery of the executive management functions including:

| |
|---|
| Advising the board on the company's business strategy |
| Delivering an effective operating model for the scheme |
| Proposing annual group business plans to the board |
| Driving group performance against agreed business plans |
| Ensuring the implementation of agreed internal control functions |
| Identifying, evaluating, monitoring and managing the group's risks |

A number of key appointments were made in the year to the executive management team as described on page 10.

The trustee board met nine times in the year. Summary reports for each of the committees can be found on pages 112 to 122. The average attendance for board meetings by directors was 94%. Attendance figures for individual directors at board and sub-committee meetings are below (maximum possible attendance in brackets):

## Board and committee meetings

| | Board | Investment | Policy | Audit | Remuneration | Governance & Nominations |
|---|---|---|---|---|---|---|
| **Meetings held in the year** | **9** | **6** | **5** | 4 | 5 | **4** |
| Sir Martin Harris (until 31 March 2015) | 9(9) | 6(6) | – | – | – | 4(4) |
| Professor Dame Glynis Breakwell | 8(9) | 4(6) | – | – | 4(5) | – |
| Mr Joseph Devlin | 9(9) | – | 5(5) | 4(4) | 5(5) | - |
| Professor Sir David Eastwood | 8(9) | – | 5(5) | – | – | 4(4) |
| Ms Kirsten English | 9(9) | – | – | 4(4) | – | 3(3) |
| Mr David McDonnell | 8(9) | 4(6) | – | 3(4) | 5(5) | 3(4) |
| Mr Bill Trythall | 9(9) | – | 5(5) | – | – | – |
| Dr Angela Roger | 9(9) | 6(6) | – | – | – | 4(4) |
| Mr Rene Poisson | 8(9) | – | 5(5) | – | 5(5) | – |
| Dr Kevin Carter | 9(9) | 6(6) | 5(5) | – | – | – |
| Mr Ian Maybury | 9(9) | 5(6) | – | – | – | – |
| Mr Michael Merton | 8(9) | – | – | 4(4) | – | – |

## Board effectiveness and training

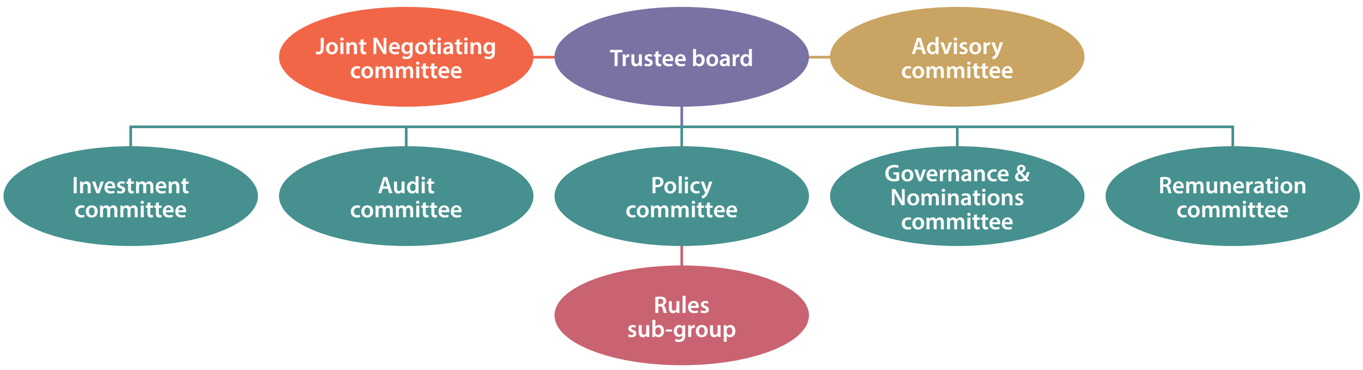
The following activities were carried out in the year to maintain and improve board effectiveness:

- The group general counsel has led work on a governance review. This has been divided into three parts: the first part reviewed governance relevant to the reference portfolio and the second part reviewed governance relating to special purpose vehicles used by the group for investment purposes. The third part of the review is looking at broader governance themes across the group and is ongoing;
- Effectiveness reviews of the board and its principal committees, evaluating performance and governance arrangements against best practice standards and objectives;
- An appraisal of the skills and experience of each director against the requirements for trustee knowledge and understanding as set out by the Pensions Regulator;
- Development of improved processes for chair election and director reappointment; and
- Development of a more robust appraisal and training programme designed to better deliver group and individual development in 2015/16.

The board took part in a full programme of education and training in the year which included sessions on:

- Actuarial assumptions;
- Strategic approach to risk appetite;
- Reference portfolio purpose, design and implementation; and
- Potential scheme design changes and their implications.

As reported in 2014, a number of changes have been made to committee structures to support the board as it increasingly focusses on scheme strategy and policy frameworks, whilst allowing the executive to focus on implementation and delivery. The new committee structure came into operation on 1 April 2014 and has operated throughout the year. The diagram below sets out the governance structure of the scheme.



## Audit committee

In line with the trustee's policy on the appointment, remuneration and rotation of external auditors (approved by the audit committee in October 2013), the committee completed its annual review of the effectiveness of the external audit process. The performance of the external auditor was evaluated against criteria agreed by the audit committee taking into consideration the guidance for audit committees published by the Financial Reporting Council (FRC) and relevant UK professional and regulatory requirements. The evaluation of the external auditor's performance was completed in October 2014. Key assessment areas included whether the auditor has met the agreed plan, the robustness and perceptiveness of the auditor's handling of key accounting and audit judgements, the conduct of the audit and the quality of the content of the external auditor's management letter.

The outcomes of this review were considered by the committee and informed its report to the board on the effectiveness of external audit. The committee assessed overall auditor performance as satisfactory and noted no actions identified for improvement. The committee was satisfied that performance requirements had been met and reported this to the board.

The current auditor was appointed following a full tendering process in November 2012. In line with the agreed policy the contract is next expected to be put to tender no later than 2019.

The external auditor has not provided any non-audit services in the reporting period.

## Remuneration committee

The Remuneration Committee sets and oversees for the implementation of the policy for the recruitment and retention of group employees, with the exception of the GCEO, whose remuneration is determined at board level and the Chief Investment Officer/Chief Executive of USSIM Ltd whose remuneration is determined by the Remuneration Committee Chair in conjunction with the Chair of the investment management subsidiary.

Compensation is benchmarked using external consultants, including a financial services specialist. Bonus payments are linked to the long term aims and objectives of the organisation, and are paid based on performance measured over two and five year periods. Performance is measured at an individual, team and total company level. Bonus arrangements stipulate that above a certain threshold, the award is deferred for a period of three years, during which time, the employee must remain employed by the trustee company. In addition, certain senior employees are invited to participate in a long term incentive plan (LTIP) which is linked to performance over three, four or five years and is only payable after that period if investments outperform certain benchmarks.

As explained on page 16 ensuring value for money for our members and attracting and retaining an excellent team remains a key objective to the organisation. During the year, the committee considered the total level of compensation and benefits including the bonus scheme and long-term incentive plans for investment staff. It approved revised remuneration arrangements for USSIM Ltd employees to be introduced from January 2015. This included simplifying the design and developing a clearer link between compensation and business objectives, alongside the existing links to individual and fund performance.

Overall personnel costs have increased by 26% or £9.0m in the year to 31 March 2015 due to the impact of improved investment performance on the incentive plans payable (impact of £4.0m representing 11%) and due also to increased headcount (impact of £4.6m representing 13%) including a number of key appointments to the Group Executive team as outlined in the Group Chief Executive Officer's update. Other net movements (impact £0.4m) represented a 2% increase. The trustee has also strengthened the internal support for organisational change in preparation for the scheme and company changes likely to take place this year. There has also been recruitment into the investment management team, with building of a strategy co-ordination function to support the development of the reference portfolio and additional technology and support functions.

# Other matters

## Scheme mergers

The trustee company has a mergers policy in place which is available to support institutions that wish to investigate the potential consolidation of their pension arrangements and associated trusteeship/management responsibilities, for example through the merger with USS of a scheme for support staff. Specific flexibilities are available in appropriate circumstances, for example within the economic terms upon which the merger takes place, on any deficit repayment periods, and on the treatment of transferring staff.

## Pensions increases

USS pensions are generally increased in line with increases in 'official pensions' as defined in the Pensions (Increase) Act 1971, although from 1 October 2011 scheme changes introduced limits on such increases in respect of rights that accrue after that date. From April 2015 USS pensions which started in payment before 22 April 2014 were increased by 1.2%, representing the increase in the Consumer Price Index (CPI) over the 12 month period to September 2014. Pensions which commenced on or after 22 April 2014 received a proportionate increase. Deferred pensions and deferred lump sums were increased at the same rate.

## Institutions' meeting

The annual meeting with institutions' representatives took place in London in December 2014. A report of the proceedings and meeting content is available on USSonline, the USS employer portal.

## Late payments

During the year there were no late payments of contributions from participating employers.

## Internal dispute resolution (IDR) process

Dispute resolution procedures in the trustee company provide for the Head of Pensions Operations, on the application of a complainant, to give a decision. If the complainant is dissatisfied with the outcome of the decision they can make a further, second stage application for the trustee to review the matter and either confirm or alter the decision.

This second stage review is undertaken by the advisory committee, augmented for this purpose alone by two members of the trustee board (one nominated by Universities UK and the other by UCU). The augmented advisory committee met on three occasions to consider the decisions given by the Head of Pensions Operations at stage one of the internal dispute resolution procedure. Eleven cases were considered at stage two of the procedure. In ten out of eleven of the cases, the decision at stage one of the internal disputes resolution procedure was upheld.

## Contribution rates

The rates of ordinary contributions payable by members and institutions between 1 April 2014 and 31 March 2015 were as follows:

**Final salary section**

| | | |
|---|---|---|
| **USS main section** | **Member** | 7.15% of salary |
| | **Institution** | 16% of salary |
| **USS supplementary section** | **Member** | 0.35% of salary |
| | **Institution** | Nil |

**Career revalued benefits section (CRB)**

| | | |
|---|---|---|
| **USS main section** | **Member** | 6.15% of salary |
| | **Institution** | 16% of salary |
| **USS supplementary section** | **Member** | 0.35% of salary |
| | **Institution** | Nil |

### Non-joiners

During the year, the trustee company was notified of approximately 6,000 employees, which equates to 21% of those, who became eligible to join the scheme but elected not to do so.

### Scheme rules changes

During the year there have been two formal changes to the scheme rules which have been agreed by the trustee board in conjunction with the Joint Negotiating Committee, with the changes covering the following areas:

- The enhancement of benefits upon retirement due to incapacity was extended to members with concurrent variable time posts with the execution of the fourteenth deed of amendment.
- Rule amendments were implemented via the fifteenth deed of amendment which extended the transitional auto-enrolment provisions for one further year for eligible employees who are re-employed pensioners or flexible retirees. The deed also made changes within the scheme rules to clarify the application of shared parental leave.

## Acknowledgements

The board wishes to recognise a number of directors and committee members for their contribution to USS matters over the course of the year.

Special thanks goes to Sir Martin Harris, who served on the trustee board for 24 years, nine of which as the Chair. The board is grateful for his stewardship of the scheme during his tenure, and for the deftness with which he steered the trustee through the difficult economic circumstances the scheme has faced in recent years.

The board would also like to extend its gratitude to Sir Andrew Cubie, and all the members of the Joint Negotiating Committee, for the care and commitment with which they have approached the discussions around future benefits provided by USS.

Finally, the board also wishes to again express its appreciation of the services given by all those involved in the administration and management of USS, including the staff of the trustee company and of the investment subsidiary based at its Liverpool and London locations, as well as the officers of the institutions that participate in the scheme who make an enormous contribution in their interactions with both members and officers of the trustee company. The trustee also wishes to thank the USS consultants and advisors whose specialist knowledge and experience make a valuable contribution to the company.

# Investment report

- The value of the scheme's net assets under management rose by 18.1% or £7.5 billion over the financial year to £49.0 billion (excluding money purchase AVC investments).
- Over the year, as gilt yields fell, the scheme's deficit rose by 53.7% or £2.9 billion to £8.3 billion, (when calculated on a basis consistent with the proposed 2014 valuation).
- The global economy continues to grow moderately, with a recent upturn in the Eurozone.
- The collapse in the oil price has depressed headline inflation below the modest underlying levels we expect to persist.
- Developed government bond yields reached historic lows in the first calendar quarter of 2015.
- The in-house investment team delivered strong investment performance during the year; outperformance against benchmarks contributed approximately £500m to the value of the scheme over the financial year.

## Global market review

There has been a considerable divergence in economic growth rates amongst the major economies over the past 12 months. Stronger growth in the UK and US has led to speculation about the timing of interest rate rises in these markets whilst lower growth led to looser monetary policy in Europe, Japan and China. Some emerging market economies, notably Brazil and Russia, have experienced a painful mixture of weakness in key commodity sectors, economic activity and investor confidence, which has limited policy flexibility. The dramatic collapse in oil prices in late 2014 has depressed headline inflation rates in many economies and renewed concerns about deflation. In Europe, the European Central Bank had initially resisted calls to loosen monetary policy, arguing that governments needed to take responsibility for a sustainable economic recovery via structural reform and prudent fiscal policy. However, it ultimately launched its own large-scale quantitative easing programme. The UK Consumer Price Index (CPI) inflation rate during the year to 31 March 2015 was 0.0%. This is the lowest figure since the Great Depression of the 1930s and compares with a rate of 1.6% recorded in the prior year.

The available yield on government bonds, persistently low interest rates and the continuation of a more pessimistic outlook for investors has caused a further increase in the discounted present value of pension fund liabilities. The yield on ten-year UK index linked gilts fell to -1.0% on 31 March 2015 from -0.3% on 31 March 2014, whilst the yield on ten-year nominal gilts fell from 2.7% to 1.6% over the same period. Longer-dated yields also declined, with 30 year index-linked and nominal gilt yields both making all-time lows in the first calendar quarter of 2015.

However, there was some positive news; the value of pension fund assets was boosted by another year of strong returns from markets. Sterling had a mixed year as it strengthened and weakened by about 12% respectively against the Euro and against the Dollar. The MSCI All Countries World Index for Equities rose 14% in local currencies (19% in Sterling) during the year to 31 March 2015, with strong performances coming from the US and Japan. India was also a strong performer following the decisive win of Narendra Modi's reformist BJP party in May's general election. Greece, Portugal, Brazil and Russia all recorded significant declines for the year. UK and international government bonds, especially longer-dated maturities delivered strong positive returns. The FTSE Actuaries over five years inflation-linked gilts index returned +22.1%. Investment grade credit markets performed well, but the high yield segment delivered weaker returns, particularly for the energy sector. Property, measured by the Investment Property Databank (IPD) Index rose 18% over the year to 31 March 2015. Within the alternative asset classes, commodities measured by the GSCI index had a poor year falling 40% largely due to the collapse in the oil price, while hedge funds measured by the HFRI Global Hedge Fund Index rose 3%. Private equity benefited from rising public equity markets which allowed gains in a number of holdings to be realised via trade sales or floatation on the public markets.

## Investment Performance

Investment performance is shown below on both a calendar year and financial year basis. Calendar year measures, particularly over five years annualised, are used in assessing managers within USSIM Ltd. The IPD Large Life and Pension Funds benchmark used for evaluating the property portfolio is only calculated in full on a calendar year basis and is estimated for other periods. Unless otherwise stated, the commentary in this section refers to calendar years i.e. 2014 is the year to December 2014.

The total fund rose 15.1% in 2014 outperforming the scheme's strategic asset allocation (SAA) benchmark by 1.9% but underperforming the gilts proxy for the scheme's liabilities by 5.5%. Over the last three years, the total fund outperformed the SAA benchmark by 0.7% and the gilts liability proxy by 5.6% p.a. whilst over the last 5 years the total fund outperformed the SAA benchmark by 0.6% but underperformed the gilts liability proxy by 0.2% p.a.

| | 12 months to December 2014 | | | Three years (annualised) | | | Five Years (annualised) | | |
|---|---|---|---|---|---|---|---|---|---|
| | Fund | Benchmark | Relative | Fund | Benchmark | Relative | Fund | Benchmark | Relative |
| Total Fund | +15.1% | +13.0% | **+1.9%** | +13.1% | +12.3% | **+0.7%** | +10.2% | +9.5% | **+0.6%** |

| | Financial Year to March 2015 | | | Three years (annualised) | | | Five Years (annualised) | | |
|---|---|---|---|---|---|---|---|---|---|
| | Fund | Benchmark | Relative | Fund | Benchmark | Relative | Fund | Benchmark | Relative |
| Total Fund | +17.9% | +16.8% | **+1.0%** | +12.9% | +12.0% | **+0.8%** | +10.1% | +9.5% | **+0.5%** |

## USS Investment Management Limited structure

USS Investment Management Limited (USSIM Ltd), a wholly owned subsidiary of Universities Superannuation Scheme Limited, is the principal investment manager and advisor to the scheme.

The trustee sets an investment strategy which is appropriate for the level of risk it is willing to take. A number of factors affect the trustee's appetite for risk including the strength of the employer covenant, the scheme's funding position, its cash-flow profile and its liability profile. The trustee monitors these factors regularly and may alter its investment objectives, risk tolerance and/or return targets as appropriate in the event of any significant change. As at 1 January 2015, the trustee adopted a reference portfolio approach, or framework, for investment management of the scheme's assets. This replaces the more granular Strategic Asset Allocation previously set as the benchmark for USSIM Ltd.

Under the reference portfolio framework, the trustee board focusses on strategic scheme objectives, the investment committee on the appropriateness of the overall investment strategy and delegations, and USSIM Ltd on the specifics of asset allocation, implementation and reporting. In particular, the trustee board has appointed USSIM Ltd to manage the scheme's investments whilst remaining within specified limitations in terms of risk and illiquidity. As such the reference portfolio's return and risk characteristics represent new long-term "benchmarks" for USSIM Ltd. In principle, the reference portfolio represents a mix of assets and a market-based return that the trustee board would be able to access without requiring the full range of investment and operational expertise within USSIM Ltd.

The trustee company believes the reference portfolio approach improves governance by delegating decision making within clearly defined boundaries to those best placed to respond dynamically to changing market conditions.

The in-house investment team is tasked with delivering greater returns than those derived from the reference portfolio whilst targeting a similar level of risk. The actual allocation of assets is referred to as the implemented portfolio and differs from the reference portfolio as a consequence of the investment team seeking higher returns for similar risk by investing in a broad range of asset classes. Using the reference portfolio as its benchmark, USSIM Ltd selects and manages the scheme's implemented investment portfolio.

The return objective of the implemented portfolio is to outperform the reference portfolio by 0.55% or more per annum on an annualised basis over rolling five year periods, net of applicable costs. The target outperformance represents a strong outcome over periods of five years and longer, given the rarity of sustained outperformance in asset management.

As the majority of the fund's assets are managed internally; the trustee believes in-house investment management encourages a greater focus on delivering the investment requirements of the scheme, and a strong alignment of interests as it removes the potentially conflicting commercial motivations. However, some areas of investment sought for the scheme may not be possible using existing internal capabilities in a cost-effective, timely manner. In these circumstances, USSIM Ltd will select external managers to undertake investment on its behalf. The following table shows the principal investment managers, their mandate and their share of the total scheme managed as at 31 March 2015:

| | Mandate | % Assets |
|---|---|---|
| USSIM Ltd (Internally managed) | Multiple | 67% |
| External funds (Private markets and absolute return) | Multiple | 19% |
| Legal & General Assurance (Pensions management) | Multiple | 9% |
| BlueBay Asset Management | Euro Investment Grade Credit | <1% |
| Royal London Asset Management | Sterling Investment Grade Credit | <1% |
| Credit Suisse | Emerging Market Debt | 1% |
| Investec | Emerging Market Debt | >1% |
| Pictet | Emerging Market Debt | <1% |

The property team at USSIM Ltd uses external investment advisors, property management services and some externally managed property funds. The contracts currently in place are shown in the following table:

| Role | Portfolio | |
|---|---|---|
| **Investment Advisory** | Retail and Leisure | Jones Lang LaSalle |
| | Offices and International | DTZ Investment Management |
| | Industrial | Jones Lang LaSalle |
| **Property Management** | Grand Arcade Shopping Centre, Cambridge | DTZ |
| | Monks Cross Shopping Park, York | Savills |
| | Whiteley, Fareham | Munroe K Asset Management |
| | Other Retail and Leisure, Offices and Industrial | Workman & Partners |

The trustee company has, on the recommendation of the investment committee and after consultation with the sponsoring employers and investment advisors, established a liability driven investment (LDI) portfolio. This should help to reduce the volatility in the scheme funding position and in part, recognises the gradual maturing of the scheme's membership.

