

USS

UNIVERSITIES SUPERANNUATION SCHEME



Members' Annual Report 2012

Members' Annual Report

2012

- Statement from the Chairman of USS 2/3
- Saving more for your retirement 4/5
- USS website and modelling tools 6/7
 - Auto-enrolment
 - Audit Commission exercise 8/9
 - Good record keeping
- Information security 10
- Pensions increases 11
- Financial summary 12
- Income and expenditure 13/14
 - Distribution of assets
- Responsible investment 15/18
 - Investment performance
- Largest listed bond and equity holdings 19/20
 - Membership statistics
 - Management of the scheme
- Summary Funding Statement 21/27



Statement from the Chairman of USS



Sir Martin Harris
Chairman

The last year has proved to be a challenging time for USS both economically and in terms of scheme change, with the introduction of substantial changes to member benefits and contributions in October 2011, together with turbulent times in many of the world's financial markets.

Looking at the scheme's investment management activities, during the year ended 31 March 2012 the fund's assets increased by 4.4% to a value of £33.9 billion. Investment performance is measured based on the calendar year to 31 December 2011, and over this period the total value of the fund's assets increased by 0.32%, outperforming the overall benchmark return of -0.55%. The most recent actuarial valuation of the scheme, which took place as at 31 March 2011, showed a funding position of 92% and a deficit of £2.9 billion. During the year, the board finalised its proposals for meeting

the funding deficit, in consultation with Universities UK and the University and College Union. The Bank of England's quantitative easing policy has had a substantial effect on the scheme's funding level, in common with many other defined benefit pension schemes. This, together with worries about sovereign debt and the slow pace of economic growth, has had a material impact on the value of the scheme's assets and liabilities. The scheme's latest funding position, at 31 March 2012, shows a funding level of 77% with a deficit of £9.8 billion. These are undoubtedly challenging times. However, the board believes that careful management of the scheme's assets, coupled with a long-term approach to funding and, of course, the ongoing support of the scheme's employers, will ensure that USS remains viable and sustainable for the future. More information about the funding level and the recovery plan are available in the Summary Funding Statement on page 21.

The last year has seen significant changes to HM Revenue & Customs (HMRC) pensions tax rules, in particular relating to the Annual Allowance and Lifetime Allowance, and these will

“More information about the funding level and the recovery plan are available in the Summary Funding Statement on page 21.”

impact upon some scheme members. Options have been introduced for members potentially affected and these can be found on www.uss.co.uk in the ‘Tax relief limits’ section.

Throughout the year, the trustee company has continued to meet high service standards for members. Also, following the scheme review, members joining USS from 1 October 2011 participate in the new Career Revalued Benefits section. There are transitional arrangements in place for individuals who re-join the scheme having previously been a member of the Final Salary section. The scheme changes also saw the introduction of flexible retirement arrangements, and we are beginning to see the first members take advantage of this new facility.

Sir Martin Harris
Chairman



A large print version of this Members’ Annual Report is available on request from USS.
Telephone: 0151 227 4711





Saving more for your retirement

Members can pay extra contributions called **Additional Voluntary Contributions (AVCs)** to buy either additional defined benefits directly with USS or to invest in the USS Money Purchase AVC facility.

AVCs are a tax-efficient way to save

AVCs attract tax relief, which is an incentive to encourage you to save more towards retirement. Standard-rate tax payers save 20% of the AVCs they make from their tax bills, and higher-rate tax payers 40%.

So, if a standard-rate tax payer can afford to save £100 a month from their net pay, £125 is paid into their AVC each month. For a higher-rate tax payer the amount paid into their AVC increases to £166 a month.

Standard-rate tax payer example:

£100
(monthly contribution from net pay)



+

£25
(tax relief at 20%)



=

£125*
(paid each month)



USS members have two AVC options

1. Buy extra USS benefits – Pay an extra contribution directly to USS to increase your annual pension and tax-free sum at retirement.
2. Money Purchase AVCs – Invest your contributions in a fund(s) of your choice and at retirement choose whether to take a tax-free sum (within limits) or use the fund to buy a pension, from USS or from the open market.

AVCs help you reach your retirement goals

Bear in mind that you won't be able to access your savings until retirement, so AVCs should be viewed as a long-term method of saving.

Please note, early exit charges apply to new Money Purchase AVC accounts opened since 19 August 2012. If you retire and draw the funds within five years of opening the account an early charge may apply. To avoid any potential charge, make sure you open a Money Purchase AVC more than five years before you plan to retire.

