Lisa Harley

From: GCEO@uss.co.uk <USS@dotdigital-email.com>
Sent: 10 October 2022 13:25
To: Lisa Harley
Subject: Update from USS

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USS

USS update
10 October 2022

Colleagues,

Some UK defined benefit (DB) pension schemes have been experiencing liquidity issues linked to Liability-Driven Investment (LDI) strategies and recent unprecedented changes in the value of index-linked UK government bonds.

Contrary to the impression recent media coverage may have given, USS is far less affected by these issues than others. Our strategy has elements of LDI but, as one of the relatively few DB schemes in the UK still open to new members, we have relatively higher levels of growth assets. So, liquidity has not been a problem for us – and, perhaps more to the point, rising interest rates mean the scheme's funding position has almost certainly improved.

We would recommend reading this Pensions Expert article, by a partner at Aon Investments, for a balanced and well-informed explanation of recent events.

Excessive use of leverage in an LDI strategy can be difficult to manage in volatile markets – as the associated collateral calls from counterparties might need to be processed more quickly than in more "normal" conditions. In extreme circumstances, this can lead to short-term liquidity issues – and that is what happened when the Chancellor's recent 'mini-budget' triggered a collapse in the price of long-dated index-linked government bonds (also known as 'gilts').

Our approach to monitoring and managing the risks associated with LDI and leverage were set out in our extensive engagement with employers on the scheme's investment strategy over November 2021 to early March 2022. A summary of the Trustee's response to the feedback received can be found here.

This was followed by a formal consultation with employers on proposed revisions to the Trustee's Statement of Investment Principles. A summary of the responses received, and the Trustee's position, can be found here. This shows that our strategy has the broad support of employers who felt strongly enough to give us their views. The programme to develop the strategy was overseen by the Trustee Board's Investment Committee, but the Trustee Board was the ultimate decision-maker.

The concerns with leverage raised in a letter to USS by Cambridge, Oxford and Imperial College – specifically that USS could become a "forced seller" in volatile markets – have not materialised, despite the extreme volatility seen in recent weeks. The statement we published on 28 September sets out how well the in-house team at USS Investment Management has navigated these unprecedented events:

- We were (and remain) very well collateralised in respect of our LDI positions.

- Having an experienced in-house team enabled us to be very responsive and react quickly – so, while the speed of response required was challenging, it was manageable.

- We have not been a forced seller of any assets through this period.

We have actually been a net *buyer* of gilts over the past fortnight – at what we believe to be good prices – so did not contribute to the gilt market collapse and the associated issues some schemes have faced.

Fundamentally, as an open DB scheme, USS is relatively ‘immature’ and has relatively modest levels of liability-matching in place and higher allocations to liquid growth assets (such as developed markets equities) than most other schemes. While we have increased investments in liability-matching assets since 2019, we have done so prudently and in tandem with building our own in-house capabilities.

Perhaps most importantly of all, falling gilt prices are synonymous with rising interest rates – and rising interest rates reduce the value of our liabilities. So, **the scheme is likely to be in an increasingly good position going forward.**

We continue to monitor market conditions and respond as required.

Dame Kate Barker, Chair of the USSL Trustee Board