While the size of the liability hedging programme is expected to expand over time, its scale will depend on market conditions. As is common with such programmes, the investments in index-linked gilts or equivalent instruments need not be fully funded by equivalent sales of return-seeking asset exposures, which introduces an element of (implicit) borrowing. This is considered prudent as it allows the fund's assets to be utilised more efficiently to maintain the level of expected returns.

In addition to the liability hedging mandate, USSIM Ltd has invested directly in assets such as infrastructure, which can offer returns that are significantly correlated with the scheme's liabilities in the long term. Opportunities are also explored across other areas of the capital markets where liability alignment can be attractively sourced. Having a well-resourced in-house manager enables innovative solutions to the scheme's specific needs to be introduced cost effectively.

## Summary of the Statement of Investment Principles

The Statement of Investment Principles (SIP), as required by section 35 of the Pensions Act 1995, sets out the principles governing decisions about investments for the scheme. The SIP also provides information on certain other aspects of the scheme's investment programme. The SIP can be found on pages 36 to 49 and outlines the SIP governing the scheme throughout the financial year to 31 March 2015. The investment committee reviews the SIP each year; and recommends any necessary changes to the board. The statement is agreed by the board on advice from the investment committee, the scheme's external investment consultants and the scheme actuary and following consultation with the participating employers. The investment committee where relevant monitors compliance with the SIP at least annually and obtains confirmation from USSIM Ltd and the appointed external managers, to the extent practicable, that it has exercised the powers delegated to it in keeping with the principles contained in the SIP. During the last financial year, the scheme's investments were made in accordance with the SIP on pages 36 to 49. As described on page 37, the SIP will be changed post year end.

## Custody of the scheme's assets

The scheme's assets are generally held in the name of the scheme by independent professional custodians. The trustee company is responsible for appointing custodians for the scheme's assets; it does so on the advice of the investment committee and its advisors.

The scheme's custodians are responsible for the safekeeping of the scheme's assets which are entrusted to them and perform associated administrative duties (e.g. trade settlement, dividend collection, corporate actions, tax reclaims and proxy voting).

The trustee company has appointed JP Morgan Chase and Northern Trust to act as custodians for the assets of the scheme.

## Distribution of the scheme's assets

The table below sets out the approximate distribution of the scheme's asset exposure, and its position relative to the reference portfolio as at 31 March 2015. The table excludes the money purchase AVC programme, which is separately managed by Prudential.

| % | Implemented Portfolio |
|---|---|
| **Equities** | **44.5%** |
| – UK | 14.1% |
| – Europe Ex-UK | 8.3% |
| – N America | 8.8% |
| – Pacific inc Japan | 5.2% |
| – Emerging Markets | 8.1% |
| **Credit** | **5.2%** |
| **Nominal Bonds** | **13.2%** |
| **Index Linked Bonds** | **1.8%** |
| **Commodity Sensitive** | **0.2%** |
| **LDI (Funded and Unfunded)** | **7.4%** |
| **Absolute Return** | **3.9%** |
| **Private Markets** | **21.4%** |
| – Inflation Linked Debt/Equity | 5.3% |
| – Private Debt/Equity | 7.9% |
| – Special Situations | 2.2% |
| – Property | 6.0% |
| **Overlays** | **2.1%** |
| **Cash*** | **0.3%** |
| **Total Fund** | **100%** |

N.B. Figures in the table may not add up due to rounding

*Includes Liability-driven investment funding

## Money Purchase AVCs

The board has selected Prudential to be the scheme's money purchase AVC provider. The Investment Committee reviews the range of funds made available to AVC participants to ensure it offers an appropriate range of investment choices.

## Summary of the investments

Below are the scheme's 20 largest investments in listed equities and in bonds.

| Asset | Value £m | Fund % |
|---|---|---|
| UK Treasury 0.75% IL 22/03/2034 | 1,614.5 | 3.3% |
| UK Treasury 4.5% 07/09/2034 | 1,090.6 | 2.2% |
| UK Treasury 3.5% 22/07/2068 | 931.2 | 1.9% |
| UK Treasury 4.25% 07/12/2040 | 822.3 | 1.7% |
| UK Treasury 0.625% IL 22/03/2044 | 619.0 | 1.2% |
| UK Treasury 4.25% 07/12/2040 | 606.5 | 1.2% |
| UK Treasury 4.75% 07/12/2030 | 574.3 | 1.2% |
| US Treasury 0.625% IL 15/02/2043 | 509.5 | 1.0% |
| UK Treasury Gilt 0.125% 22/03/2044 | 454.8 | 0.9% |
| UK Treasury 3.5% 22/01/2045 | 388.6 | 0.8% |
| Royal Dutch Shell | 344.4 | 0.7% |
| HSBC Holdings | 299.2 | 0.6% |
| UK Treasury 4.25% 07/09/2039 | 268.5 | 0.5% |
| US Treasury 0.75% 15/02/2042 | 265.0 | 0.5% |
| Vodafone Group | 254.3 | 0.5% |
| UK Treasury 5% 07/03/2025 | 242.3 | 0.5% |
| Nestle | 227.1 | 0.5% |
| British American Tobacco | 211.2 | 0.4% |
| Roche Holding AG | 205.3 | 0.4% |
| UK Treasury 07/12/2028 | 199.5 | 0.4% |

A list of all the fund's equity holdings and a more comprehensive review of corporate governance issues is available on the USS website: **www.uss.co.uk**

## Responsible Investment (RI)

As described within the Statement of Investment Principles on page 36, the trustee company is an active and responsible steward of the assets in which it invests. It expects this approach both to protect and enhance the value of the scheme in the long-term.

The trustee remains committed to a programme of engagement and stewardship across all asset classes, and responsible investment continues to be an important part of the investment team's activity. The trustee requires its investment managers to integrate all material financial factors, including corporate governance, environmental and social considerations, into the decision-making process for all scheme investments. The trustee does this in a manner which is consistent with its investment objectives, legal duties and other relevant commitments e.g. the UN-backed Principles for Responsible Investment and the UK Stewardship Code. Specifically, the trustee has instructed USSIM Ltd, as its principal investment manager and advisor, to follow good practice and use its influence as a major institutional investor and long-term steward of capital to promote good practice in the investee companies and markets to which the scheme is exposed.

The in-house responsible investment team engages with the companies in which the trustee invests and with global policy makers on issues which could impact the company's potential to deliver long term sustainable returns. These issues are taken into account in the selection, retention and realisation of the scheme's investments where they are material. The investment committee monitors responsible investment activity with the aim of maximising its impact and effectiveness. The trustee's governance, social, ethical and environmental policies are also reviewed regularly by the board and updated as appropriate to ensure that they are in line with good practice.

During the course of the year, the responsible investment team has continued to apply pressure on boards of directors across its equity holdings to ensure that management is held to account for the delivery of objectives which are in the best long-term interests of the company and its shareholders. Appropriate attention is paid to the composition of the board, the incentive arrangements for management and the extent to which long-term risks and opportunities, such as climate change and human capital management, are effectively managed. The responsible investment team has directly engaged with companies on issues ranging from supply chain management in Bangladesh to the potential stranding of coal assets, and from executive remuneration at banks to the regulation of e-cigarettes.

Over the course of the year, the responsible investment team has also engaged with regulators and policy makers on a number of key issues in various markets to ensure that the scheme's interests are safeguarded. A broad range of issues have been addressed; on the issue of climate change the team contributed to briefing papers for European legislators ahead of the COP21 meeting later this year. The team has also carried out a number of engagements with European officials in the issue of shareholder rights. On the issue of fiduciary duties of investment intermediaries in the UK the responsible investment team submitted responses to consultations by both the Law Commission and the Department for Work and Pensions. The trustee is now actively considering the implications of the Law Commission's 2014 recommendation on fiduciary and ethical issues and will provide an update once the government's position becomes clear later in 2015.

Finally, as the fund continues to diversify into illiquid asset classes, it is essential that appropriate attention is paid during the due diligence process to the future governance of assets and their exposure to long term risks such as climate change. This will continue to be a key area of focus for the responsible investment team over 2015/16 as the in-house investment manager seeks out long-term, inflation linked returns such as those which can be found in infrastructure. This activity builds on the experiences gained from the due diligence process conducted on private equity and hedge funds developed by the in-house investment team.

More details of the fund's RI activities, including voting records, are available on the USS website: **www.uss.co.uk**

# Statement of Investment Principles

The Statement of Investment Principles (SIP) has recently been reviewed and is in the process of being updated. The statement provided below is that which has been applied throughout the financial year to 31 March 2015. However, this is being updated as part of the outcome of the funding review in preparation for finalising the 2014 actuarial valuation.

The adoption of the revised SIP was subject to consultation with participating employers and is available on the USS website, **www.uss.co.uk**

## 1. Introduction

This statement details the principles governing the investment policy of the Universities Superannuation Scheme (the scheme). It has been prepared by Universities Superannuation Scheme Ltd (the trustee company), having been advised by its investment consultants and after consultation with all the participating employers in the scheme.

It complies with requirements of the Pensions Act 1995, as amended, and the Occupational Pension Schemes (Investment) Regulations 2005.

It is reviewed at least every three years, to coincide with the triennial valuation process, or sooner if there are any significant changes in investment policy or there is a material change in the scheme's funding position or other circumstances which, the trustee company determines, warrant a reconsideration of strategic asset allocation and risk tolerance beyond responses envisaged in the latest Statement of Investment Principles.

## 2. Objectives

The trustee company is responsible for the stewardship of the scheme's assets. Its main objective is to ensure sufficiency of assets to pay benefits as they fall due.

Pensions' legislation requires trustees to set out their funding objectives in a Statement of Funding Principles. A copy of the latest document is available on the USS website, **www.uss.co.uk**

The trustee company has adopted a strategic asset allocation with an expected investment return which, together with contributions, will meet the scheme's objectives. The strategic allocation results in a scheme specific benchmark which enables the trustee company to monitor the actual performance of the scheme assets and to assess the investment managers appointed to manage the assets on a day-to-day basis.

## 3. Investment beliefs

The assumptions and beliefs concerning investment risk and returns, on which the trustee company's benchmark and investment management structure are based, are reviewed regularly by the investment committee and the board. The current beliefs are set out in annex 2.

The board's current beliefs on the equilibrium long-term real returns across asset classes are set out in annex 3.

## 4. Investment management structure

The trustee company has delegated management of the scheme's assets to its 100% owned subsidiary USS Investment Management Limited (USSIM Ltd). This relationship is governed by an investment management agreement covering discretionary investment management, certain investment advisory and ancillary services. USSIM Ltd recovers its cost from the scheme via the trustee company.

The majority of the fund's investments are currently managed internally by USSIM Ltd. This is generally supported by USSIM Ltd's longer-term investment orientation and incentives, lower costs, greater transparency and alignment of interests, including the absence of marketing, asset-gathering or commercial demands. USSIM Ltd is also tasked with managing the scheme's external investment managers as appropriate. It does this by assessing their skill, their ability to generate expected net returns versus relevant benchmarks, ability to diversify the scheme's market risks, fund manager risks and range of opportunities and styles beyond what could be delivered economically and competitively by USSIM Ltd internally. Index tracking is used as appropriate to reduce investment management costs and risk relative to benchmark.

The alternative asset programme is managed by USSIM Ltd, substantially through sub-contracting management functions to external specialist managers and funds, but also through co-investment and direct investment, notably in infrastructure.

The overall property portfolio is managed by USSIM Ltd, primarily on a direct basis, with advice received from external specialists. External managers or funds are used as appropriate.

The external investment 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 or USSIM Ltd as its agent to be the best way of securing their services while encouraging outperformance and ensuring value for money.

## 5. Governance

The current terms of reference of the sub-committees of the board and the matters reserved for the board are on the USS website. The key elements relevant to the management of the scheme's investments are as follows.

**The trustee company's board's responsibilities include:**

| |
|---|
| approving the statement of funding principles; |
| approving the statement of investment principles after consultation with the sponsoring employers; |
| determining the risk tolerance of the scheme; |
| ensuring that the investment policy is appropriate given the scheme's funding position, liabilities and covenant; |
| setting the assumptions used to determine the scheme liabilities (technical provisions) as part of the triennial valuation; |
| establishing the strategic asset allocation; |
| approving the overall investment management structure, including approving changes to the investment management agreement with USS Investment Management Ltd; |
| appointing independent custodians, investment performance consultants and investment consultants for the scheme. |

**The investment committee's responsibilities include:**

| |
|---|
| monitoring and reviewing the strategic asset allocation of the scheme, risk tolerance, asset class ranges and frequency of re-balancing; |
| monitoring and reviewing the case for including new asset classes or strategies; |
| recommending changes to the strategic asset allocation in accordance with the above; |
| determining the appropriate benchmarks, risk parameters and performance targets; |
| monitoring the overall performance of the scheme and each of its appointed investment managers and making recommendations to the board related to performance; |
| setting the overall risk budget for the investment managers; |
| developing and maintaining the scheme's approach to investment and operational risk; |
| reviewing and determining compliance with the investment beliefs and statement of investment principles and, where appropriate, recommending changes to the board; |
| overseeing the delivery of services under the investment management agreement with USSIM Ltd and, if applicable, the delivery of services by other managers; |
| recommending to the board any necessary changes to the investment management agreement with USSIM Ltd ; |
| reviewing and selecting the range of investment options under the money purchase additional voluntary contribution scheme; |
| ensuring that the scheme's assets are held either in the name of the scheme or with a professional custodian; and |
| establishing, where necessary, sub-committees to assist in fulfilling its duties. |

**USSIM Ltd's responsibilities include:**

| |
|---|
| implementation of the scheme's investment policy with due care to quality of services, robustness, risks and costs; |
| discretionary investment management of the scheme's assets, including oversight over external managers appointed by USSIM Ltd under its delegated authority; |
| advising the trustee company on changes to the strategic asset allocation, risk tolerances and risk management strategies; |
| advising the trustee company on other matters relating to the management of the scheme's assets or liability risks, including the provision of custodial and performance measurement services; and |
| reporting on investment and operational performance to the investment committee and board as required. |

## 6. Risk management

The trustee company recognises the scheme is exposed to both investment and operational risks. The trustee company gives quantitative and qualitative consideration to these risks when deciding investment policy, strategic asset allocation and the investment manager structure. Although it would be theoretically possible to select investments producing income flows broadly similar to the estimated liability cash flows, the trustee company recognises the constraints and costs in seeking to do so.

Therefore, in order to meet the long-term funding objective to pay the scheme benefits as they fall due whilst managing the level of contributions, the trustee company takes a degree of investment risk relative to the liabilities. This targets a greater return than the liability matching assets would provide whilst maintaining a prudent approach to meeting the scheme's liabilities.

The trustee company's willingness to take investment risk is dependent on the continuing financial strength of the employers and their willingness to bear the associated risk of contribution increases to the scheme, the funding position of the scheme and the scheme's cash-flow and liability profiles. The trustee company monitors these factors regularly with a view to altering the investment objectives, risk tolerance and/or return target as appropriate in the event of significant changes in any of the factors.

The overall investment risk to the scheme is diversified across a range of different investment opportunities, which are expected to provide excess return over time, commensurate with risk. The trustee company aims to diversify the asset allocation exposures geographically, by asset class and across active management strategies. It also aims gradually to increase the allocation to risk-reducing assets (such as government bonds and index-linked gilts) and other risk-hedging instruments, recognising the desire of the employers to minimise the likelihood and magnitude of an increase in the scheme contribution rate.

The increasing allocation to risk-reducing assets has primarily been drawn from the allocation to developed market equities. Further incremental allocations may be driven by pre-set thresholds for improvements in the scheme funding level or other market-related triggers.

To reduce asset-liability risk and/or optimise the investment return for a given level of risk, the scheme may take on additional exposure to liability hedging assets without reducing its return-seeking assets. This could result in the economic value of the total assets exposure exceeding the net assets of the scheme. The trustee company's policy is to hedge back to Sterling an appropriate proportion of the developed market currency exposure.

The key risks, relevant to the investment strategy, identified by the trustee company are:

| Risks | Definition, controls & mitigants |
|---|---|
| **Asset-liability (matching risk)** | Risk: the scheme's return-seeking assets do not achieve expected excess returns relative to liability-hedging assets.<br><br>Controls & mitigants: diversify the return-seeking assets exposure. Increase the exposure to liability-hedging or liability-like assets, in physical or derivative form. |
| **Currency** | Risk: the scheme has large exposures to overseas assets, denominated in currencies which may fluctuate relative to Sterling, the currency of the scheme's liabilities.<br><br>Controls & mitigants: monitor currency exposure. The trustee company's policy is to hedge back to Sterling an appropriate proportion of the developed market currency exposure. |
| **Returns relative to strategic benchmark** | Risk: actual returns may lag the strategic benchmark as a result of active management, costs or inability to access desired exposures.<br><br>Controls & mitigants: focus on a properly resourced and organised investment operation. Considered use of external managers. Realistic assumptions regarding costs and implementation to be embedded in strategic benchmarking and planning for the scheme. Ongoing cost monitoring and regular investment performance monitoring. |
| **Liquidity** | Risk: the scheme may be unable to meet its obligations as they fall due.<br><br>Controls & mitigants: monitor the amount of cash and other liquid instruments held and maintain robust and timely disinvestment procedures in order to ensure that all liabilities e.g. benefits, collateral, margin, expenses and other cash calls can be paid as they fall due. |

| Risks | Definition, controls & mitigants |
|---|---|
| **Operational** | Risk: loss or error arising from the failures of people, processes and systems, or disruption due to an external event.<br>Controls & mitigants: operational risk is managed at all levels in the organisation as processes and controls pervade almost every activity. Key controls and mitigants include segregation of duties, organisational structures, authorisation routines, physical access, supervisory controls, personnel management, logical access and managerial oversight and review. |
| **Sponsor** | Risk: the sponsoring employers may be unable to provide future support to the scheme.<br>Controls & mitigants: regular engagement with Universities UK and other bodies to ensure the trustee company can monitor the willingness and ability of the sponsoring employers to make contributions at a level necessary to fund the scheme's benefits. |

## 7. Strategic asset allocation and the benchmark

The fund's strategic investment benchmark is reviewed periodically to ensure that it is appropriate for the circumstances and objectives of the scheme.

The target strategic asset allocation following the last review can be found in annex 4. The permitted ranges for each asset class are intended to ensure that the investment risk remains appropriate. The investment committee allows USSIM Ltd to deviate tactically from the strategic asset allocation within certain specified limits. The investment committee may mandate USSIM Ltd to adopt a dynamic asset allocation framework whereby the strategic asset allocation is altered based on changes in the scheme's funding ratio, the rate of return required to achieve the long-term objective and/or the ability to access assets expected to provide a more efficient and appropriate blend of long-term return and risk for the scheme.

## 8. Types of investment that may be held

Subject always to the relevant regulations, the scheme may invest in a wide range of assets and strategies, including quoted equity, government and non-government debt (including inflation-linked), currencies, money market instruments, property, as well as alternative assets and strategies including private equity and debt, infrastructure, commodities and absolute return strategies. Investment may be undertaken directly, indirectly (e.g. via funds), in physical assets or using derivatives.

The trustee company believes that, over the long-term, returns on risk-free assets (e.g. UK gilts) will lag those on return-seeking assets, including non-government debt, publicly traded equities, property and investment in alternative asset classes and strategies. The investment management structure and asset allocation across an appropriately diversified blend of return-seeking and risk-free assets are intended to provide returns in excess of pure liability-hedging assets, while controlling the level of asset-liability risk.

Derivatives or other financial instruments may be used to hedge the scheme's liability risks (principally interest rate, inflation and longevity risks) or other risks (e.g. equity or currency risks).

## 9. Responsible investment

The trustee company aims to be an active and responsible long-term investor and steward of the assets and markets in which it invests. The trustee company expects this approach to both protect and enhance the value of the scheme's investments in the long-term.

The trustee company therefore requires its investment managers to integrate material extra-financial factors, including corporate, environmental, social, governance and ethical considerations, into the selection, retention and realisation of all fund investments. The trustee company expects this to be done in a manner which is consistent with the trustee company's investment objectives, legal duties and other relevant commitments e.g. the UN backed Principles for Responsible Investment and the UK Stewardship Code.

Specifically, the trustee company has instructed USS Investment Management Ltd and called on its external investment managers to follow good practice themselves and to use their influence as major institutional investors to promote good practice in the investee companies and markets to which the fund is exposed.

The trustee company also expects all the scheme's investment managers to undertake appropriate monitoring of current and potential investments with regard to their policies and practices on material corporate, governance, social, ethical and environmental issues. These extra-financial factors should, where material, be taken into account when making investment decisions. Early identification can enable engagement with boards and management of investee companies to seek appropriate resolution of such problems. The trustee company tasks USSIM Ltd to provide oversight of external managers in this respect.