*equates to a gross contribution of £125.

Tax relief = £125 x 20% = £25



Find out more

Take a look at the 'Additional Voluntary Contributions' factsheet at www.uss.co.uk

Meet with Prudential, USS's Money Purchase AVC provider

You may be able to meet with a Prudential consultant to discuss both of the USS AVC options.

Call 0800 515 914 to find out more.

Contact Prudential

Existing Money Purchase AVC members who wish to switch funds can use the online facility www.pru.co.uk/uss or call Prudential's Customer Services team on 0845 6000 343.

Or, if you want to investigate taking out an AVC, you can speak to a Prudential AVC specialist by calling 0800 515 914.

Prudential is appointed as the sole provider for the USS Money Purchase AVC and provides:

- A UK-based team
- Knowledge of USS
- No pressure
- The same consultant every time you call.



Access your Money Purchase AVC online at any time

If you have a Money Purchase AVC, visit your online account at www.pru.co.uk/uss where you can find information on:

- Fund values
- Viewing individual contribution/plan records
- Switching funds
- Redirecting contributions
- Changing personal details.

On your first log in, your username will be the plan number (U291) and your national insurance number. Your password is your national insurance number.

For example:

Username: U291TN010760F

Password: TN010760F



www.uss.co.uk and modelling tools

We are constantly updating the USS website www.uss.co.uk with the most up to date and relevant information about USS.

Visit www.uss.co.uk to:

- **Download USS publications** including the full Report and Accounts for the year ended 31 March 2012.
- **Watch Pensions TV** for straightforward video presentations about the scheme.
- **Find detailed scheme information.**
- **Complete an 'Expression of wish' form** to let us know who you want to nominate to receive any lump sum payment in the event of your death.
- **Update your contact details.**
- **Use the benefit modeller** if you are currently contributing to USS. You can log in to view your information and to:
 - See what your benefits are worth today and at retirement
 - Vary your retirement package to see the impact on your pension and tax-free cash
 - See the impact of paying additional contributions.

- **Investigate flexible retirement.** The benefit modeller has been updated to provide quotes on the new flexible retirement option that was introduced from 1 October 2011.

- **Check the deferred pensions increase modeller.** If you have left USS, but not yet retired, use this to work out the current value of your benefits.
- **Try the enhanced annual allowance modeller.** HM Revenue & Customs set two limits to the amount of benefits you can earn in a UK pension scheme tax effectively. Exceeding the limits results in tax charges.





Annual Allowance

Currently the Annual Allowance (AA), the maximum annual pension benefit you can earn in the UK without incurring tax charges, is £50,000. This generally only affects those members with long service and higher than average salaries. Final Salary section members can use the benefit modeller to get an estimate of the AA they will potentially use for the 2012/13 year and an estimate for 2011/12 usage. HMRC has confirmed that, if you need to complete a tax return with your AA value, estimated figures are acceptable for the 2011/12 year. USS will provide statements of the AA value from October 2013.

Lifetime Allowance

The Lifetime Allowance (LTA) is a limit to the total retirement 'pot' you can earn in the UK tax effectively. This is currently £1.5 million and will therefore affect only the highest earners in USS. Final Salary section members can get an estimate of the amount of benefit they have built up towards the LTA from the benefit modeller.

Career Revalued Benefit members

- To exceed the AA you will need to have earned a pension of at least £2,630 in one year. Therefore, only the very highest earning members of the Career Revalued Benefit section will be affected (or where substantial extra payments have been made).
- To exceed the LTA you would need a total pension of at least £65,217 a year.





Auto-enrolment

What is auto-enrolment?

You may have heard on the radio, or seen in the press, adverts about 'workplace pension reforms', or 'auto-enrolment'. This government initiative will mean that millions of workers, currently without a pension arrangement, will be enrolled into their workplace pension from October 2012. Auto-enrolment primarily targets employers not currently providing a pension arrangement for employees which meets certain standards. Larger employers will be required to begin auto-enrolling eligible employees from October 2012, with small and medium-sized employers following over several years.

Does it affect you?

Some changes have been made to the USS rules to address specific issues relating to auto-enrolment. These changes centre on eligibility for, and the process of becoming a member of, the scheme. Any impact on current members of the scheme will be limited.

Where can further information be obtained?

Information on auto-enrolment will be added to www.uss.co.uk over the coming months.



Audit Commission exercise

In accordance with the Data Protection Act 1998, Universities Superannuation Scheme Ltd is required to inform you that, along with other organisations, it is taking part in the Audit Commission's National Fraud Initiative 2012/2013.

This initiative checks the data we hold against registered deaths to identify cases where pensions are still being paid despite a pensioner's or another beneficiary's death. This data matching exercise meets the requirements of the data protection law. The Audit Commission will be processing the data for this purpose only, and will comply with data protection principles.

The main purpose of participation is to ensure that USS benefits are paid to the correct beneficiaries. It will also assist in the identification of potential beneficiaries following the death of a deferred member. This will not affect members who are currently contributing to USS and is for information purposes only. **You do not need to take any action.**





Good record keeping – the importance of accurate data

USS places great importance on keeping accurate data and has a dedicated data quality team to ensure that records are correct and fit for purpose.

It works to ensure all information held in relation to USS members is accurate and up to date.

The Pensions Regulator (tPR) aims to improve the standard of record keeping across the industry. The data quality team has been working on the common data framework to enable the scheme to meet tPR's expectations.

Further information in relation to tPR's guidance can be found at www.thepensionsregulator.gov.uk

Your role

Data accuracy is not just restricted to the work of the data quality team at USS; and members also play a vital role. As highlighted by tPR it is important to keep USS informed and we therefore ask that any changes of importance (such as a change of address, name changes, beneficiary nominations etc) are reported to USS as soon as possible. This will help to ensure we continue to comply with regulatory requirements, and ultimately provide you with the correct information relating to your benefits.

Complete a form on www.uss.co.uk to let us know of any change to your circumstances.

Update your details

Deferred or pensioner members

You can use the enclosed form to tell us about any changes. If your surname has changed, you will need to send us a certified copy of an official document supporting the change, so we can update our records.

Members currently contributing

You do not need to notify USS directly; you should notify your employer who will keep your details up to date.



Information security – keeping your data safe

USS takes the security of your personal data very seriously.

Simple actions help us to protect your data and help you to protect your data at home.

Do not send personal data by email. USS does not currently have secure messaging and your data will not be protected. Instead, send a letter or telephone us.

USS will never contact you by email or telephone to verify personal information, nor should any organisation. If contacted this way be extra vigilant. Ask for a name and a contact number for verification.

If you lose information relating to your USS membership and worry it may be used maliciously, then let us know. We can place a marker on your file to help guard against someone trying to impersonate you.

Be protected. We don't leave our physical possessions unprotected, and the same should be true for our digital ones. Internet security software could be as important as an alarm system in your home.



Choose strong passwords that:

- Use letters, numbers and symbols.
- Are at least seven characters long.
- Do not contain your user, real, or company name.
- Contain upper and lower case letters.
- Are changed regularly.

Backup information. Most people leave important data on computers and devices, from financial records to family photos. Backing up files to a USB, external hard drive, or offsite data centre helps protect against loss.

Use a shredding device to securely dispose of documents not needed.

For more advice and guidance visit the government-sponsored website www.getsafeonline.org



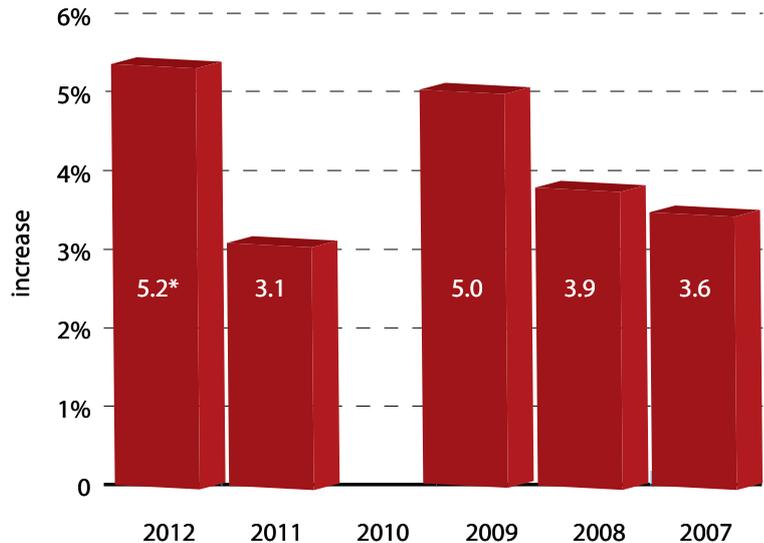
Pensions increases

Pensions in payment and deferred benefits are reviewed annually and increases are applied in line with the rise in 'official pensions', such as those paid to members of public service schemes, for example, the Civil Service, Teachers and NHS pension schemes.