The trustee company aims to use its voting rights as part of its engagement work, in a prioritised, value-adding and informed manner. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the trustee company expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

The investment committee monitors this activity on an ongoing 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 board and updated as appropriate to ensure that they are in line with good practice.

## 10. Money purchase Additional Voluntary Contribution assets

Money purchase additional voluntary contributions (AVCs) from members to purchase additional benefits on a money purchase basis are invested separately from the other assets of the scheme and are managed and administered externally. They do, however form part of the scheme. The appointment of AVC providers is subject to review by the board and their investment performance is monitored by the investment committee.

# Annex 1: Glossary of terms

### Absolute return strategies

The objective of absolute return strategies is absolute (positive) returns regardless of the direction of the relevant financial markets. To meet this objective, such strategies typically involve opportunistic long and short positions in selected instruments with zero or limited market exposure. In statistical terms, absolute return strategies should have very low correlation with the market return.

### Alternative assets

Alternatives are investment products other than traditional investments of listed equity, stocks, bonds, cash or property. The term is used for financial or physical assets such as commodities, timberland, private equity, hedge funds or absolute return strategies, infrastructure and venture capital.

### Benchmark

A yardstick against which the investment policy or performance of a fund manager can be compared, usually an index relating to the particular assets held.

### Derivatives

A derivative is a financial instrument whose value is dependent on one or more underlying assets. In practice, it is a contract between two parties that specifies conditions (especially the dates, resulting values of the underlying variables, and notional amounts) under which payments are to be made between the parties. The most common types of derivatives are forwards, futures, options and swaps. The most common underlying assets include commodities, stocks, bonds, interest rates, currencies and related indices.

### Dynamic asset allocation

An investment technique where the strategic asset allocation (SAA) can be changed in response to changes to factors such as market conditions and/or the scheme's funding ratio.

### Equities

Equities represent the ordinary share capital of a limited company. They share in the distribution of corporate profits via the payment of dividends after interest has been paid to preference shareholders and other creditors. In the event of default, equity investors rank behind all other creditors to the company and carry the right to the residue of a company's assets after it has paid all its creditors. Public equities are traded on registered stock exchanges with transaction prices and volumes visible to all market participants. Private equity is traded directly with a counterparty and there is no obligation for transaction details to be disclosed.

### Government debt

A government debt obligation is backed by the credit and taxing power of a country, which for prudent and credit-worthy countries entails little risk of default. Government debt ('Treasury securities' or 'gilts') include short-term bills, medium-term notes, and long-term bonds.

### Gilts

These are the simplest form of UK government bond. A conventional gilt is a bond issued by the UK government which pays the holder a fixed cash payment (or coupon) every six months until maturity, at which point the holder receives his final coupon payment and the return of the principal.

### Index tracking

An investment technique where a portfolio or fund follows a particular stock market index as closely as possible. The value will go up and down in line with the index it is matching.

### Index-linked gilts

UK government bond where the interest payments and the final redemption proceeds are linked to inflation – issues to date are linked to the Retail Price Index. Such gilts provide protection against inflation.

## Infrastructure

Infrastructure is an alternative asset class where investments are made in the basic physical systems of a nation, whether in their equity or debt. Transportation, communication, sewage, water and electric systems are all examples of infrastructure. These systems tend to involve high-cost installations. However, they are vital to a country's economic development and prosperity. Investment in infrastructure assets is designed to provide stable income flows often linked to inflation.

## Liability hedging assets

Liability hedging seeks to better align a pension fund's assets with its liabilities by hedging, in whole or in part, the fund's exposure to changes in the underlying drivers of liability valuation, in particular in interest rates and inflation.

Assets are chosen whose values move in the same way as the liabilities, typically by generating similar cash flows to the liabilities.

Historically, UK government bonds have been used by pension funds as a partial hedge for interest rate risks but recently derivatives, such as swaps, have also been used.

## Money Purchase AVC (MP AVC)

A MP AVC is an arrangement for making additional contributions to build up a separate retirement fund. The contributions are invested through a separate insurance company and then used to buy an extra pension either at retirement, or later.

## Money market instruments

Financial instruments with high liquidity and very short maturities. These instruments are a means for borrowing and lending in the short term, from several days to just under a year. Money market securities consist of negotiable certificates of deposit (CDs), bankers acceptances, Treasury bills, commercial paper, local government or municipal notes, federal funds and repurchase agreements (repos).

## Non-Government debt

Non-government debt, debt issued by corporates, may be riskier and less liquid (readily tradeable) than the debt of credit-worthy governments. Short-term debt is issued as commercial paper; long-term debt is issued as bonds.

## Performance fees

A fee charged by an investment manager where the amount payable is linked to the outperformance of the assets under management relative to an agreed benchmark. Performance fees are intended to create a strong alignment of interest between the investment manager and its client.

## Private debt

Private debt covers the bonds or other debt instruments that are not readily tradeable on an investment exchange. Private debt issuance may be linked to private equity or may be private placements by public or other companies.

## Private equity

Private equity is equity capital that is not quoted on a public exchange. Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to pursue operational and business strategy improvements, to fund new technologies, to expand working capital within an owned company, to make acquisitions, or to strengthen a balance sheet.

The majority of private equity consists of institutional investors and accredited investors who can commit large sums of money for long periods of time. Private equity investments often demand long holding periods to allow for a turnaround of a distressed company or a liquidity event such as an Initial Public Offering or sale to a public company.

## Return-seeking assets

Assets chosen with long-term returns expected to exceed risk-free assets – which compensates for their exposure to greater risk. Equities are a return-seeking asset.

### Risk-reducing assets

Assets held to reduce the amount of risk in the scheme's portfolio. Government bonds are an example of risk-reducing assets.

The expected return on risk-reducing assets is lower than that on return-seeking assets.

### Strategic Asset Allocation (SAA)

SAA is a portfolio strategy that specifies the proportion of various asset classes in a portfolio designed to provide an appropriate risk/return profile over a longer period of time. A strategic asset allocation framework will specify a range of allocations appropriate for various levels of risk tolerance. For example, those with lower risk tolerance will tend to have lower exposure to more volatile, higher-risk assets such as stocks and commodities, and higher allocations to less volatile, lower-risk assets, including bonds and cash.

SAA involves periodically rebalancing the portfolio in order to maintain a long-term goal for asset allocation.

# Annex 2: Investment beliefs

These investment beliefs are shared by the USS trustee board, investment committee and executive. They inform how we address investment and risk management for the scheme. These beliefs, the resulting investment policy and implementation process will evolve over time, along with the scheme's circumstances and experience. This document addresses the board's investment objectives, the trade-offs between return and risk, alignment of managers and cost-effective implementation.

### About USS

USS is an open defined benefit pension scheme serving the higher education sector in the UK. The scheme has a strong covenant, liabilities stretching to the end of this century and positive net cash-flow from investment income and contributions. These features characterise USS as a long-term investor.

USS is one of the largest pension funds in the UK. Its size supports the governance and management resources to invest across a wide range of traditional and alternative assets and strategies. The bulk of the scheme's assets are managed internally, but external managers are used when it is not cost-effective or feasible for USS to provide the requisite standard or range of investment activities.

### Aims

Our focus is on risk-adjusted returns after costs. We aim to:

- generate sufficient real returns to meet the scheme's liabilities with an affordable contribution rate
- limit and diversify investment risk, to maintain reasonably stable contribution rates.

These aims must be balanced against each other. A degree of mismatching between assets and liabilities is unavoidable as we balance affordability of the scheme against stability in the contribution rate. This asset-liability risk should be scaled to the scheme's changing circumstances and objectives, and should be reviewed as financial market valuations, return and risk prospects change.

### Sources of returns and risk

Investment returns and risks can be split conceptually between those that are systematic (relating to structural properties of markets) and those that come from active management or 'idiosyncratic' returns.

### Systematic risk and returns ('beta')

Risky and/or less liquid assets are normally priced so as to provide expected returns above those on risk-free assets – thus compensating investors for the danger of loss and inflexibility over particular periods. Accepting short-term volatility in returns or illiquidity can, therefore, help to achieve higher long-term returns.

The chief source of systematic investment returns is participation in economic growth, via equity markets or otherwise. In the long run, we expect equities to deliver an 'equity risk premium', materially outperforming cash and inflation. Other long-term sources of risk premia include credit, value, illiquidity, volatility and the provision of insurance. Bearing inflation or interest rate (duration) risk relative to liabilities may also be rewarded under certain circumstances – for example, when there is an imbalance between the supply and demand for long-dated inflation-linked bonds or for other liability hedging assets.

## Skill-based returns ('alpha')

No investment market is efficient all the time, with the levels of efficiency varying across markets and time periods. Active management can therefore add incremental value. We aim to provide our active managers with appropriate flexibility to generate outperformance within suitable risk controls. Certain mandates may allow scope for leverage or short positions.

Financial markets, however, bring together the views and knowledge of all investors and traders – and beating the 'field' consistently is very hard. Over the long-term, success in investing requires building, sustaining and adhering to your competitive advantages – whether they are based on investment horizon, superior information and analysis, or portfolio construction. Active trading costs and fees erode the benefits of superior insight. Where it is particularly difficult or expensive to gain an 'edge', passive management may be the most cost-effective approach.

We believe asset prices and returns are driven ultimately by fundamentals, with asset prices tending eventually towards fair value. While the fundamentals themselves are not easy to understand or predict, large mispricing can occur in the context of market failures, investor sentiment and flows. Prospective returns from any asset are thus sensitive to current valuation levels. The ability to increase/reduce exposure to under/over-valued assets can be rewarding and reduce the risk of lasting underperformance.

## USS as long-term investor: scope and constraints

As a long-term investor with the capacity to bear shorter-term underperformance, USS is relatively well placed to:

- harvest equity, credit, illiquidity and other systematic risk premia;
- position exposures according to its assessments of valuation across or within markets, avoiding or capitalising on short-term investment 'fads'.

In general, the probability of success in this endeavour increases with the investment time horizon: longer-term investors have more time to make money back if they suffer short-term losses. That said, it is not always easy to remain focused on the long term when the short term moves against you. It takes a good investment case, courage and a well-balanced approach to scaling risk exposures.

Moreover, shorter-term considerations cannot be ignored. The continuing support of sponsors, beneficiaries and regulators is required to sustain a long-term investment strategy. The risk-taking capacity of the scheme is thus limited by prudential considerations, stakeholder concerns and regulatory pressures related to scheme funding and periodic valuations. The fundamentals underlying risk-taking capacity include the strength of the funding ratio and covenant, the duration of liabilities, the maturity of the scheme, the scope for risk-sharing across beneficiaries and contributors, and the regulatory environment. The scheme monitors changes across these factors to ensure that its investment policy remains appropriate.

## Diversification

Diversification across traditional and alternative assets and strategies helps to maintain investment returns while mitigating risk – supporting the objectives both for affordability (limiting required contributions by sustaining expected investment returns) and for safety (limiting potential increases in required contributions under adverse return scenarios).

The scheme has substantial diversification across geographies, asset classes and strategies. It allocates beyond global equities into fixed income, property and alternative assets and strategies, including private equity and debt, infrastructure, timber and absolute return funds.

The scope to diversify risk, however, has limits. Correlations across assets may rise over periods of time (particularly in difficult periods) and thus reduce the benefits of diversification. Furthermore, even a long-term investor must decide how much tolerance it has for the illiquidity that is inherent in some diversifying investments.

## Hedging of asset-liability risk

In addition to risk mitigation via diversification, certain large exposures may be hedged, when this is possible at reasonable cost. For example, the scheme has a strategic hedging programme to reduce currency mismatches between its assets and liabilities. Furthermore, while no asset class perfectly matches the scheme's evolving liabilities, part of the scheme's asset allocation is to 'liability-hedging' or risk-reducing assets (inflation-linked gilts and government bonds).

## Alignment and use of managers

The fund must manage its principal/agent issues through mutual understanding and the setting of aligned and appropriate incentives. These goals will often be supported within long-term relationships – which also serve to lower turnover and associated costs, as well as to enable managers to access illiquidity, value and other factors when these are expected to deliver excess returns over time.

The in-house management team is particularly well placed to deliver these requirements. It offers long-term commitment, continuity and comprehensive understanding of the scheme. It acts both as advisor to the scheme and as the 'preferred provider' of investment management in areas where this is cost-effective. It is not distracted or conflicted by asset-gathering or other commercial interests. It operates within the broad policies set and overseen by the board, its committees and independent advisors.

Performance incentives for the in-house team (and where possible for external managers) focus on long time-frames against specified objectives. This approach captures time-windows that are more meaningful for the scheme and is more likely to reward skill rather than short-lived luck.

While in-house management will often be less costly, 'right-cost' is more important than 'low-cost' to secure the required quality of investment management and operations. External managers are accessed as required, where specialised expertise is unavailable, uneconomic or cannot be developed in time internally. We take care to address agency issues as much as possible, to ensure alignment with the scheme's long-term objectives. In alternatives, particularly, we have developed our resources and skills in evaluating managers and have constructed a diversified programme of externally managed investments to meet our requirements, rather than building up the considerable resources needed for a direct investment programme.

Excessive turnover of managers or staff is costly in terms of time, expenses and portfolio transitions. Switching managers is viewed on a forward-looking basis, incorporating transition costs. We favour a model of 'managers for the long-term', with incentives aligned appropriately (where possible, on a risk-adjusted, after-costs and longer-term basis). Shorter-term monitoring of performance and activity focuses more on assessing the quality of the investment process than on immediate outcomes.

## Responsible investment and stewardship

Across all asset classes, we seek to ensure that long-term opportunities and risks are identified and appropriately managed – including environmental, social and governance (ESG) factors. These factors should be integrated into the investment process for most effective implementation. ESG practices within investment vehicles or investee companies can be important influences on long-term returns and risks. Over the long-term, well managed companies should generate higher returns with less risk.

USS monitors and, when appropriate, engages and seeks to improve the governance of investment vehicles or investee companies. USS aims to ensure that they are run in the long-term interests of their investors or owners and that the full range of risk factors is considered. We seek similar vigilance and application in our external managers – their governance and stewardship activities are considered when their suitability for USS is assessed.

## Risk budgeting and control

A risk budgeting approach is applied when allocating assets across managers and when setting scope for their discretion. This takes account of their different styles, skills and opportunity set. We aim to provide our active managers with appropriate flexibility to generate outperformance within suitable risk controls. Risk and performance are then monitored for consistency with targets or expectations.

Beyond asset allocation and active investment management risk, the scheme is exposed to a number of operational risks. These are covered in a risk register, covering all classes of risk to which the scheme is exposed and setting out the risk owners and mitigation policies for each risk item.

# Annex 3: Equilibrium real returns

| Asset class | Equilibrium real returns |
|---|---|
| Listed equities | 5.25% |
| Private equity and debt | 5.25% to 8.25% |
| Infrastructure | 3.25% to 4.75% |
| Absolute return strategies | 4.00% to 5.25% |
| Property | 4.00% |
| Emerging market debt | 3.25% |
| Investment grade non-government bonds | 3.25% |
| UK index linked gilts | 2.00% |
| UK long government bonds | 2.25% |

The expected returns are real returns relative to UK consumer price inflation ("CPI") and reflect the board's current understanding of the normal structure of capital market returns. These expected equilibrium returns reflect long-term norms, but are not forecasts based on current pricing of assets. At any point in time, market valuations may cause prospective returns to deviate from these equilibrium levels. The ranges shown for alternative asset classes are intended to reflect different potential 'flavours' (risk and return prospects) of underlying investments that may be used within a broad class. The prospective real returns for alternative asset classes are specific to the types and weightings of underlying investments that may be held in the portfolio.

# Annex 4: Strategic asset allocation

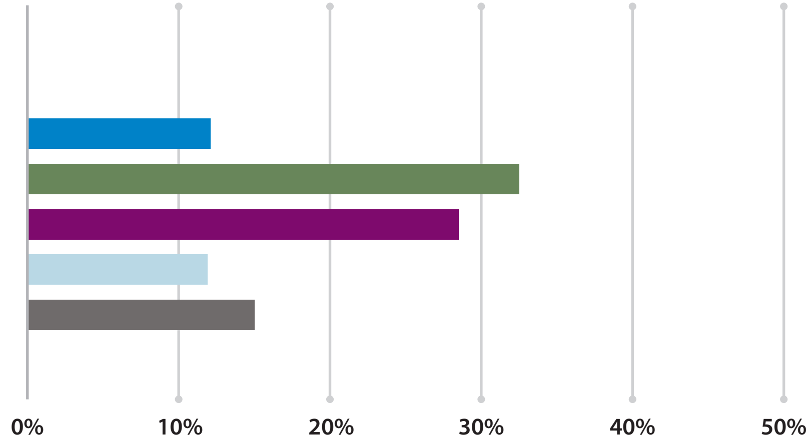
| | Asset class | Strategic asset allocation |
|---|---|---|
| **Bonds** | **Overall** | **19.5%** |
| | Index linked gilts | 4.5% |
| | Nominal government debt | 10.0% |
| | Emerging markets | 2.5% |
| | Investment grade non-govt. | 2.5% |
| | Sub-investment grade | 0% |
| **Property** | | **9%** |
| **Alternatives** | **Overall** | **21.0%** |
| | Alternatives - infrastructure/timberland/other | 7.0% |
| | Alternatives – absolute return strategies | 6.0% |
| | Alternatives – private capital | 8.0% |
| **Equities** | **Overall** | **50.5%** |
| | Equities – developed markets | 42.0% |
| | Equities – emerging markets | 8.5% |

The table above shows the target strategic asset allocation or SAA at the time of preparing this Statement of Investment Principles. In practice the SAA will vary as the scheme may adopt a dynamic asset allocation framework for responding to changes in market conditions, its funding ratio, required rate of return and risk appetite.

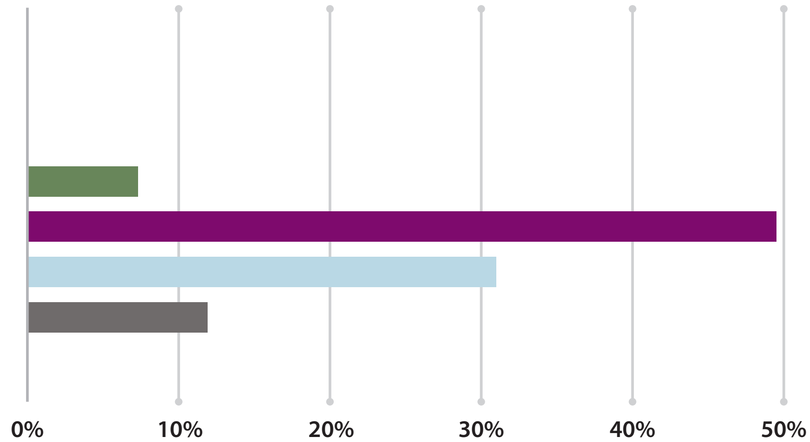
# Membership statistics

# Age profiles as at 31 March 2015

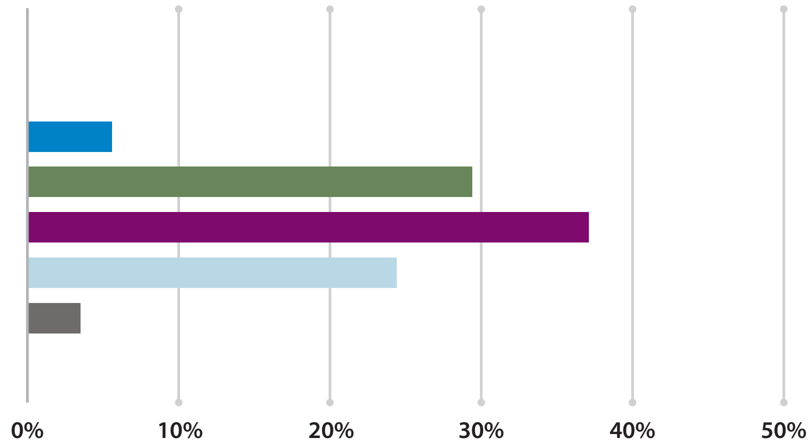
| Actives | |
|---|---|
| 30 & Under | 12.1% |
| 31 – 40 | 32.5% |
| 41 – 50 | 28.5% |
| 51 – 55 | 11.9% |
| 56 & Over | 15.0% |
| **Total** | 100% |




| Pensioners | |
|---|---|
| 50 & Under | Less than 1% |
| 51 – 60 | 7.3% |
| 61 – 70 | 49.5% |
| 71 – 80 | 31.0% |
| 81 & Over | 11.9% |
| **Total** | 100% |




| Deferred | |
|---|---|
| 30 & Under | 5.6% |
| 31 – 40 | 29.4% |
| 41 – 50 | 37.1% |
| 51 – 60 | 24.4% |
| 61 & Over | 3.5% |
| **Total** | 100% |



## Scheme membership

There are two sections of USS; the Final Salary section and the Career Revalued Benefits section and all benefits are paid out of a common asset pool.

During the year 22,594 new members joined the scheme and at 31 March 2015 the total membership, including pensioners and those entitled to deferred benefits, was 322,779 compared with 316,440 a year earlier. Further details of the changes in membership during the five years ended 31 March 2015 are shown in the summary on page 13.

## Summary of movements

| Active members | University Institutions | Non-University Institutions | Totals |
|---|---|---|---|
| Total active members at 1 April 2014 | 148,621 | 5,498 | 154,119 |
| New Members | 21,333 | 1,261 | 22,594 |
| Retirements | – | | |
| – Incapacity | 111 | 6 | 117 |
| – Normal, early & late retirement | 2,228 | 123 | 2,351 |
| Deaths In Service | 38 | 1 | 39 |
| Leavers and withdrawals | | | |
| – Refunds | 1,389 | 121 | 1,510 |
| – Deferred/undecided | 19,785 | 970 | 20,755 |
| – Retrospective* | 4,561 | 243 | 4,804 |
| **Total active members at 31 March 2015** | **141,842** | **5,295** | **147,137** |

*Retrospective withdrawals are members who withdrew from USS within three months of joining the scheme with retrospective effective to the date membership commenced. This includes members who were auto-enrolled but elected to opt-out immediately.

There are 62,822 active members of the Career Revalued Benefits (CRB) Section.

| Pensioner Members | University Institutions | Non-University Institutions | Totals |
|---|---|---|---|
| Total members at 1 April 2014 | 56,083 | 1,785 | 57,868 |
| Mergers | 0 | 0 | 0 |
| New Pensioners | 4,022 | 189 | 4,211 |
| Deaths | 1,678 | 47 | 1,725 |
| **Total pensioners at 31 March 2015** | **58,427** | **1,927** | **60,354** |

In addition at 31 March 2015, there were 11,661 pensions being paid to beneficiaries of which 968 were paid to dependent children.

| Deferred pensioners not yet receiving a pension | 115,288 |
|---|---|

**Pension sharing on divorce**
At 31 March 2015, 682 individuals have benefits within the scheme in their own right as a result of pension sharing, of whom 204 are now in receipt of their pension and are included in the pensioner member summary above.

| | |
|---|---|
| **Number of members who hold two or more separate employments which are pensionable under USS as at 31 March 2015** | **2,437** |

# Universities Superannuation Scheme Accounts

# Fund Account
# for the year ended 31 March 2015

| | Note | 2015 £m | 2014 £m |
|---|---|---|---|
| **Contributions and benefits** | | | |
| Contributions receivable | 3 | 1,759.9 | 1,672.5 |
| Premature retirement scheme receipts | | 5.5 | 7.8 |
| Transfers in | 4 | 66.2 | 106.6 |
| | | 1,831.6 | 1,786.9 |
| Benefits payable | 5 | 1,641.7 | 1,508.7 |
| Payments on account of leavers | 6 | 61.2 | 54.1 |
| Administration costs | 7 | 29.2 | 25.9 |
| | | 1,732.1 | 1,588.7 |
| **Net additions from dealings with members** | | 99.5 | 198.2 |
| **Return on investments** | | | |
| Investment income | 8 | 1,116.3 | 1,017.2 |
| Change in market value of net investments | 9 | 6,384.9 | 1,858.7 |
| Investment management expenses | 10 | (66.9) | (57.5) |
| **Net return on investments** | | 7,434.3 | 2,818.4 |
| **Net increase in the fund during the year** | | 7,533.8 | 3,016.6 |
| **Net assets of the scheme at start of the year** | | 42,016.5 | 38,999.9 |
| **Net assets of the scheme at the end of the year** | | 49,550.3 | 42,016.5 |

The notes on pages 57 to 77 form part of these financial statements.

# Statement of Net Assets as at 31 March 2015

| | Note | 2015 £m | 2014 £m |
|---|---|---|---|
| **Investment assets** | | | |
| Securities | 13 | 35,017.7 | 29,347.3 |
| Pooled investment vehicles securities | 14 | 8,971.6 | 7,619.7 |
| Pooled investment vehicles property | 14 | 915.0 | 892.6 |
| Derivatives | 15 | 286.8 | 629.3 |
| Property | 17 | 1,999.1 | 1,814.5 |
| Cash and cash equivalents | | 2,934.1 | 1,783.6 |
| Money purchase AVC investments | | 433.4 | 411.9 |
| Other investment balances | 18 | 905.7 | 632.8 |
| | | 51,463.4 | 43,131.7 |
| **Investment assets** | | | |
| Derivatives | 15 | (297.3) | (104.6) |
| Other investment balances | 19 | (1,673.7) | (1,099.2) |
| | | (1,971.0) | (1,203.8) |
| **Total net investments** | 9 | 49,492.4 | 41,927.9 |
| **Current assets** | 20 | 199.3 | 211.0 |
| **Current liabilities** | 21 | (141.4) | (122.4) |
| **Net assets of the scheme at 31 March** | | 49,550.3 | 42,016.5 |

The financial statements summarise the transactions of the scheme and deal with the net assets at the disposal of the trustee. 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 summary of the Summary of the Scheme's Funding Position scheme's funding position and Certificate of Technical Provisions on pages 78 to 85 and should be read in conjunction with this report.

The money purchase AVC investments included within net assets represent additional voluntary contributions invested with the Prudential. These assets are specifically allocated to secure extra benefits for those members that have made these additional voluntary contributions.

The financial statements on pages 55 to 77 were approved by the trustee, Universities Superannuation Scheme Limited, on 14 July 2015 and were signed on its behalf by:

**Professor Sir David Eastwood**
**Chairman**

**Bill Galvin**
**Group Chief Executive**

The notes on pages 55 to 77 form part of these financial statements.

# Notes to the Financial Statements for the year ended 31 March 2015

## 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 (revised May 2007)".

The trustee company Universities Superannuation Scheme Limited owns the share capital of a number of special purpose companies to aid the efficient administration of scheme investments. Their results have not been consolidated with the scheme's financial statements because the companies are held for investment purposes and not as an operating subsidiary. Details of these companies may be obtained by writing to the Company Secretary of Universities Superannuation Scheme Limited, Mr I M Sherlock, at Royal Liver Building, Liverpool L3 1PY.

## 2 Accounting Policies

A summary of the significant accounting policies which have been applied consistently by the scheme in both the current and prior years 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.

Where members can choose whether to take their retirement benefits as a full pension or as a lump sum with reduced pension, retirement benefits are accounted for on an accruals basis from the later of the retirement date and the date the scheme is advised of the member's choice. Other benefits are accounted for on the date of retirement or death as appropriate.

### 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; and

**(c)** Property rental income, on a straight line basis over the periods of the lease;

### Administration and investment management expenses

Administration and investment management expenses represent the costs incurred by the trustee company in managing and administering the scheme. These costs are recharged to the scheme in accordance with its rules and recognised in the scheme accounts on an accruals basis.

## Foreign currencies

Foreign currency investments and related assets and liabilities are translated into sterling at the rates of exchange ruling at the statement of net assets date. Exchange differences arising from translation are included in the fund account within the change in market value of investments. Foreign currency income and expenditure is translated at exchange rates prevailing on the appropriate dates, which are usually the transaction dates.

## 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 fair value at the year end as follows:

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

(b) **Fixed interest securities** – stated at their 'clean' prices, with accrued income accounted for within investment income;

(c) **Unquoted equities (including private equity and infrastructure direct investments)** – at fair value using appropriate valuation techniques. Significant direct investments are valued by independent valuation experts, adjusted for any cash flows since valuation. Co-investments are valued internally based on the investment partners' valuations, which are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines, and are subject to a separate internal review;

(d) **Private debt** – at fair value or amortised cost using the effective interest method where a fair value could not be readily determined;

(e) **Property** – on the basis of open market value determined in accordance with the Royal Institute of Chartered Surveyors' Valuation - Professional Standards (January 2014).

(f) **Pooled investment vehicles** – unit trusts and managed funds – at unit prices or values as advised by the fund manager based on the market valuation of the underlying assets; private equity funds – at the latest available cashflow adjusted valuations prepared in accordance with the International Private Equity and Venture Capital Guidelines; hedge funds – at fair value based on published prices; and

(g) **Money purchase AVC investments** – at net asset value provided by the AVC provider at the year end date.

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

## Derivatives

Derivative contracts are included in the net assets statement at fair value. Exchange traded derivatives with positive values are included in the net assets statement as assets at bid price, and those with negative values as liabilities at offer price.

Derivatives with an initial purchase price are reported as purchases. Those that do not have an initial purchase price but require a deposit, such as initial margin to be placed with the broker, are recorded at nil cost on purchase.

## Futures

Open futures contracts are recognised in the net assets statement at their fair value, which is the unrealised profit or loss at the current bid or offer market quoted price of the contract, as determined by the closing exchange price as at the year end.

Margin balances with the brokers represent the amounts outstanding in respect of the initial margin and any variation margin due to or from the broker.

Amounts included in the change in market value represent realised gains or losses on closed futures contracts and the unrealised gains or losses on open futures contracts.

## Forward foreign exchange contracts

Forward foreign exchange contracts outstanding at the year end are stated at fair value, which is determined as the gain or loss that would arise if each outstanding contract was matched at the year end with an equal and opposite contract at that date.

Changes in the fair value of the forward contracts are reported within change in market value in the fund account.

### Options

Traded options are recognised at fair value as determined by the exchange price for closing out the option as at the year end. Changes in the fair value of the option are reported within change in market value.

Collateral payments and receipts are reported within cash, and are not included within realised gains or losses reported within change in market value.

### Swaps

Swaps are recognised at fair value, which is the current value of future expected net cash flows arising from the swap, taking into account the time value of money.

Net receipts or payments are reported within change in market value. Realised gains or losses on closed contracts and unrealised gains and losses on open contracts are included within change in market value. The notional principal amount is used for the calculation of cash flow only.

### Repurchase agreements

Repurchase agreements (repos) – the scheme continues to recognise and value the securities that are delivered out as collateral and includes them in the financial statements. The cash received is recognised as an asset and the obligation to pay it back is recognised as a payable amount.

Reverse repurchase agreements (reverse repos) - the scheme does not recognise the securities received as collateral in its financial statements. The scheme does recognise the cash delivered to the counterparty as a receivable in the financial statements.

## 3 Contributions receivable

| | 2015 £m | 2014 £m |
|---|---|---|
| **Main section** | | |
| Employers' contributions | 1,139.9 | 1,075.6 |
| Employers' salary sacrifice contributions | 415.4 | 391.8 |
| Members' basic contributions | 72.3 | 70.4 |
| Members' additional voluntary contributions | 48.4 | 49.5 |
| | 1,676.0 | 1,587.3 |
| **Supplementary section** | | |
| Supplementary section | 23.8 | 23.1 |
| **Money purchase AVCs** | | |
| Members' additional voluntary contributions | 60.1 | 62.1 |
| | 1,759.9 | 1,672.5 |

The scheme offers two AVC facilities:

Main section additional voluntary contributions referred to above represent contributions made to purchase additional benefits under the rules of the scheme.

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

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 HMRC.

## 4 Transfers in

| | 2015 £m | 2014 £m |
|---|---|---|
| Individual transfers in | 66.2 | 101.3 |
| Group transfers in | - | 5.3 |
| | 66.2 | 106.6 |

## 5 Benefits payable

| | 2015 £m | 2014 £m |
|---|---|---|
| **Main section** | | |
| Pensions | 1,271.4 | 1,189.8 |
| Lump sums on or after retirement | 339.2 | 288.7 |
| Lump sums on death in service | 14.5 | 12.8 |
| | 1,625.1 | 1,491.3 |
| **Supplementary section** | | |
| Pensions | 13.7 | 13.2 |
| Lump sums on death in service | 4.0 | 1.5 |
| | 17.7 | 14.7 |
| **Money purchase AVCs** | | |
| Pensions | 61.7 | 53.9 |
| Lump sum death benefits | 0.5 | 0.6 |
| Transferred to USS | (63.3) | (51.8) |
| | (1.1) | 2.7 |
| **Total benefits payable** | 1,641.7 | 1,508.7 |

Money purchase AVCs transferred to USS represent amounts transferred from the Prudential to USS on members' retirement for inclusion within USS benefits.

## 6 Payments on account of leavers

| | 2015 £m | 2014 £m |
|---|---|---|
| Individual transfers to other schemes | 58.2 | 51.2 |
| Payments for members joining state scheme | 0.8 | 0.6 |
| Refunds to members leaving service | 2.2 | 2.3 |
| | 61.2 | 54.1 |

## 7 Administration costs

| | 2015 £m | 2014 £m |
|---|---|---|
| Personnel costs | 15.7 | 12.9 |
| Pension Protection Fund levies | 3.6 | 3.2 |
| Premises costs | 1.0 | 1.0 |
| Other costs | 8.9 | 8.8 |
| | 29.2 | 25.9 |

Administration costs are incurred by the trustee company and, in accordance with the trust deed, the costs of managing and administering the scheme, are chargeable to USS. Further details of personnel costs are given in note 11.

## 8 Investment income

| | 2015 £m | 2014 £m |
|---|---|---|
| Dividends from UK equities | 138.8 | 152.6 |
| Net property income | 97.2 | 100.8 |
| Income from pooled investment vehicles | 125.7 | 160.6 |
| Dividends from overseas equities | 364.0 | 317.9 |
| Income from UK fixed interest securities | 210.1 | 135.1 |
| Income from overseas fixed interest securities | 164.5 | 147.8 |
| Interest on cash deposits | 10.9 | 10.2 |
| Interest from money purchase AVCs | 0.3 | 0.3 |
| Other income | 19.5 | 6.8 |
| | 1,131.0 | 1,032.1 |
| Irrecoverable withholding tax | (14.7) | (14.9) |
| | 1,116.3 | 1,017.2 |

Income from property is net of property related expenses of £7.1m (2014: £5.7m).

# 9 Change in market value of investments

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

| | Market value 2014 | Purchases and derivative payments during the year at cost | Proceeds of sales and derivative receipts during the year | Changes in value during the year | Market value 2015 |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| Securities | 29,347.3 | 13,907.6 | (12,806.9) | 4,569.7 | 35,017.7 |
| Pooled investment vehicles-securities | 7,619.7 | 1,840.2 | (1,764.9) | 1,276.6 | 8,971.6 |
| Pooled investment vehicles-property | 892.6 | 6.2 | (25.1) | 41.3 | 915.0 |
| Derivatives | 524.7 | 107,261.1 | (107,936.4) | 140.1 | (10.5) |
| Property | 1,814.5 | 109.0 | (171.1) | 246.7 | 1,999.1 |
| Money purchase AVC investments | 411.9 | 61.0 | (63.2) | 23.7 | 433.4 |
| Cash and cash equivalents | 1,783.6 | 1,063.7 | - | 86.8 | 2,934.1 |
| | 42,394.3 | 124,248.8 | (122,767.6) | 6,384.9 | 50,260.4 |
| Other investment balances (net) | (466.4) | | | | (768.0) |
| Total | 41,927.9 | | | | 49,492.4 |

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. Included in the amount for derivatives are realised and unrealised losses of £389.9m from forward currency contracts, which are used to hedge the currency risk relating to overseas investments (see note 16). These are offset by gains in the values of the corresponding overseas assets. Turnover in derivatives primarily represents the rolling of these forward currency contracts.

Transaction costs are included in the cost of purchases and sale proceeds. Transaction costs include costs charged directly to the scheme such as fees, commissions, stamp duty and other fees. Transaction costs incurred during the year amounted to £41.8m (2014: £18.5m). In addition to these transaction costs, indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. The amount of indirect costs is not separately provided to the scheme.

The 2015 securities balance includes £50.1m (2014: £54.9m), and the pooled investment vehicles balance includes £27.7m (2014: £31.2m), of holdings in entities with underlying trade which the scheme controls. These trading entities generated £22.2m (2014: £53.4m) of revenue in aggregate, with £12.3m (2014: £53.1m) of operating expenses and hence £9.9m (2014: £0.3m) of gross profit. USS's share of the distributed gross profit has been included within income from pooled investment vehicles in note 8. As noted in the basis of preparation in note 1, they have not been consolidated in the scheme's accounts reflecting the true nature of the shareholding, that of an investment vehicle.

Within cash and cash equivalents there are £2,715.9m (2014 £1,511.8m) of liquidity funds and £218.2m (2014: £271.8m) of direct cash deposits.

The cash flows relating to derivatives are recognised in the table above as follows:

(A) Options – premiums paid and received are reported as payments or receipts in the table together with any close out costs or proceeds arising from early termination.

(B) Futures – on close out or expiry of the futures contract the variation margin balances held in respect of unrealised gains or losses are recognised as cash receipts or payments in the investment reconciliation table, depending on whether there is a gain or loss.

(C) Swaps – the payments or receipts under the swap contract are reported in the reconciliation table, together with any close out costs or proceeds arising on early termination.

(D) Forward foreign exchange - the forward FX trades settled during the period are reported within the table on a gross basis.

# 10 Investment management expenses

| | 2015 £m | 2014 £m |
|---|---|---|
| **Investment costs** | | |
| Securities research costs | 9.6 | 9.1 |
| **Securities management** | | |
| - External manager base fees | 7.8 | 5.4 |
| - External manager performance fees | 2.1 | - |
| - Professional fees | 1.8 | 1.8 |
| **Property Management** | | |
| - External manager fees | 1.4 | 1.8 |
| - External manager performance fees | 0.2 | 1.4 |
| - Rent review and letting fees | 1.2 | 1.6 |
| - Other | 0.3 | 0.2 |
| Legal and professional fees | 1.3 | 1.3 |
| Custodial services | 2.0 | 2.0 |
| Personnel costs | 26.4 | 22.3 |
| Premises costs | 3.0 | 2.5 |
| Sundry costs | 9.8 | 8.1 |
| | 66.9 | 57.5 |

Securities research costs represent the costs paid by the internally managed fund to its brokers for research.

Investment management costs comprise all costs directly attributable to the scheme's investment activities, including the operating costs of USS Investment Management Limited (USSIM Ltd) and the costs of management and agency services rendered by third parties.

## 11 Supplementary information in respect of personnel costs

| | 2015 £m | 2014 £m |
|---|---|---|
| **Personnel costs** | | |
| Included in administration costs | 15.7 | 12.9 |
| Included in investment management costs | 26.4 | 22.3 |
| | 42.1 | 35.2 |

| | 2015 £m | 2014 £m |
|---|---|---|
| **Analysed as:** | | |
| Wages and salaries | 31.9 | 25.0 |
| Pension costs | 2.9 | 3.7 |
| Social security costs | 3.1 | 2.6 |
| Other | 4.2 | 3.9 |
| | 42.1 | 35.2 |

Mr Galvin was appointed as the Group Chief Executive with effect from 1 August 2013. Included in the above are the emoluments of Mr Galvin, Group Chief Executive, comprising salary and benefits amounting to £432,000 (2014: £309,000). Mr Galvin is a member of the career revalued benefits section of the scheme and at 31 March 2015 his accrued pension was £7,696 (2014: £3,000) and accrued lump sum of £23,088 (2014: £9,030). This accrued pension relates to amounts earned in respect of services to the scheme and excludes transfers-in from other schemes, the value of which is in the process of being finalised. Mr Galvin is eligible to participate in an individual three year long-term incentive plan which will comprise of an annual maximum amount of £100,000 which will be entirely related to performance and the achievement of set objectives.

Universities Superannuation Scheme Limited puts in place salary and reward packages which are designed to enable it to recruit and retain suitably qualified and talented individuals. In addition to base salary and benefit package, some staff participate in incentive schemes. The main plans relate to USSIM Ltd. There are two main plans in operation, an annual bonus plan and a long-term incentive plan (LTIP). Payments under the annual bonus plan are linked to the individual's performance, the performance of their own investment mandate and the overall investment performance of the scheme. Investment performance is measured against the relevant benchmark over two and five year timeframes. Included within personnel costs is £6,740,000 (2014: £7,128,000) in respect of USSIM Ltd annual bonus plans and associated national insurance contributions. Part of the annual incentive plan is deferred for a period of three years to encourage the retention of key staff.

The LTIP vests over a three, four or five year period where the payout is dependent upon the rolling outperformance of the relevant benchmark over the vesting period. For all plans issued after 2013, the award will have phased vesting of one third of the annual value in each of years three, four and five, at which point the appropriate payment will be made. A provision of £1,758,000 has been made as at 31 March 2015 (2014: £1,000,000). All incentive plans are reviewed and approved by the remuneration committee on an annual basis.

The aggregate amount of compensation payable for loss of office to employees during the year was £0.6m (2014: £1.3m) of which £0.5m (2014: £1.1m) was payable to employees whose remuneration exceeded £100,000 during the year.

## 11 Supplementary information in respect of personnel costs (continued)

Remuneration payable to other higher paid staff, excluding employer's national insurance and employer's pension contributions; but including benefits in kind and accrued amounts in respect of deferred payments under the incentive plan terms during the year was as follows:

| | 2015 | 2014 |
|---|---|---|
| | Number | Number |
| £100,001-£110,000 | 4 | 3 |
| £110,001-£120,000 | 4 | 8 |
| £120,001-£130,000 | 7 | 4 |
| £130,001-£140,000 | 3 | 3 |
| £140,001-£150,000 | 5 | 5 |
| £150,001-£160,000 | 2 | 6 |
| £160,001-£170,000 | 7 | 4 |
| £170,001-£180,000 | 1 | 5 |
| £180,001-£190,000 | 4 | 1 |
| £190,001-£200,000 | 7 | 5 |
| £200,001-£210,000 | 2 | 2 |
| £210,001-£220,000 | 2 | 2 |
| £220,001-£230,000 | 3 | 3 |
| £230,001-£240,000 | 1 | 1 |
| £240,001-£250,000 | 0 | 1 |

| | 2015 | 2014 |
|---|---|---|
| | Number | Number |
| £250,001-£260,000 | 3 | 0 |
| £270,001-£280,000 | 1 | 2 |
| £280,001-£290,000 | 0 | 3 |
| £290,001-£300,000 | 0 | 1 |
| £300,001-£310,000 | 0 | 1 |
| £310,001-£320,000 | 1 | 0 |
| £320,001-£330,000 | 1 | 0 |
| £330,001-£340,000 | 3 | 1 |
| £360,001-£370,000 | 3 | 1 |
| £370,001-£380,000 | 1 | 0 |
| £380,001-£390,000 | 3 | 0 |
| £420,001-£430,000 | 2 | 1 |
| £560,001-£570,000 | 1 | 0 |
| £610,001-£620,000 | 1 | 0 |
| £900,001-£950,000 | 1 | 1 |

Figures for both 2015 and 2014 include remuneration earned in those years, irrespective of when it may be paid.

## 12 Taxation

### UK tax

USS is a registered pension scheme for tax purposes and is therefore not normally liable to 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 under local domestic law. Where double taxation treaties exist between the UK and the country in which the income arises, the tax withheld may be reduced to a lesser rate or to zero by the operation of the relevant treaty. Final withholding taxes suffered, after applying any beneficial treaty rates are shown as irrecoverable withholding tax in note 8.

## 13 Securities

| | 2015 £m | 2014 £m |
|---|---|---|
| **Quoted** | | |
| UK equities | 4,657.1 | 4,218.3 |
| Overseas equities | 14,853.0 | 12,323.4 |
| UK fixed interest - public sector | 5,855.6 | 5,044.9 |
| UK fixed interest - other | 401.4 | 330.7 |
| UK index linked - public sector | 3,624.8 | 3,306.7 |
| Overseas fixed interest - public sector | 1,434.4 | 1,348.6 |
| Overseas fixed interest - other | 714.2 | 439.3 |
| Overseas index linked - public sector | 1,259.9 | 784.3 |
| **Unquoted** | | |
| UK equities | 853.2 | 679.3 |
| Overseas equities | 924.9 | 451.4 |
| UK fixed interest - other | 366.4 | 331.2 |
| Overseas fixed interest - other | 72.8 | 89.2 |
| | 35,017.7 | 29,347.3 |

## 14 Pooled investment vehicles

| | 2015 £m | 2014 £m |
|---|---|---|
| **Securities** | | |
| Managed Funds and Limited Partnerships | 7,921.3 | 6,904.2 |
| Unit Trusts | 1,050.3 | 715.5 |
| | 8,971.6 | 7,619.7 |
| **Property** | | |
| Unit Trusts | 488.7 | 477.8 |
| Property companies | 19.6 | 27.7 |
| Limited Partnerships | 406.7 | 387.1 |
| | 915.0 | 892.6 |
| | 9,886.6 | 8,512.3 |

Included within pooled investment vehicles is £7,110.5m (2014: £5,510.8m) where the company operating the vehicle is registered overseas. For the remainder, the company operating the vehicle is registered in the UK.

# 15 Derivative contracts

| | Note | 2015 £m | 2014 £m |
|---|---|---|---|
| **Assets** | | | |
| Options | 16 (a) | 0.2 | 0.7 |
| Futures contracts | 16 (b) | 89.1 | 106.4 |
| Swaps | 16 (c) | 93.0 | 418.3 |
| Forward foreign exchange contracts | 16 (d) | 104.5 | 103.9 |
| | | 286.8 | 629.3 |
| **Liabilities** | | | |
| Options | 16 (a) | (7.3) | (4.6) |
| Futures contracts | 16 (b) | (38.0) | (20.7) |
| Swaps | 16 (c) | (14.7) | (11.3) |
| Forward foreign exchange contracts | 16 (d) | (237.3) | (68.0) |
| | | (297.3) | (104.6) |

## Objectives and policies

The trustee has authorised the use of derivatives by the investment managers in accordance with the investment guidelines for each mandate. Investment in derivative instruments is only permitted for the purposes of:

**(a)** Contributing to a reduction of risks;

**(b)** Facilitating efficient portfolio management (including the reduction of cost or the generation of additional capital or income with an acceptable level of risk).

Processes and controls are in place to ensure risk exposures to a single counterparty and to other derivative operations are maintained within acceptable levels.

The main objectives for the use of derivatives are summarised as follows:

**(i) Protection**
Derivatives may be used as part of the permitted instrument types available to managers to protect (or enhance) active returns relative to the specified strategic benchmarks, for example, through the use of options and credit default swaps.

**(ii) Modify exposure to asset classes**
Derivatives are bought or sold to allow the scheme to change its exposure to a particular market or asset class more quickly than by transacting in the underlying physical assets. They may also be easier to trade than conventional stocks, particularly in large amounts.

**(iii) Hedging**
Forward currency contracts are used to partially hedge the currency risk relating to overseas investments. This aims to achieve a better match between the fund's assets and the base currency of its future liabilities. Derivatives may also be used for the purpose of hedging risk exposures affecting future scheme liabilities, for example, through the use of inflation and interest rate swaps.

**(iv) Replication**
Derivatives are used where liquidity or funding for generating a relevant investment exposure is perceived to be more efficient in derivatives, rather than the underlying physical assets.

A fully funded swap has been entered into in order to obtain the return on an emerging markets local currency sovereign bond index without the requirement to physically hold all its constituent securities. This fully funded swap is the bond total return swap disclosed in note 16(c).

# 16 Derivative contracts outstanding

The information provided below in relation to derivatives has been presented in accordance with the SORP (revised May 2007). The valuations are based on the unrealised fair values of the various investments as at 31 March 2015. These valuations will not necessarily reflect the fair values that will be realised on maturity or sale of the various investments.

## a) Options

| Type of Option | Notional amount of outstanding contracts £m | Asset £m | Liability £m |
|---|---|---|---|
| Euro Stoxx 50 Index Options (exchange traded) | 16.5 | 0.2 | – |
| Commodity Options | 131.2 | – | (7.3) |
| | 147.7 | 0.2 | (7.3) |

The notional amount of outstanding contracts represents the value of underlying stock protected by the options. The Euro Stoxx options have expiry dates of nine months after the year end, the commodity options have expiry dates of three months after the year end.

## b) Futures (exchange traded)

| Type of future | Economic exposure £m | Asset £m | Liability £m |
|---|---|---|---|
| UK equities | 1,154.6 | 0.3 | (12.7) |
| Overseas equities | 2,617.9 | 27.5 | (7.1) |
| UK fixed interest | 1,946.7 | 34.6 | - |
| Overseas fixed interest | 3,568.5 | 24.0 | (12.4) |
| Commodities | 327.8 | 2.7 | (5.8) |
| | 9,615.5 | 89.1 | (38.0) |

The economic exposure represents the notional value of stock purchased under the futures contract and is therefore subject to market movements. The contracts have expiry dates of up to one year and nine months after the year end, except for certain Euro Stoxx 50 dividend futures which have expiry dates of up to four years and nine months after the year end with a total economic exposure of £141.9m and a net value of £9.7m.

### c) Swaps (OTC)

| Contract | Expiration | Nature of Swap | Counterparty | Notional principal £m | Asset £m | Liability £m |
|---|---|---|---|---|---|---|
| Bond Total Return | 0 year 4 months 4 year 4 months | CS EM Bond Index | Credit Suisse | 471.5 | 31.4 | – |
| Interest Rate | 1 year 1 month 28 year 2 months | Fixed for Floating and Floating for Fixed | Deutsche Bank | 204.4 | 19.0 | (0.2) |
| | 8 year 8 months 28 year 2 months | Fixed for Floating | Credit Suisse | 198.4 | 23.6 | – |
| | 8 year 8 months 28 year 2 months | Fixed for Floating | HSBC | 114.1 | 16.8 | – |
| | 1 year 1 month 28 year 2 months | Fixed for Floating and Floating for Fixed | Various | 62.0 | 0.1 | (1.1) |
| Dividend Swap | 9 months - 7 year 9 months | S&P 500 Index | JP Morgan | 146.7 | 0.4 | (6.1) |
| | 9 months - 7 year 9 months | S&P 500 Index | Various | 131.4 | 0.9 | (4.5) |
| Credit Default | 1 year 6 months 4 year 9 months | ITRAXX Europe and single entity | Various | 120.1 | 0.8 | (2.8) |
| | | | | 1,448.7 | 93.0 | (14.7) |

## d) Forward foreign exchange (OTC)

| Currency bought | Currency sold | Notional Principal £m | Asset £m | Liability £m |
|---|---|---|---|---|
| BRL | USD | 74.1 | 0.1 | (2.5) |
| CAD | USD | 105.3 | - | (1.2) |
| EUR | AUD | 225.0 | - | (2.8) |
| EUR | CHF | 72.9 | - | (1.9) |
| EUR | GBP | 233.2 | - | (0.5) |
| EUR | JPY | 225.0 | - | (7.5) |
| EUR | OTHER | 14.7 | - | (0.2) |
| EUR | USD | 93.2 | 0.1 | (3.1) |
| GBP | AUD | 959.8 | 1.5 | (7.8) |
| GBP | CHF | 602.8 | 4.7 | (23.0) |
| GBP | EUR | 2,551.7 | 43.3 | (7.0) |
| GBP | HKD | 166.8 | - | (1.9) |
| GBP | JPY | 1,050.6 | 1.6 | (12.2) |
| GBP | OTHER | 125.3 | 0.8 | (0.5) |
| GBP | SEK | 133.5 | 5.7 | (0.1) |
| GBP | SGD | 75.3 | - | (1.7) |
| GBP | USD | 7,918.2 | 5.0 | (142.6) |
| IDR | USD | 115.0 | 0.2 | (1.0) |
| INR | USD | 369.9 | 0.5 | (1.3) |
| JPY | EUR | 395.5 | 5.2 | - |
| JPY | OTHER | 2.9 | - | - |
| MXN | USD | 249.1 | 0.3 | (3.8) |
| NOK | GBP | 72.4 | - | (1.7) |
| OTHER | EUR | 7.5 | 0.1 | - |
| OTHER | GBP | 343.3 | 0.9 | - |
| OTHER | USD | 368.7 | 1.0 | (3.2) |
| RUB | USD | 73.3 | 4.6 | (0.2) |
| USD | BRL | 131.2 | 6.9 | (0.7) |
| USD | CHF | 134.2 | - | (5.2) |
| USD | COP | 31.4 | 2.0 | - |
| USD | EUR | 190.4 | 7.4 | (0.2) |
| USD | GBP | 152.8 | 3.0 | - |
| USD | JPY | 28.8 | - | (0.3) |

### d) Forward foreign exchange (OTC) (Continued)

| Currency bought | Currency sold | Notional Principal £m | Asset £m | Liability £m |
|---|---|---|---|---|
| USD | MXN | 51.7 | 1.0 | - |
| USD | MYR | 22.5 | 1.1 | - |
| USD | NZD | 116.4 | 2.0 | (1.1) |
| USD | OTHER | 703.4 | 5.5 | (2.1) |
| | | 18,187.8 | 104.5 | (237.3) |

Other currency relates to a number of smaller contracts in denominations not disclosed above.

All of the above contracts settle within one year. The counterparties to the forward foreign exchange contracts are large investment banks.

## 17 Property

| | 2015 £m | 2014 £m |
|---|---|---|
| UK completed properties | 1,908.8 | 1,806.5 |
| UK developments in progress | 90.3 | 8.0 |
| | 1,999.1 | 1,814.5 |
| **Properties analysed by type:** | | |
| Freehold | 1,611.3 | 1,499.4 |
| Leasehold | 387.8 | 315.1 |
| | 1,999.1 | 1,814.5 |

The completed properties and developments in progress have been valued on the basis of market value as at 31 March 2015 and 31 March 2014 for accounts purposes by CB Richard Ellis Ltd acting as independent valuers. The valuations have been undertaken in accordance with the RICS Valuation - Professional Standards (January 2014).

## 18 Other investment balances (assets)

| | 2015 £m | 2014 £m |
|---|---|---|
| Amount due from stockbrokers | 120.4 | 87.3 |
| Dividends and accrued interest | 167.5 | 153.4 |
| Initial margin | 283.8 | 306.1 |
| Variation margin | 65.9 | 92.7 |
| Broker cash | 268.1 | (6.7) |
| | 905.7 | 632.8 |

## 19 Other investment balances (liabilities)

| | 2015 £m | 2014 £m |
|---|---|---|
| Amount due to stockbrokers | (501.4) | (82.4) |
| Variation margin | (14.9) | (7.0) |
| Broker cash | (391.6) | (404.9) |
| Repurchase agreements | (763.6) | (604.2) |
| Accrued interest | (2.2) | (0.7) |
| | (1,673.7) | (1,099.2) |

## 20 Current assets

| | 2015 £m | 2014 £m |
|---|---|---|
| Contributions due from institutions; | | |
| - employers' contributions | 92.7 | 91.8 |
| - members' basic contributions | 41.1 | 40.6 |
| - members' additional voluntary contributions | 3.6 | 3.9 |
| Other debtors | 19.3 | 30.8 |
| Cash at bank and in hand | 42.6 | 43.9 |
| | 199.3 | 211.0 |

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

## 21 Current liabilities

| | 2015 £m | 2014 £m |
|---|---|---|
| Rents & service charges received in advance | (69.8) | (55.9) |
| Benefits payable | (51.3) | (48.3) |
| Taxation creditor | (2.1) | (3.1) |
| Due to trustee company | (13.6) | (8.4) |
| Other creditors | (4.6) | (6.7) |
| | (141.4) | (122.4) |

## 22 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.

| | 2015 £m | 2014 £m |
|---|---|---|
| **Value of stock on loan at 31 March** | | |
| Equities | 1,403.0 | 1,083.0 |
| Fixed interest | 1,628.9 | 335.5 |
| | 3,031.9 | 1,418.5 |
| Value of collateral held at 31 March | 3,268.8 | 1,495.7 |

## 23 Financial commitments

| | 2015 £m | 2014 £m |
|---|---|---|
| **Property** | | |
| Contracts placed but not provided for | 22.3 | 12.0 |
| **Pooled investment vehicles - securities** | | |
| Outstanding commitments to private equity partnerships | 3,280.2 | 2,397.2 |

These represent amounts subscribed and committed to private equity partnerships that had not been drawndown at the year end.

## 24 Self investment

The scheme had no Employer Related Investments (ERI) at 31 March 2015, as defined by relevant legislation, except equity and loan investments made in the normal course of business to certain Special Purpose Entities (SPEs). The funding of these SPEs, which are held for investment purposes and not as operating subsidiaries as explained on page 57, amounts to less than 6% of the net assets of the scheme.

## 25 Contingent liability

As at the balance sheet date the scheme issued legal proceedings relating to one of its investments. The events to which the proceedings relate occurred wholly before the balance sheet date. Should the outcome of the proceedings be unfavourable, the scheme would be liable to incur a proportion of the defendant's legal costs. No provision has been made in these financial statements since contingent liability cannot currently be quantified and the timing of the resolution of the action is unknown.

During the normal course of business, the scheme enters into derivative transactions which are reflected in the scheme financial statements. As a consequence of the clearing arrangements in respect of these transactions, certain charges have been granted by Universities Superannuation Scheme Limited. No liability is expected to arise as a result of these charges.

## 26 Related party transactions

The only related party transactions are between the scheme and its trustee company and certain employees and directors of the trustee company through their membership of the scheme. The trustee company provides administration services, the cost of which includes directors' emoluments of £0.6m (2014: £0.7m) and investment management services to the scheme, charging £29.2m and £66.9m respectively (2014: £25.9m and £57.5m), with a balance due from the scheme of £13.6m as at 31 March 2015 (2014: £8.4m). Additionally, a number of the directors are members of the governing bodies of participating institutions, in addition to their membership of the board of the trustee company.

# Trustee's responsibilities

The audited financial statements, which are to be prepared in accordance with UK Generally Accepted Accounting Practice, are the responsibility of the trustee. 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 the 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 on whether the accounts 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 estimates and judgements on a reasonable and prudent basis. The trustee is also responsible for making available certain other information about the scheme in the form of the Annual Report.

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 on page 75.

The trustee is responsible for the maintenance and integrity of the financial information of the scheme included on the scheme's website. Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

The trustee also 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 14 July 2015.

**Professor Sir David Eastwood**
**Chairman**

**Bill Galvin**
**Group Chief Executive**

# Statements 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 a revised 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 monitoring whether contributions are made to the scheme in accordance with the schedule of contributions. Where breaches of the Schedule occur, the trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to the Pensions Regulator and the members.

## Trustee's summary of contributions payable under the schedule in respect of the scheme year ended 31 March 2015

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 2014 to 31 March 2015 under the schedule of contributions certified by the actuary 15 June 2012. 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

| **Employer** | **£m** |
|---|---|
| Normal contributions | 1,539.6 |
| Salary sacrifice contributions | - |
| Special contributions | 0.2 |
| Additional contributions | 21.0 |
| **Member** | |
| Normal contributions | 96.1 |
| Additional contributions | |
| Contributions payable under the schedule (as reported on by the scheme auditor) | 1,656.9 |

## 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 | 1,656.9 |
| Contributions payable in addition to those payable under the schedule (and not reported on by the scheme auditor): Member additional voluntary contributions (including those paid to the Prudential) | 108.5 |
| Total contributions (including premature retirement scheme receipts) | 1,765.4 |
| Less premature retirement scheme receipts shown separately in the fund account | (5.5) |
| Total contributions (excluding premature retirement receipts) in the fund account | 1,759.9 |

Signed on behalf of the trustee on 14 July 2015

**Professor Sir David Eastwood**
**Chairman**

# Independent Auditor's Report to the trustee of Universities Superannuation Scheme

We have audited the financial statements of Universities Superannuation Scheme for the year ended 31 March 2015 which comprise the Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the 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's Trustees 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 Scheme and the Scheme's Trustees as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of trustees and auditor

As explained more fully in the Trustees' Responsibilities Statement on page 74, the Scheme's Trustees are responsible for the preparation of financial statements which show a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Scheme's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Trustees; and the overall presentation of the financial statements. In addition, we read all the financial and nonfinancial information in the rest of the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Opinion

In our opinion, the financial statements:

- show a true and fair view of the financial transactions of the Scheme during the year ended 31 March 2015, 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;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; 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.

**Grant Thornton UK LLP**
**Statutory Auditor, Chartered Accountants, Liverpool, 14 July 2015**

# Independent Auditor's Statement about Contributions to the trustee of Universities Superannuation Scheme Ltd

We have examined the Summary of Contributions to the Universities Superannuation Scheme in respect of the scheme year ended 31 March 2015 which is set out on page 75.

This statement is made solely to the Trustees, as a body, in accordance with Pensions Act 1995 and Regulations made thereunder. Our work has been undertaken so that we might state to the Scheme's Trustees those matters we are required to state to them in an auditor's 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 and the Scheme's Trustees as a body, for our work, for this statement, or for the opinions we have formed.

## Respective responsibilities of trustees and the auditor

As explained more fully in the Trustees' Responsibilities Statement on page 75, the Scheme's Trustees are responsible for ensuring that there is prepared, maintained and from time to time revised a Schedule of Contributions showing 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 Trustees are also responsible for keeping records in respect of contributions received in respect of the active members of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the Schedule of Contributions.

It is our responsibility to provide a statement about contributions paid under the Schedule of Contributions and to report our opinion to you.

## Scope of work on Statement about Contributions

Our examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported in the Summary of Contributions have in all material respects been paid at least in accordance with the Schedule of Contributions. This includes examination, on a test basis, of evidence relevant to the amounts of contributions payable to the Scheme and the timing of those payments under the Schedule of Contributions.

## Statement about contributions payable under the Schedule of Contributions

In our opinion, contributions for the Scheme year ended 31 March 2015 as reported in the Summary of Contributions and payable under the Schedule of Contributions have, in all material respects, been paid at least in accordance with the Schedule of Contributions certified by the Scheme Actuary on 15 June 2012.

**Grant Thornton UK LLP**
**Statutory Auditor, Chartered Accountants, Liverpool, 14 July 2015**

# Summary of the Scheme’s Funding Position

# Summary of the Scheme's Funding Position as at 31 March 2015

## Overview

Each year the trustee company publishes a summary of the scheme's funding position in the form of a Summary Funding Statement. This statement provides an update on how the scheme's assets compare with the value of its liabilities, the latter being the amount needed to pay current and future benefits accrued to date, given prevailing market conditions.

In making its assessment of the financial position of the scheme, the trustee compares the current market value of the scheme's assets to its estimate of the current value of the scheme's liabilities. Once every three years, the trustee carries out a full review of all of the underlying assumptions used to place a value on the scheme's liabilities as described in the triennial valuation section on page 15.

The scheme, like other pension schemes, has operated in difficult economic conditions in recent years and the employer and member representatives have carefully considered the responses available in order to rebalance scheme funding. As described elsewhere in this report, these discussions have led to the employer and member representatives putting forward a joint proposal for changes to both employer and member contribution rates and to future benefits.

The trustee's assessment of the scheme's liabilities includes an assumption around how the benefits already earned will build up over time, as well as the anticipated value of the returns on the scheme's investments. The proposed changes to future benefits will affect these assumptions, which means the formal valuation as at 31 March 2014 and the following 2015 funding update cannot be finalised until the changes have been decided upon. However, in order to provide complete transparency around scheme funding levels an assessment of the liabilities is provided below, using the updated 'technical provisions' assumptions on the basis that the current funding arrangements were to continue. In addition set out below is the liability value and funding level as at 31 March 2014 and 31 March 2015 assuming that the proposed changes are implemented broadly in the form described in the employers consultation materials. These figures may change once the consultation with affected employees on changes to future benefit arrangements has been completed and the employer and member representatives have decided upon the final form of future benefits to be provided by USS. Members will receive a formal update once the valuation process is complete.

## How does USS work?

USS provides a defined set of benefits as set out in the scheme rules. The financing of these benefits is provided by the contributions from the sponsoring institutions and from the scheme members, which are paid into the USS fund. Together with the investment returns achieved on the fund's assets, these cover the payment of benefits to scheme members and / or their dependants, now and in the future, as well as the operating costs for the scheme.

## How is the financial position of the scheme measured?

One way to measure the scheme's financial position is to compare the current value of the assets of the scheme with an estimate of the current value of the scheme's liabilities. The scheme's liabilities are the total value of all the benefits that members have accrued to date and which are paid now and in the future.

The current value of the scheme's assets is relatively easy to determine at a particular point in time, using their present market value. There are however uncertainties inherent in estimating the current value of accrued liabilities, for example, for how long a future pension might be paid, the possibility that a survivor's benefit might be paid and at what level, as well as the rate of return on future investments. This final factor in particular is used to determine the size of the funds that would be required today to enable the scheme to meet the benefits already accrued by scheme members.

The trustee board carries out an in-depth review of the scheme's finances every three years; this is known as an actuarial valuation and was last completed as at 31 March 2011. The actuarial valuation as at 31 March 2014 is being progressed and shall be finalised following completion of the consultation on proposed future benefit arrangements. The actuarial valuation compares the value of the scheme's assets to its liabilities using two approaches, the technical provisions basis and the buy-out basis, as required by statutory regulations. The technical provisions basis reflects the trustee board's ongoing approach to funding the scheme and is used to determine the current funding level and, where appropriate, the extent of any deficit or surplus. The buy-out basis is based on the assumption that the scheme is being wound-up and all of the liabilities of the scheme are to be secured through an insurance company. USS is required by law to publish this buy-out funding information even though neither the trustee board nor the scheme's stakeholders have any plans to wind-up the scheme. This same approach will be used to complete the 2014 actuarial valuation, which shall be published later this year.

## What was the position at the last full actuarial valuation?

The latest full valuation, as at 31 March 2011, calculated that the funding level was 92% on a technical provisions basis and 57% on a buy-out basis.

## How has the position of the scheme changed since then?

At March 2012 the actuarial report showed the funding level of the scheme on a technical provisions basis had fallen to 77% due to a large increase in the value of the liabilities, primarily due to the fall in gilt yields. The funding position on a buy-out basis fell to 50%.

During the year to 31 March 2013 the assets of the fund increased by £4.7bn, which equated to a 13.9% increase. At the same time further reductions in gilt yields and changes to the investment outlook meant that the value placed on the scheme's liabilities also increased substantially in the year (by £6.4bn, an increase of 14.6%). The funding ratio remained unchanged at 77%, albeit the deficit was larger in absolute terms at £11.5bn. The funding position on a buy-out basis was 51%, which was a slight improvement on the 2012 figure.

Using the updated base assumptions which the trustee board will apply to the 2014 valuation and assuming that the funding and benefits arrangements will continue unchanged, the estimated funding deficit as at 31 March 2014 would be £12.4bn. This would represent an overall funding ratio of assets to liabilities of approximately 77%. If we assume the changes are implemented as described in the employers' consultation with affected members, the funding deficit would be £5.4bn, representing a funding level of 88% as at 31 March 2014. This illustration makes no assumptions as to the outcome of the employer consultation with affected employees and these figures are entirely subject to change pending the completion of that consultation and the final decision on changes to future benefit provision.

The funding ratio over the period since the last actuarial valuation is summarised in the table below:

| | Actuarial valuation as at March 2011 | March 2012 actuarial report | March 2013 actuarial report | March 2014 update |
|---|---|---|---|---|
| Assets | £32.4bn | £33.9bn | £38.6bn | £41.5bn |
| Value placed on scheme liabilities | £35.3bn | £43.7bn | £50.1bn | £53.9bn |
| Deficit | £2.9bn | £9.8bn | £11.5bn | £12.4bn |
| **Funding Ratio** | 92% | 77% | 77% | 77% |

| | March 2014 update* | March 2015 update* |
|---|---|---|
| Assets | £41.5bn | £49.0bn |
| Value placed on scheme liabilities | £46.9bn | £57.3bn |
| Deficit | £5.4bn | £8.3bn |
| **Funding Ratio** | 88% | 86% |

*Assuming:

i) changes to employer and member contribution rates and future benefit arrangements are implemented as described in the employer consultation with affected employees.

ii) Use of updated base assumptions which the trustee board will apply to the 2014 valuation.

The figures shown above for the value of the scheme's liabilities (the value at a point in time of the pensions and other benefits payable to current and future beneficiaries) are calculated on an ongoing basis, which assumes that the scheme will continue into the future and that the employers and members will continue to make contributions.

## What is the trustee board's funding plan?

Following the 2011 valuation the trustee board implemented a deficit recovery plan over a period of ten years in consultation with employers and with the University and College Union (UCU), full details are available on page 16.

The trustee board is required to review and consult with employers regarding the contributions payable to the scheme following each actuarial valuation and to update the recovery plan as necessary. The precise details of the update will depend upon the final decision around changes to future benefit arrangements, contribution levels and the level of investment risk the trustee feels it is appropriate to take in the future.

## ADDITIONAL INFORMATION

Although this statement is not a formal Summary Funding Statement, the legal disclosure requirements have been followed for consistency and are provided below.

### Pension Protection Fund

The government established the Pension Protection Fund (PPF) to provide benefits in the event that a scheme's sponsoring employer (or employers) becomes insolvent without there being sufficient funds available in the scheme. USS is recognised by the PPF as a last-man standing scheme, which means that it would only become eligible for the PPF in the extremely unlikely event that the vast majority (if not all) of the scheme's employers were to become insolvent.

If such circumstances were ever to occur, benefits would be payable to members from the PPF, but they might be less than the full benefit earned in USS. The precise amount would depend on the member's age, when the pension benefits were earned and the amount of the benefits overall.

Further information and guidance about the PPF is available on its website at **www.pensionprotectionfund.org.uk** or you can write to Pension Protection Fund, Knollys House, 17 Addiscombe Road, Croydon, CR0 6SR.

### Statutory Statement

There has been no payment out of the fund's assets over the period from April 2014 to March 2015 to the scheme's sponsoring employers, nor has this happened previously. There has been no intervention from the Pensions Regulator to use its powers to modify the scheme or to impose a direction or schedule of contributions.

### Where can you get more information?

If you would like to find out more about USS, please contact the person at your employer who deals with USS matters, or alternatively visit the USS website at **www.uss.co.uk**

You can also contact USS Liverpool office at Universities Superannuation Scheme Ltd, Royal Liver Building, Liverpool, L3 1PY.

## Additional documents available on the USS website or on request

### Statement of Investment Principles

This explains how we invest the money paid into, and manage the investments held by, the scheme. The Statement of Investment Principles is being revised to reflect the trustee's updated approach following consultation with the participating employers and the finalisation of the process following this consultation.

### Statement of Funding Principles

This sets out the policies of the trustee board for ensuring funding objectives are met.

### Schedule of Contributions

This shows how much money is being paid into the scheme by the institutions and the contributing members, and includes a certificate from the actuary showing that it is sufficient. A new schedule of contributions will be issued following completion of the 2014 actuarial valuation.

### Report and Accounts for prior years

This shows the scheme's income and expenditure, and historic details regarding the scheme and the trustee company.

### Actuarial reports for prior years

These reports contain the details of the trustee board's review of the scheme's financial position each year as at 31 March of that year.

# Certificate of Technical Provisions

# Certificate of Technical Provisions



## APPENDIX E

### Certificate of technical provisions

| | |
|---|---|
| Name of the Scheme | Universities Superannuation Scheme |

**Calculation of technical provisions**

I certify that, in my opinion, the calculation of the Scheme's technical provisions as at 31 March 2011 is made in accordance with regulations under section 222 of the Pensions Act 2004. The calculation uses a method and assumptions determined by the Trustee of the Scheme and set out in the statement of funding principles dated ~~15~~ June 2012.

| | |
|---|---|
| **Signature** | Edwin Topper |
| **Name** | Edwin Topper |
| **Date of signing** | 15 June 2012 |
| **Name of employer** | Mercer Limited |
| **Address** | Belvedere<br>12 Booth Street<br>Manchester<br>M2 4 AW |
| **Qualification** | Fellow of the Institute and Faculty of Actuaries |

# Certificate of Schedule of Contributions

# Certificate of Schedule of Contributions

SCHEDULE OF CONTRIBUTIONS

## CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS

| | |
|---|---|
| **Name of Scheme** | Universities Superannuation Scheme |

### Adequacy of rates of contributions

1. I certify that, in my opinion, the rates of contributions shown in this schedule of contributions are such that the statutory funding objective could have been expected on 31 March 2011 to be met by the end of the period specified in the recovery plan dated 15 June 2012 .

### Adherence to statement of funding principles

2. I hereby certify that, in my opinion, this schedule of contributions is consistent with the statement of funding principles dated 15 June 2012.

The certification of the adequacy of the rates of contributions for the purpose of securing that the statutory funding objective can be expected to be met is not a certification of their adequacy for the purpose of securing the Scheme's liabilities by the purchase of annuities, if the Scheme were to be wound up.

| | |
|---|---|
| **Signature** | |
| **Scheme Actuary** | E S Topper |
| **Qualification** | Fellow of the Institute and Faculty of Actuaries |
| **Date of signing** | 15 June 2012 |
| **Name of employer** | Mercer Limited |
| **Address** | Belvedere, 12 Booth Street, Manchester M2 4AW |

108667/520/40496566.1

# Universities Superannuation Scheme Limited Accounts

# Company Information

| | |
|---|---|
| **Company registration number** | 01167127 |
| **Registered office** | Royal Liver Building<br>Liverpool<br>L3 1PY |
| **Company secretary** | Mr I M Sherlock |
| **Directors** | Sir Martin Harris (Chair - resigned 31 March 2015)<br>Professor Sir David Eastwood (Chair with effect from 1 April 2015)<br>Dr K J Carter (Deputy Chair)<br>Professor Dame Glynis Breakwell<br>Mr J W Devlin<br>Ms K English (appointed 1 May 2014)<br>Mr I R Maybury<br>Mr M R Merton<br>Professor Anton Muscatelli (appointed 1 April 2015)<br>Mr D C McDonnell<br>Mr M R Poisson<br>Dr A M Roger<br>Mr J W D Trythall |
| **Bankers** | Barclays Bank Plc<br>48b to 50 Lord Street<br>Liverpool L2 1TD |
| **Independent Auditors** | Grant Thornton UK LLP<br>Statutory Auditor<br>Chartered Accountants<br>Royal Liver Building<br>Liverpool L3 1PS |
| **Solicitors** | DLA Piper UK LLP<br>India Buildings<br>Water Street<br>Liverpool<br>L2 0NH |

# Strategic report for the year ended 31 March 2015

The directors submit their strategic report, directors' report and the financial statements for the year ended 31 March 2015.

Universities Superannuation Scheme Limited (the company), which is limited by guarantee and does not have share capital, is the corporate trustee of Universities Superannuation Scheme (USS or 'the scheme').

USS Investment Management Limited (USSIM Ltd) is a wholly-owned subsidiary of the company. Its principal activity is to provide investment management and advisory services exclusively to Universities Superannuation Scheme Limited. Together these companies are referred to as 'the group'.

The primary key performance indicator used by the directors in measuring the financial performance of the group is the level of operating costs relative to scheme size. Costs as a proportion of assets under management were 0.19p and 0.20p in 2015 and 2014 respectively. The company recovers its costs in accordance with the scheme rules generating neither profit nor loss.

## Principal risks and uncertainties

The directors' approach to risk management within the group is set down in USS' risk governance policy which defines the Trustee board's risk appetite, the types of risks USS is exposed to and the related risk governance arrangements. Risks that could impact on the delivery of USS' business objectives, and the internal control systems that support them, are documented and assessed against risk appetite. Where risks are found to be operating outside risk appetite, appropriate remedial actions are developed, implemented and tracked to resolution. This strategic report analyses those risks relevant to the group's performance as the trustee company, generating neither a profit nor a loss. There are a number of potential risks and uncertainties that could impact the company's long term performance. The Board of Directors (the Board) assesses these risks and uncertainties and takes appropriate action to mitigate where necessary. The subsidiary company, USSIM Ltd is regulated by the Financial Conduct Authority (FCA). The Board, together with a dedicated team, regularly assesses regulatory developments and the subsidiary's compliance with those applicable. The principal risks of the group can be classified into three categories: delivering against expectations for scheme performance, effective cost control and the recruitment and retention of appropriate talent to manage the business effectively. Further detail is set out below along with the relevant metrics where appropriate.

## Scheme Performance

For details of the scheme's performance, and how uncertainty related to this is managed, please refer to its Report and Accounts, published at **www.uss.co.uk**

The Board regularly reviews the performance of the investments with reference to clear targets in order to monitor and assess this principal risk and uncertainty.

## Effective Cost Control

The group must demonstrate value for money and transparency of engagement activity with its suppliers since costs are recharged to the scheme. This is achieved by setting appropriate budgeting controls which are monitored each month.

Operating costs for the year amounted to £96,094,000 (2014: £83,403,000), representing an overall increase of 15% compared to the prior year. This level of cost was within the budget approved by the Board at the start of the year and is deemed to be appropriate relative to the scheme growth and activity during the year. A large proportion of the cost relates to the performance of external fund managers and therefore costs increase in proportion to the underlying performance of the scheme's investments.

A summary of total operating costs for the year by nature of expense is as follows:

| | 2015 £'000 | 2014 £'000 | (Increase)/decrease £'000 | Variance % |
|---|---|---|---|---|
| Personnel | 44,121 | 35,096 | (9,025) | (26) |
| Premises | 3,480 | 3,516 | 36 | 1 |
| Investment management | 28,607 | 25,765 | (2,842) | (11) |
| Other | 19,886 | 19,026 | (860) | (5) |
| | 96,094 | 83,403 | (12,691) | (15) |

The 26% increase in personnel costs reflects the impact of improved investment performance on incentive plans payable, contributing an 11% increase. Increased recruitment (10% increase in headcount) contributed a 13% increase in personnel costs. During the year, the executive management team has been strengthened and we have continued to invest in the recruitment and retention of talented people as discussed further below. Other net movements in personnel costs have contributed 2% to the increase.

Personnel costs contain a £1,758,000 provision (2014: £1,000,000) which represents a reasonable estimate of future payout of the long term investment plans (LTIPs) and which represents a critical accounting judgement and source of estimation uncertainty. Further details are in note 14 to the financial statements.

Investment costs have increased by £2,842,000 following a number of changes to assets managed by external fund managers and an increase in the size of assets managed. The level of investment cost may vary according to fund valuation and performance.

## Recruitment and Retention of Talent

In order to deliver the required performance of assets under management, the company has consistently sought to recruit and retain an excellent team. The company regularly reviews its remuneration packages with reference to appropriate benchmarks. A substantial review was completed in 2014/15. The company also seeks to apply best practice in performance management, development and training for its employees. There has been continued investment in our people during the year, as seen in increased average employee numbers (permanent) from 319 to 343. Furthermore, there has been a review of the composition of the leadership team, and additional appointments have been made to the Group Executive Committee. Further information on our approach to employee matters is set out on page 92.

This report was approved by the board on 14 July 2015 and signed on its behalf.

By order of the board

**I M Sherlock**
**Company Secretary**

# Directors' report for the year ended 31 March 2015

## Directors

The directors who held office during the year or prior to the approval of these financial statements are set out on page 89.

During the year, the company made qualifying third party indemnity provisions for the benefit of its directors which remain in force at the date of this report.

## Employees

The group is committed to the principles of equal opportunities and eliminating discrimination in every aspect of the work of the organisation.

Policies in place are such that, in respect of the employment of disabled persons, as defined by the Disability Discrimination Act 1995, the group strives to ensure that no individual or group is treated more or less favourably than others, or will be disadvantaged by any conditions of employment or requirements that cannot be justified as necessary on operational grounds. That principle is enshrined in the group's recruitment and selection policies. The same principle is applied to the continued employment and training of persons who might become disabled while in the group's employment, and to the training, career development and promotion opportunities provided to disabled persons.

Arrangements are in place to provide employees with information on matters of concern to them which are likely to affect their interests. This is normally achieved by consultation with staff representatives and/or the union with the outcomes being communicated to all employees in the most appropriate manner.

The business plan and group objectives are an important part of the process of setting objectives for staff, so that a common awareness on the part of all employees of the financial and economic factors affecting the performance of the group can be achieved.

## Donations

During the year there were no political donations made and no charitable donations made over £2,000.

## Statement of directors' responsibilities

The directors are responsible for preparing the strategic report, the directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable laws).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and the group and of the result of the company and the group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- 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 adequate accounting records that are sufficient to show and explain the company's transactions and 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 2006. 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.

## Going concern

The company's business activities, together with the principal risks and uncertainties are set out in the Strategic Report. As highlighted on page 90, the company manages the investment activities of the scheme and makes neither a profit nor a loss. There are no factors of which the directors are aware that would materially impact the ability of the company to continue as a going concern and accordingly the financial statements have been prepared on a going concern basis of accounting in preparing the annual financial statements.

## Provision of information to auditor

The directors confirm that:

- so far as each director is aware, there is no relevant audit information of which the company's auditor is unaware; and
- they have taken all the steps that they ought to have taken as directors in order to be aware of any relevant audit information and to establish that the company's auditor is aware of that information.

## Auditor

Grant Thornton UK LLP have indicated their willingness to be reappointed and appropriate arrangements have been made for them to be deemed reappointed as auditor in the absence of an Annual General meeting.

This report was approved by the board on 14 July 2015 and signed on its behalf.

By order of the board

**I M Sherlock**
**Company Secretary**

# Independent auditor's report to the members of Universities Superannuation Scheme Ltd

We have audited the financial statements of Universities Superannuation Scheme Limited for the year ended 31 March 2015 which comprise the group profit and loss account, the group and parent company balance sheets, the group cash flow statement, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor

As explained more fully in the Directors' Responsibilities Statement set out on pages 92 and 93, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at **www.frc.org.uk/auditscopeukprivate**

## Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2015 and of the group's result for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

**Paul Flatley**
**Senior Statutory Auditor**
for and on behalf of Grant Thornton UK LLP,
Statutory Auditor,
Chartered Accountants
Liverpool

14 July 2015

# Consolidated profit and loss account for the year ended 31 March 2015

| | Note | 2015 £'000 | 2014 £'000 |
|---|---|---|---|
| Turnover | 1 | 96,094 | 83,403 |
| Operating costs | 2 | (96,094) | (83,403) |
| Profit or loss on ordinary activities before and after taxation | | - | - |

There were no recognised gains and losses for 2015 or 2014 other than those included in the profit and loss account and accordingly a statement of total recognised gains and losses has not been presented in either year.

All amounts relate to continuing operations.

The notes on pages 98 to 111 form part of these financial statements.

# Balance sheets as at 31 March 2015

**Company registration number: 01167127**

| | | Group | | Company | |
|---|---|---|---|---|---|
| | Note | 2015 £'000 | 2014 £'000 | 2015 £'000 | 2014 £'000 |
| **Fixed assets** | | | | | |
| Tangible fixed assets | 9 | 4,243 | 4,576 | 3,892 | 4,116 |
| Investment in subsidiary undertakings | 10 | - | - | 921 | 921 |
| | | 4,243 | 4,576 | 4,813 | 5,037 |
| **Current assets** | | | | | |
| Debtors | 11 | 17,464 | 11,225 | 14,932 | 9,091 |
| Cash at bank and in hand | 15 | 4,013 | 4,065 | 7 | 6 |
| | | 21,477 | 15,290 | 14,939 | 9,097 |
| **Creditors: amounts falling due within one year** | **12** | **(21,797)** | **(17,189)** | **(19,752)** | **(14,134)** |
| Net current liabilities | | (320) | (1,899) | (4,813) | (5,037) |
| **Total assets less current liabilities** | | **3,923** | **2,677** | **-** | **-** |
| **Creditors: amounts falling due after more than one year** | **13** | **(2,165)** | **(1,677)** | **-** | **-** |
| **Provision for liabilities** | **14** | **(1,758)** | **(1,000)** | **-** | **-** |
| **Net assets** | | **-** | **-** | **-** | **-** |

The notes on pages 98 to 111 form part of these financial statements.

The financial statements on pages 89 to 111 were approved by the board of directors on 14 July 2015 and were signed on its behalf by:

**Professor Sir David Eastwood**
**Chairman**

**Dr Kevin Carter**
**Deputy Chairman**

# Consolidated cash flow statement for the year ended 31 March 2015

| | Note | 2015<br>£'000 | 2014<br>£'000 |
|---|---|---|---|
| **Operating activities** | | | |
| Cash received from USS | | 90,824 | 80,311 |
| Operating costs paid | 15 | (89,160) | (78,000) |
| Net cash inflow from operating activities | | 1,664 | 2,311 |
| **Capital expenditure** | | | |
| Purchase of tangible fixed assets | 9 | (1,722) | (3,559) |
| Sale of tangible fixed assets | | 6 | 122 |
| | | (1,716) | (3,437) |
| **Decrease in cash** | **15** | **(52)** | **(1,126)** |

The notes on pages 98 to 111 form part of these financial statements.

# Notes to the financial statements for the year ended 31 March 2015

## 1 Accounting policies

### Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with the Companies Act 2006 and applicable United Kingdom law and accounting standards (UK Generally Accepted Accounting Practice).

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 trustee of USS.

The accounting policies of the group have been applied consistently throughout the current and preceding years and are set out below.

### Basis of consolidation

The consolidated financial statements include the accounts of the company and its wholly owned subsidiary USSIM Ltd drawn up to 31 March 2015. All intercompany balances and transactions have been eliminated on consolidation.

The company owns the share capital of a number of special purpose entities to aid the efficient administration of scheme investments. Their results have not been consolidated into these financial statements because they are considered to be assets of the scheme. Details of these entities may be obtained by writing to the Company Secretary of Universities Superannuation Scheme Limited, Mr I M Sherlock, at Royal Liver Building, Liverpool, L3 1PY.

The company has taken advantage of the exemption allowed under s408 of the Companies Act 2006 and has not presented its own profit and loss account in these financial statements. The parent company's result for the year was £nil (2014: £nil) since operating costs are recharged in full to the scheme.

### Going concern

In performing their going concern assessment the directors have reviewed the principal risks and uncertainties facing the group as set out on pages 90 and 91. The group's fundamental objective and purpose is to manage the day to day administration of the scheme and therefore the main risks from a going concern perspective relate to the ability of the company to continue to administer the scheme. These risks identified are not considered to be of a magnitude which cast significant doubt on the group's ability to continue as a going concern and accordingly the financial statements have been prepared on a going concern basis.

### Turnover

Turnover represents the recharge of costs to USS on an accruals basis in accordance with the rules of the scheme which state that all costs and expenses of managing and administering the scheme incurred by the trustee company during the year shall be paid out of the fund.

### Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost, less depreciation and any provision for impairment. Depreciation is calculated so as to write off the cost of fixed assets on a straight line basis over the expected useful economic lives of the assets concerned. The expected useful economic life of an asset commences when the asset is ready for use. The principal annual rates used for this purpose are:

| | % | | % |
|---|---|---|---|
| Alterations to rented premises | 20 | Office equipment | 15 |
| Computer equipment | 33⅓ | Motor vehicles | 25 |
| Computer software | 33⅓ | | |

# 1 Accounting policies (continued)

## Operating leases

Rental costs under operating leases are charged on a straight line basis over the lease term.

## Pensions

The group participates in the Universities Superannuation Scheme (USS or the scheme), a defined benefit scheme which is contracted out of the State Second Pension (S2P). The assets of the scheme are held in a separate trustee-administered fund. Because of the mutual nature of the scheme, the scheme's assets are not attributed to individual institutions and a scheme-wide contribution rate is set. The group is therefore exposed to actuarial risks associated with other institutions' employees and at 31 March 2015 is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis. As required by FRS 17 "Retirement benefits", the group therefore accounts for the scheme as if it were a defined contribution scheme. As a result, the amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting period.

## Provisions

A provision is recognised in the balance sheet when the company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at the directors' best estimate of the consideration required to settle the obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the liability, its carrying amount is the present value of those cashflows. When some or all of the economic benefits required to settle a provision are expected to be recovered from USS Ltd, a receivable is recognised as an asset since it is virtually certain that reimbursement will be received and can be measured reliably. Amounts that the group have provided for are explained in more detail in note 14.

## Contingent liabilities

A contingent liability is not recognised but is disclosed where the existence of the obligation will only be confirmed by future events or where it is not probable that an outflow of resources will be required to settle the obligation or where the amount of the obligation cannot be measured with reasonable reliability. Contingent assets are not recognised but are disclosed where an inflow of economic benefits is probable.

## VAT

The group is registered for Value Added Tax (VAT) activities and recovers a proportion of the input tax on administrative expenditure directly attributable to the scheme's investment activities. The unrecovered VAT element is written back against operating expenses, apportioned by standard rated expenditure.

## Investments

Investments are stated at cost, less any provision for impairment.

## 2 Operating costs

| | Note | 2015 £'000 | 2014 £'000 |
|---|---|---|---|
| **Personnel** | | | |
| Employee costs | 3 | 41,490 | 32,641 |
| Directors' emoluments and expenses | 4 | 561 | 677 |
| Recruitment, training and welfare | | 2,070 | 1,778 |
| | | 44,121 | 35,096 |
| **Premises** | | | |
| Rents, rates, service charges and utilities | | 2,878 | 2,803 |
| Depreciation and maintenance | | 602 | 713 |
| | | 3,480 | 3,516 |
| **Investment management** | | | |
| Securities research | | 9,578 | 9,136 |
| Securities management fees | | 8,239 | 7,200 |
| Property management fees | | 5,366 | 5,008 |
| Custodial services | | 2,447 | 2,014 |
| Legal costs - property management | | 1,413 | 923 |
| - other | | 136 | 356 |
| Property valuation fees | | 206 | 232 |
| Investment accounting services* | | 870 | 733 |
| Investment performance measurement | | 352 | 163 |
| | | 28,607 | 25,765 |

*Investment accounting services are now included in investment management expenses. £733,000 in 2014 has been reclassified from computer and information services costs. The change is made to reflect more accurately the nature of the expense. There is no overall impact on total operating costs.

## 2 Operating costs (continued)

| | Note | 2015 £'000 | 2014 £'000 |
|---|---|---|---|
| **Other costs** | | | |
| Computer and information services costs* | 5 | 6,848 | 5,890 |
| Pension protection fund levy | 6 | 3,600 | 3,248 |
| Professional fees | 7 | 5,992 | 6,834 |
| Travel and car costs (including depreciation of £17,000 (2014: £63,000)) | | 1,384 | 1,072 |
| Office equipment (including depreciation of £233,000 (2014: £186,000) | | 498 | 418 |
| Institution liaison and member communication | | 384 | 431 |
| Telephones and postage | | 306 | 431 |
| Printing and stationery | | 193 | 256 |
| Insurance | | 142 | 140 |
| Auditors' remuneration | 8 | 122 | 119 |
| Regulatory fees | | 110 | 109 |
| Loss/(profit) on disposal of fixed assets | | 72 | (42) |
| Sundry expenditure | | 235 | 120 |
| | | 19,886 | 19,026 |
| Total operating costs | | 96,094 | 83,403 |

*Investment accounting services are now included in investment management expenses. £733,000 in 2014 has been reclassified from computer and information services costs. The change is made to reflect more accurately the nature of the expense. There is no overall impact on total operating costs.

## 3 Employee costs

| | 2015 | 2014 |
|---|---|---|
| **The average weekly number of persons employed by the group during the year (excluding directors) was:** | | |
| Permanent employees | 343 | 319 |
| Contractors | 36 | 29 |
| | 379 | 348 |

| | 2015<br>£'000 | 2014<br>£'000 |
|---|---|---|
| **Staff costs for the above persons were:** | | |
| Wages and salaries: Permanent employees | 27,539 | 21,419 |
| Contractors | 6,010 | 3,591 |
| Pension costs | 4,166 | 3,644 |
| Social security costs | 3,122 | 2,644 |
| Restructuring costs | 653 | 1,343 |
| | 41,490 | 32,641 |

## 4 Directors' emoluments and expenses

| | 2015<br>£'000 | 2014<br>£'000 |
|---|---|---|
| Fees | 456 | 568 |
| Employer's costs – National Insurance contributions | 71 | 75 |
| Expenses | 34 | 34 |
| | 561 | 677 |

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 the company and their legal responsibilities.

The emoluments of the highest paid director were £70,000 (2014: £70,000). No pension contributions have been made on behalf of directors in either the current or preceding year. As at 31 March 2015, six of the directors were members of USS (2014: six). Membership, whether deferred, pensioner or active is through their past or present employment with the institutions.

In addition to those fees above, one director is also a director of the subsidiary company, receiving £40,000 (2014: one director received £29,000).

## 5 Computer and information services costs

| | 2015 £'000 | 2014 £'000 |
|---|---|---|
| Investment information services | 3,649 | 3,725 |
| Computer running costs | 2,004 | 1,576 |
| Software depreciation | 462 | 335 |
| Hardware depreciation | 732 | 254 |
| Computer bureau fees | 1 | - |
| | 6,848 | 5,890 |

## 6 Pension protection fund

| | 2015 £'000 | 2014 £'000 |
|---|---|---|
| Scheme-based and risk based levies | 3,033 | 2,727 |
| Administration levy | 297 | 273 |
| General levy | 270 | 248 |
| | 3,600 | 3,248 |

## 7 Professional fees

| | 2015 £'000 | 2014 £'000 |
|---|---|---|
| Financial Management Plan | 1,168 | 3,104 |
| Legal | 1,506 | 1,257 |
| Consultancy | 1,463 | 1,089 |
| Actuarial | 1,126 | 794 |
| Committee members | 350 | 302 |
| Public relations | 111 | 111 |
| Other | 201 | 110 |
| Member matters | 67 | 67 |
| | 5,992 | 6,834 |

## 8 Auditors' remuneration

| | 2015 £'000 | 2014 £'000 |
|---|---|---|
| USS | 85 | 83 |
| USS Investment Management Limited | 26 | 26 |
| Universities Superannuation Scheme Limited | 11 | 10 |
| | 122 | 119 |

No remuneration has been paid to the group and company's auditor in respect of non-audit services (2014 :£nil).

# 9 Tangible fixed assets

| Group | Alterations to rented premises £'000 | Computer equipment £'000 | Computer software £'000 | Office equipment £'000 | Motor vehicles £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At 1 April 2014 | 5,625 | 3,578 | 5,806 | 3,235 | 180 | 18,424 |
| Additions | 48 | 534 | 1,059 | 81 | - | 1,722 |
| Disposals | (1,388) | (1) | (83) | (1,246) | (90) | (2,808) |
| At 31 March 2015 | 4,285 | 4,111 | 6,782 | 2,070 | 90 | 17,338 |
| **Accumulated depreciation** | | | | | | |
| At 1 April 2014 | 4,220 | 1,899 | 5,264 | 2,352 | 113 | 13,848 |
| Charge for year | 450 | 732 | 545 | 233 | 17 | 1,977 |
| Disposals | (1,350) | - | (83) | (1,221) | (76) | (2,730) |
| At 31 March 2015 | 3,320 | 2,631 | 5,726 | 1,364 | 54 | 13,095 |
| **Net book value** | | | | | | |
| At 31 March 2015 | 965 | 1,480 | 1,056 | 706 | 36 | 4,243 |
| At 31 March 2014 | 1,405 | 1,679 | 542 | 883 | 67 | 4,576 |

## Company

| | | | | | | |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At 1 April 2014 | 5,625 | 3,578 | 5,806 | 1,692 | 180 | 16,881 |
| Additions | 48 | 534 | 1,059 | 18 | - | 1,659 |
| Disposals | (1,388) | (1) | (83) | (1,246) | (90) | (2,808) |
| At 31 March 2015 | 4,285 | 4,111 | 6,782 | 464 | 90 | 15,732 |
| **Accumulated depreciation** | | | | | | |
| At 1 April 2014 | 4,220 | 1,899 | 5,264 | 1,269 | 113 | 12,765 |
| Charge for year | 450 | 732 | 545 | 61 | 17 | 1,805 |
| Disposals | (1,350) | - | (83) | (1,221) | (76) | (2,730) |
| At 31 March 2015 | 3,320 | 2,631 | 5,726 | 109 | 54 | 11,840 |
| **Net book value** | | | | | | |
| At 31 March 2015 | 965 | 1,480 | 1,056 | 355 | 36 | 3,892 |
| At 31 March 2014 | 1,405 | 1,679 | 542 | 423 | 67 | 4,116 |

## 10 Investment in subsidiary undertakings

| | Company |
|---|---|
| | £'000 |
| At 1 April 2014 and 31 March 2015 | 921 |

On 1 October 2012, 920,643 ordinary shares of £1 were issued to the company by USSIM Ltd, incorporated in England and Wales, which is 100% owned directly. The principal activity of USSIM Ltd is to provide investment management services.

## 11 Debtors

| | Group | | Company | |
|---|---|---|---|---|
| | 2015 £'000 | 2014 £'000 | 2015 £'000 | 2014 £'000 |
| Amounts due from related party (USS) | 13,639 | 8,369 | 13,639 | 8,369 |
| Prepayments | 2,961 | 2,603 | 879 | 684 |
| Other debtors | 864 | 253 | 414 | 38 |
| | 17,464 | 11,225 | 14,932 | 9,091 |

## 12 Creditors - Amounts falling due within one year

| | Group | | Company | |
|---|---|---|---|---|
| | 2015 £'000 | 2014 £'000 | 2015 £'000 | 2014 £'000 |
| Amounts due to group undertakings (USS Investment Management Ltd) | - | - | 8,802 | 5,657 |
| Accrued expenditure | 13,347 | 9,514 | 8,630 | 5,784 |
| Other creditors | 2,993 | 4,246 | 1,850 | 2,442 |
| Taxation and social security | 5,457 | 3,429 | 470 | 251 |
| | 21,797 | 17,189 | 19,752 | 14,134 |

## 13 Creditors - Amounts falling due after more than one year

An accrual of £2,165,000 (2014: £1,677,000) has been made for future payments relating to remuneration awards. An element of the award is deferred for a period of three years if the total award earned exceeds a certain threshold and attracts an interest payment linked to scheme performance.

## 14 Provision for liabilities and charges

The company awards long term incentive plans (LTIPs) to certain employees that require the company to pay the fair value of the LTIPS to those employees once the awards have vested. The vesting period is either three, four or five years, dependent on the plan awarded. The objective of the plans, which are awarded annually, is to ensure that a significant portion of the compensation payable to key employees is aligned with the long-term performance of the scheme.

A provision has been recorded for £1,758,000 (2014: £1,000,000) which is a reasonable estimate of the amount to be paid in future. £639,000 (2014: £1,000,000) is expected to be paid in the next 12 months. The plan is aligned to the performance of the scheme and individuals vest over either a three, four or five year period.

Each plan is individually assessed, on an annual basis, for the payment and for likelihood of future payments. This is based on the achievement of annualised investment outperformance relative to pre-determined benchmarks. The amount that is likely to be paid is charged to the profit and loss in equal instalments. The likelihood of payment is also dependent on the retention of the employees eligible for the awards. Both the investment outperformance and the staff retention rates are reviewed annually and provision is reassessed. Given the performance achieved to date, the outperformance hurdles set in the plans and the fact that future outperformance cannot be guaranteed, it is considered that £1,758,000 is a best estimate of the amount to be paid out in relation to employees services rendered up to the balance sheet date and a provision has been made in the financial statements.

The table below sets out the movement in the provision since 31 March 2014:

| Reconciliation of provision | £'000 |
|---|---|
| As at 1 April 2014 | 1,000 |
| Amount paid during year | (920) |
| Unutilised charge released | (80) |
| Charge for year | 1,758 |
| As at 31 March 2015 | 1,758 |

# 15 Notes to the cash flow statement

## 15a Reconciliation of net cash flow from operating activities

| | 2015<br>£'000 | 2014<br>£'000 |
|---|---|---|
| Operating costs - recoverable from USS | 96,094 | 83,403 |
| Increase in creditors and provisions | (5,854) | (4,193) |
| Increase in debtors (excluding USS shown above) | 969 | 90 |
| (Loss)/profit on sale of tangible fixed assets | (72) | 42 |
| Depreciation | (1,977) | (1,342) |
| Operating costs paid | 89,160 | 78,000 |

A reconciliation between the operating profit reported in the profit and loss account and the net cash flow from operating activities reported in the cash flow statement is a requirement of FRS 1 paragraph 12. The directors believe that the format above remains more appropriate given the nature of the group and the environment in which it operates.

## 15b Reconciliation of net cash flow to movement in cash

| | 2015<br>£'000 | 2014<br>£'000 |
|---|---|---|
| Decrease in cash in the period | (52) | (1,126) |
| Change in cash | (52) | (1,126) |
| Cash at 1 April | 4,065 | 5,191 |
| Cash at 31 March | 4,013 | 4,065 |

## 16 Operating lease arrangements

| | 2015 £'000 | 2014 £'000 |
|---|---|---|
| Lease payments under operating leases recognised as an expense in the year | 1,780 | 1,467 |

The group is committed to making future annual payments under operating leases which expire as follows:

| | Land and buildings | | Other | |
|---|---|---|---|---|
| | 2015 £'000 | 2014 £'000 | 2015 £'000 | 2014 £'000 |
| Less than one year | - | 90 | 13 | - |
| Between two and five years | - | - | 76 | 133 |
| Over five years | 1,557 | 1,557 | - | - |

## 17 Contingent liabilities and assets

A contingent liability exists in relation to the pension valuation recovery plan, since the company is an employer of members within the scheme. The contingent liability relates to the amount generated by past service of current members and the associated proportion of the deficit. Given that the scheme is a multi-employer scheme and the company is unable to identify its share of the underlying assets and liabilities, the contingent liability is not recognised as a provision on the balance sheet. The associated receivable from the scheme in respect of the reimbursement of the company's expenditure is similarly not recognised.

## 18 Capital commitments

The group and company had no capital commitments at 31 March 2015 or 31 March 2014.

## 19 Pension costs

The company participates in the Universities Superannuation Scheme (USS), a defined benefit scheme which is contracted out of the State Second Pension (S2P). The assets of the scheme are held in a separate fund administered by the trustee, Universities Superannuation Scheme Limited. The company is required to contribute a specified percentage of payroll costs to the pension scheme to fund the benefits payable to the company's employees. In 2015, the percentage was 16% (2014: 16%). 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 FRS 17 "Retirement benefits", accounts for the scheme as if it were a defined contribution scheme.

The total cost charged to the profit and loss account is £4.2m (2014: £3.6m) as shown in notes 3 and 4. There was neither a prepayment nor an accrual at the end of the financial year in respect of these contributions. The disclosures below represent the position from the scheme's financial statements.

The latest available triennial actuarial valuation of the scheme was at 31 March 2011 ("the valuation date"), which was carried out using the projected unit method. The 2014 valuation is not yet finalised and is under consultation in order to agree a recovery plan to reduce benefits and to reduce the deficit and an increase in employer contributions. It is expected that employer contributions will increase to 18% from 1 April 2016.

The 2011 valuation was the second valuation for USS under the scheme-specific funding regime introduced by the Pensions Act 2004, which requires schemes to adopt a statutory funding objective, which is to have sufficient and appropriate assets to cover their technical provisions. At the valuation date, the value of the assets of the scheme was £32.4bn and the value of the scheme's technical provisions was £35.3bn indicating a shortfall of £2.9bn. The assets therefore were sufficient to cover 92% of the benefits which had accrued to members after allowing for expected future increases in earnings.

FRS 17 liability numbers have been produced for the scheme using the following assumptions:

| | 2015 | 2014 |
|---|---|---|
| Discount rate | 3.3% | 4.5% |
| Pensionable salary growth | 3.5% in the first year and 4.0% thereafter | 4.4% |
| Price inflation (CPI) | 2.2% | 2.6% |

The main demographic assumption used relates to the mortality assumptions. Mortality in retirement is assumed to be in line with the Continuous Mortality Investigation's (CMI) S1NA tables as follows:

| |
|---|
| Male members' mortality - S1NA ["light"] YoB tables – No age rating |
| Female members' mortality - S1NA ["light"] YoB tables – rated down 1 year |

Use of these mortality tables reasonably reflects the actual USS experience. To allow for further improvements in mortality rates the CMI 2009 projections with a 1.25% pa long term rate were also adopted for the 2014 FRS17 figures, for the March 2015 figures the long term rate has been increased to 1.5% and the CMI 2014 projections adopted and the tables have been weighted by 98% for males and 99% for females.

## 19 Pension costs (continued)

The current life expectancies on retirement at age 65 are:

| | 2015 | 2014 |
|---|---|---|
| Males currently aged 65 (years) | 24.2 | 23.7 |
| Females currently aged 65 (years) | 26.3 | 25.6 |
| Males currently aged 45 (years) | 26.2 | 25.5 |
| Females currently aged 45 (years) | 28.6 | 27.6 |

| Calculated based on existing benefits* | 2015 | 2014 |
|---|---|---|
| Scheme assets | £49.0bn | £41.6bn |
| FRS 17 liabilities | £67.6bn | £55.5bn |
| FRS 17 deficit | £18.4bn | £13.9bn |
| FRS 17 funding level | 72% | 75% |

* i.e. the calculation has not been updated to reflect any potential changes in benefits. This is due to the fact that such changes had not been agreed at the balance sheet date.

## 20 Related party transactions

There are no related party transactions other than transactions between the company and USS and transactions with group entities. The company acts as the trustee of the USS and, as such, holds investments and other assets in its own name, but these are not included in the balance sheet, as the company holds the assets as trustee of USS.

The group provides administration and investment management services to USS charging £96,094,000 (2014: £83,403,000) respectively, with a balance due from USS of £13,639,000 as at 31 March 2015 (2014: £8,369,000).

The group has taken advantage of the exemptions within Financial Reporting Standard No 8 "Related Parties" and has not disclosed transactions with group undertakings where the company is a 100% subsidiary as consolidated financial statements are prepared.

# Committee Reports

# Investment Committee

## Membership & Meetings

The committee's members are appointed by the board and comprise board and special members. The meetings are typically attended by the Group CEO, the CEO of USSIM, the chief financial officer, group general counsel, chief financial risk officer and members of the executive of USS Investment Management Limited (USSIM Ltd). Miss Docherty retired at the end of September 2014, after serving for 6 years as a special member of the committee. In addition, Sir Martin, who was first appointed as a member of the committee in 2006, retired at the end of March 2015. An investment specialist from Mercer also attends the meetings. Membership and meeting attendance is detailed below:

| | Meetings | |
|---|---|---|
| **Member** | **Eligible to attend** | **Attended** |
| Dr Kevin Carter (Chair, special member) | 6 | 6 |
| Ms Sarah Bates (special member) | 6 | 6 |
| Professor Dame Glynis Breakwell | 6 | 4 |
| Miss Angela Docherty (special member - retired on 24 September 2014) | 3 | 3 |
| Sir Martin Harris (retired on 31 March 2015) | 6 | 6 |
| Mrs Virginia Holmes (special member) | 6 | 6 |
| Mr Ian Maybury (special member) | 6 | 5 |
| Mr David McDonnell | 6 | 4 |
| Dr Angela Roger | 6 | 6 |
| **Average attendance at meetings** | | **90%** |

## Role

The committee was established under article 49 of the Articles of Association of USS and rule 63 of the scheme rules by the board to advise the trustee company on all strategic matters relating to, and provide oversight of, the investment of the Scheme's assets.

The committee's responsibilities are detailed in their terms of reference available at **www.uss.co.uk**

## Key activities in 2014/15

The committee has considered and made decisions or recommendations to the board as appropriate on the following key matters during the year:

- Development of the reference and implemented portfolio and the governance framework, including governance documents, terms of reference, investment management and advisory agreement, applicable policies, reference portfolio reporting, key parameters, delegation/reallocation of responsibilities between USS/the committee and the investment advisor, USSIM;
- Review of the liability hedging in the context of the reference portfolio;
- Private markets opportunities and planned portfolio construction in terms of required and expected returns v. funding sources;
- Review of the asset allocation and investment strategy;
- Review of arrangements for safe custody; and
- Review of statement of investment beliefs.

# Policy Committee

## Membership & Meetings

Professor Sir David Eastwood chaired the policy committee until 31 March 2015 when following his appointment as board chair, Professor Dame Glynis Breakwell took up the position as policy committee chair. The committee made up of members appointed by and from the board, including at least one independent director, one Universities UK nominated director and one UCU nominated director.

The committee met five times during the year. Membership and meeting attendance throughout the year is set out below:

| | Meetings | |
|---|---|---|
| **Member** | **Eligible to attend** | **Attended** |
| Professor Sir David Eastwood (Chair until 31 March 2015) | 5 | 5 |
| Dr Kevin Carter | 5 | 5 |
| Mr Joseph Devlin | 5 | 5 |
| Mr Rene Poisson | 5 | 5 |
| Mr Bill Trythall | 5 | 5 |
| **Average attendance at meetings** | | **100%** |

In addition to committee members, meetings are usually attended by the group chief executive, chief policy and external affairs officer, group general counsel, chief financial risk officer, chief service delivery officer, chief funding strategy officer, or their designate, and company secretary who is secretary to the committee.

## Role

The committee was established by the trustee board on 1 April 2014 to provide advice to the board on issues of strategy and policy, to keep the scheme rules under review and to oversee the scheme rule amendment process and provide advice to the board on proposed rule amendments.

All committee responsibilities are set out in its terms of reference which can be viewed on the USS website here **www.uss.co.uk/HowUssIsRun/overview/Pages/default.aspx**

## Key activities in 2014/15

The committee has considered and made recommendations where required in the following key areas during the year:

- Scheme changes and their impact on the scheme rules;
- Statutory consultation on proposed scheme changes;
- Impact of the 2014 budget on the scheme;
- Employer participation;
- Employer debt and re-structuring;
- Policy trends in higher education and their impact on USS services and scheme benefits;
- Communication strategy; and
- Relevant regulatory and legislative changes.

# Audit Committee

## Membership & Meetings

Mr Michael Merton chairs the audit committee which is comprised of members appointed by the board. Membership includes four non-executive directors and a special committee member appointed to provide specific expertise. The members have significant experience in areas relevant to the committee's work including finance and audit. The biographical details for director members can be found on pages 7 and 8. In addition, the special member of the committee, Mr Gordon Coull, provides the committee with recent and relevant financial experience as a former partner with EY.

The committee met four times during the year. Membership and meeting attendance are set out below:

| | Meetings | |
|---|---|---|
| **Member** | **Eligible to attend** | **Attended** |
| Mr Michael Merton (Chair) | 4 | 4 |
| Mr David McDonnell | 4 | 3 |
| Mr Joseph Devlin | 4 | 4 |
| Mr Gordon Coull | 4 | 4 |
| Ms Kirsten English (from 1 May 2014) | 4 | 4 |
| **Average attendance at meetings** | | **95%** |

Ms English was appointed as a member of the committee on 1 May 2014.

In addition to committee members, meetings are usually attended by the group chief executive officer, chief financial officer, group general counsel, chief service delivery officer, chief technology and change officer, chief financial risk officer, head of internal audit, head of risk, head of IT and the company secretary who is secretary to the committee.

## Role

The committee was established by the board in March 1982 to:

- provide assurance to the board on all matters relating to the appropriateness and effectiveness of the trustee company's risk management and internal control systems and those of its investment subsidiary, USS Investment Management Limited (USSIM); and
- assist the board in ensuring that financial and business reporting arrangements are appropriate to achieve accurate, balanced and understandable corporate reporting.

All committee responsibilities are set out in its terms of reference which can be viewed on the USS website here **www.uss.co.uk/HowUssIsRun/overview/Pages/default.aspx**

## Key activities in 2014/15

The committee undertook each of its principal responsibilities during the year. The following key areas were formally discussed, reviewed and where appropriate approved by the committee or recommended for board approval during 2014/15.

- external audit programme including assessment of audit effectiveness, independence and objectivity;
- internal audit programme, internal audit role and responsibilities and effectiveness;
- internal audit reports with limited assessments;
- the effectiveness of internal control systems;
- developments in the group's risk management processes including a comprehensive review of the group's second line of defence;
- accounting and reporting policies against legal requirements, regulatory requirements and best practice;
- draft financial statements for USs Ltd and USSIM and other material published with the accounts;
- key USS tax objectives and strategy;
- implementation of FRS102 reporting standard;
- policies relating to financial crime;
- arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters;
- establishment of a fair value committee to oversee the effective and consistent adherence to the group valuation policy and to review and approve valuation methodologies and controls; and
- committee terms of reference and committee effectiveness.

# Governance & Nominations Committee

## Membership & Meetings

Mr David McDonnell chairs the governance and nominations committee, made up of members appointed by and from the board, which met four times during the year and considered 41 items of business. Membership and meeting attendance throughout the year is set out below:

| | Meetings | |
|---|---|---|
| **Member** | **Eligible to attend** | **Attended** |
| Mr David McDonnell (Chair) | 4 | 3 |
| Sir Martin Harris | 4 | 4 |
| Professor Sir David Eastwood | 4 | 4 |
| Dr Angela Roger | 4 | 4 |
| Ms Kirsten English (from 1 July 2014) | 3 | 3 |
| Mr Bill Galvin | 4 | 4 |
| **Average attendance at meetings** | | **96%** |

Professor John Bull retired as a director and committee chair on 31 March 2014. Mr David McDonnell joined the committee to take up the position of chair with effect from 1 April 2014.

Ms Kirsten English joined the committee on 1 July 2014.

In addition to committee members, meetings are usually attended by the group general counsel, company secretary, and assistant company secretary who is secretary to the committee.

## Role

The committee was established by the trustee board to consider and make recommendations on the recruitment, induction and training of board and committee members to ensure that there is an appropriate balance of skills, experience and knowledge to effectively discharge board and committee responsibilities. The committee also has responsibility for ensuring that the agreed governance framework is appropriately implemented.

All committee responsibilities are set out in its terms of reference which can be viewed on the USS website here **www.uss.co.uk/HowUssIsRun/overview/Pages/default.aspx**

## Key activities in 2014/15

The committee has considered and made recommendations where required in the following key areas during the year:

- USS' governance structure and arrangements, including the governance review being led by group general counsel referred to on page 25;
- Trustee board chair selection;
- Succession planning for board and committee members;
- Succession planning for the executive;
- Appointment and reappointment of directors and committee chairs and members;
- Appraisal, training and development for the board and committees; and
- Regulatory and statutory issues relating to governance.

# Remuneration Committee

## Membership & Meetings

Mr Rene Poisson was appointed as chair of the Remuneration Committee on 1 April 2014. The committee is comprised of members appointed by the board having received the advice of the governance nominations committee. The committee met five times during the year. Membership and meeting attendance are set out below:

| | Meetings | |
|---|---|---|
| **Member** | **Eligible to attend** | **Attended** |
| Mr Rene Poisson (chair) | 5 | 5 |
| Mr David McDonnell | 5 | 5 |
| Professor Dame Glynis Breakwell | 5 | 4 |
| Mr Joseph Devlin | 5 | 5 |
| **Average attendance at meetings** | | **95%** |

Mr David McDonnell retired as chair in March 2014 in order to take on the chairmanship of the governance and nominations committee. He continues to serve as a member of the remuneration committee. Mr Rene Poisson was invited to join the committee as its chair from 1 April 2014. The committee would like to extend its thanks to Mr McDonnell for his valued leadership during his tenure as chair.

In addition to committee members, the group chief executive officer, the head of HR and the company secretary (who acts as secretary to the committee) ordinarily attend committee meetings and other attendees are invited as required for the effective conduct of business.

## Role

The committee was established by the trustee board to set and oversee the implementation of policy for the recruitment, motivation and retention of group employees with the exception of the chief executive whose remuneration package is determined at board level and the chief executive (USSIM) whose remuneration package is agreed by the chairman of the committee in conjunction with the chairman of the investment management subsidiary (USSIM). The committee also has responsibility for reviewing and making recommendations to the board on director remuneration within an overall cap set by the Joint Negotiating Committee.

All committee responsibilities are set out in its terms of reference which can be viewed on the USS website here **www.uss.co.uk/HowUssIsRun/overview/Pages/default.aspx**

## Key activities in 2014/15

In the year the committee has:

- Reviewed and made recommendations to the trustee board on staff compensation and benefits for employees;
- Reviewed and made recommendations on the bonus scheme and long-term incentive plans for investment staff; and
- Commenced a review of USS Ltd and USSIM Ltd non-executive director remuneration.

# Joint Negotiating Committee

## Purpose

The Joint Negotiating Committee (JNC) is established under the rules of the scheme, and its powers are derived from those rules.

The committee's purpose is to decide on changes to the scheme rules, to consider the application of the cost-sharing arrangements in the event they are activated, and to consider and decide on specific governance issues as set out in the rules.

## Membership

The JNC is a body comprising five representatives of Universities UK and five representatives of the University and College Union (UCU), together with an independent committee member who acts as chairman. Membership at 31 March 2015 was:

| Member |
|---|
| Sir Andrew Cubie (Independent committee member and chair) |
| Dr Tony Bruce (Universities UK) |
| Mr Phil Harding (Universities UK) |
| Mr John Neilson (Universities UK) |
| Mr Will Spinks (Universities UK) |
| Mr Cliff Vidgeon (Universities UK) |
| Mr Roger Brooks (UCU) |
| Dr Jimmy Donaghey (UCU) |
| Ms Geraldine Egan (UCU) |
| Dr Marion Hersh (UCU) |
| Mr Gordon Watson (UCU) |

## Committee performance

The table below provides key data on committee performance during the year:

| | |
|---|---|
| Number of meetings | 4* |
| Attendance | 100% |
| Number of items received and considered | 34 |

* In addition, there were two informal meetings of the JNC and the funding and benefits sub-committee of the JNC met on 10 occasions with business concluded via resolution.

## Key activities in 2014/15

The committee has considered and made decisions or recommendations (as appropriate) on the following key matters during the year:

- The committee, with the support of its funding and benefits sub-committee, has dedicated the majority of its time over the course of the year to consider issues relating to scheme funding, the likely outcome of the 2014 valuation and the structure, affordability and attractiveness of the future benefits provided by the scheme.
- The committee considered proposals for scheme changes from UCU, UUK and an alternative proposal to be considered jointly. At its meeting on 29 January 2015 the committee supported the alternative proposal for scheme changes with a proposed implementation date of 1 April 2016 at the earliest.
- The committee agreed the appointment of a new independent director to the trustee board.
- The enhancement of benefits upon retirement due to incapacity was extended to members with concurrent variable time posts with the execution of the fourteenth deed of amendment.
- The committee considered an amendment to allow members with a USS money purchase AVC fund to defer the securing of an annuity past age 75. This was agreed and executed via a resolution of the trustee board.
- The committee agreed rule amendments via the fifteenth deed of amendment which extended the transitional auto-enrolment provisions for one further year for eligible employees who are re-employed pensioners or flexible retirers. This will maintain the status quo and allow employers who have not yet attained their auto-enrolment staging date to decide whether they would wish to meet their statutory duties for this group of employees via USS or some alternative arrangement. A further review to decide the long term policy will be undertaken in 2015.

The committee dealt with technical changes to allow for shared parental leave from April 2015.

- The changes proposed by the Chancellor of the Exchequer in his 2014 budget, due to come into force from April 2015, were noted by the committee. It was agreed that the additional flexibilities would be considered as part of the scheme change activities.

# Advisory Committee

## Membership & Meetings

Ms Pauline Collins and Mr Cliff Vidgeon acted as chairs of the advisory committee during the period 1 April 2014 to 31 March 2015. The committee is comprised of six ordinary members (appointed equally by UUK and UCU) and two additional members (appointed by UUK board and UCU board) and met three times during the year dealing with 55 items of business. Membership and meeting attendance are set out below:

| | Meetings | |
|---|---|---|
| **Member** | **Eligible to attend** | **Attended** |
| Ms Pauline Collins (chair until 30 June 2014) | 3 | 3 |
| Mr Cliff Vidgeon (chair from 1 July 2014) | 3 | 3 |
| Mr David Goode (until 30 June 2014) | 1 | 1 |
| Mr Denis Linfoot | 3 | 3 |
| Dr Anthony Bruce | 3 | 3 |
| Dr Marion Hersh | 3 | 3 |
| Dr Gordon Watson (from 1 July 2014) | 2 | 2 |
| Dr Angela Roger* | 3 | 2 |
| Professor Dame Glynis Breakwell* | 3 | 3 |
| **Average attendance at meetings** | | **96%** |

*USS Ltd directors appointed to participate solely in consideration of Internal Dispute Resolution (IDR) Cases.

Ms Collins was replaced as chair of the committee on 1 July 2014 by Mr Vidgeon. Mr Goode left the committee and was succeeded by Mr Watson on 1 July 2014. We are grateful to Ms Collins for her contribution as chair of the committee and also to Mr Goode for his contribution to the committee.

In addition to committee members, meetings are usually attended by the Head of Pensions Operations and a legal representative from DLA Piper.

## Role

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, on complaints received from members or participating institutions and any other matters on which the trustee company requires advice.

## Key activities in 2014/2015

- The majority of questions raised on the application or interpretation of the rules of USS were dealt with by senior officers. There were 39 cases which required detailed consideration by the advisory committee during the year.
- 28 cases related to members requesting full commutation of their benefits on the grounds of serious incapacity and in each case the full commutation was granted. This was an increase from 18 cases during the previous reporting year.
- 11 cases were considered at stage two of the IDR procedure (the same number as considered during the previous reporting year). Of these:
  - Four cases related to the effect of the scheme rules, three cases related to decisions regarding early retirement on grounds of incapacity, two cases related to the terms of historic AVC contracts, and two cases related to calculation errors.
  - In ten cases, the officers' decisions at stage one of the IDR procedure were upheld.
  - In one case the complaint was upheld. The officers' decision at stage one of the IDR procedure was also to uphold the complaint, but the complainant also wanted compensation. The advisory committee made an award of £250.
  - One conflict of interest was declared and the committee member absented themselves from consideration of the case.
- In addition to making adjudications on these individual cases the committee considered a number of other areas of the scheme. In particular, the committee considered in detail the procedure and requirements for awarding full commutation of benefits on serious ill-health, and recommended that the JNC review the rules relating to the ways in which members can take their Prudential AVC benefits.

## Chairman

Professor Sir David Eastwood
*Chairman*

## Chair of principal sub-committees

Dr Kevin Carter
*Investment Committee*

Professor Dame Glynis Breakwell
*Policy Committee*

Michael Merton
*Audit Committee*

David McDonnell
*Governance & Nominations*

Cliff Vidgeon
*Advisory Committee*

Sir Andrew Cubie
*Joint Negotiating Committee*

Rene Poisson
*Remuneration Committee*

## Group Executive

**From top left:**

Jeremy Hill
Howard Brindle
Kevin Smith
Guy Coughlan

**From bottom left:**

Jennifer Halliday
Bill Galvin
Roger Gray
Brendan Mulkern

USS

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