For service built up before October 2011, increases will reflect the full rise in official pensions. Increases to pensions built up from 1 October 2011 will match the rise in official pensions for the first 5%. If official pensions increase by more than 5%, then USS will match half the difference, up to a maximum of 10%.

In periods of negative inflation (deflation), pensions are not reduced but no increase is applied (as was the case in 2010).

In 2012, pension increases were 5.2% (5.1% for benefits built up since 1 October 2011).



*Pension benefits built up since 1 October 2011 are subject to a cap of 5.1%.



Financial summary



Roger Gray
Chief Investment Officer

Over the year to 31 March 2012, USS's assets rose in value by 4.4% or £1.5 billion. However, since reporting to you last year that bond yields were at exceptionally low levels these have declined further. Falling UK gilt yields lead to a lower discount rate being used to calculate the value of the scheme's liabilities, and this increases their value.

As a result, the estimated value of the scheme's liabilities rose by 24% or £8.4 billion over the same period.

USS's investment strategy remains focused on the long term to ensure the scheme remains able to meet its commitments. Whilst the current period is challenging, the scheme's positive cash flow and the profile of its liabilities makes it better able to withstand short-term market volatility than more mature or closed schemes. The scheme's investment performance remains satisfactory. The scheme outperformed its benchmark in the calendar year 2011 by 0.9% and has delivered performance in line with its benchmark over the last five years.

Unfortunately, the investment outlook remains challenging. In the UK it is difficult to predict when bond yields might return to more 'normal' levels. Typically, these rise with expectations of future growth and inflation, or when their safe haven status is in less demand. Repercussions of the 2008 financial crisis continue to reverberate through economies and financial markets and we anticipate a prolonged period of slow growth in many developed countries. The Eurozone crisis also continues a pattern of periods of high tension, followed by a political response which is soon shown to be less complete and robust than first believed.

On the positive side, volatility and uncertainty creates opportunities which longer-term investors can take advantage of. We continue to expand the range of investment capabilities we have to diversify the sources of return that USS is exposed to with the objective of creating a more robust and less volatile stream of returns.

Roger Gray
Chief Investment Officer



Income and expenditure

USS fund account for the year ended 31 March 2012.

	£m
Fund at start of year	32,779.7
Contributions and benefits	
Contributions from members and institutions	1,465.8
Premature retirement scheme receipts	13.4
Transfers-in from other schemes	109.9
Total member income	1,589.1

Expenditure for the year	
Benefits paid	1,408.3
Refunds	30.7
Administration costs	21.5
Total expenditure	1,460.5
Member income less expenditure	128.6

	£m
Returns on investments	
Investment income	832.8
Change in market value of investments	541.9
Investment management expenses	- 48.1
Net returns on investments	1,326.6
Net increase in the fund during the year	1,455.2
Fund at the end of the year	34,234.9

Fund at start of year £32,779.7m	+	Income £1,589.1m	-	Expenditure £1,460.5m	+	Investment return £1,326.6m	=	Fund at end of year £34,234.9m
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Distribution of assets

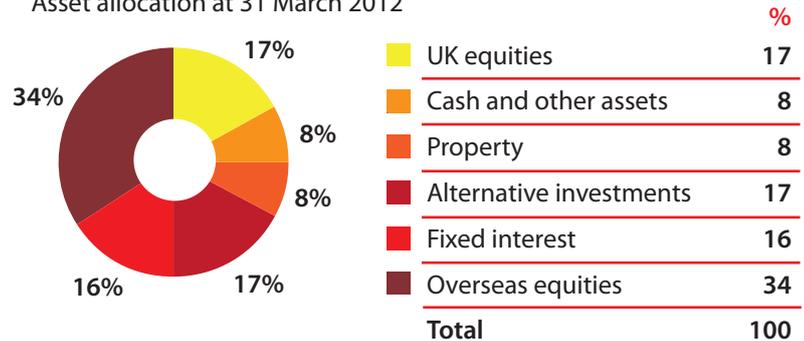
The value of the fund increased from £32.4 billion at 31 March 2011, to £33.9 billion at 31 March 2012 (excluding money market purchase AVC investments held with the Prudential). The distribution of assets at that date is shown to the right. Included within these figures is £5.7 billion of alternative assets.

Following the triennial valuation, USS reviewed its strategic asset allocation (SAA) to ensure it remained appropriate for the scheme.

This resulted in:

- a further reduction in allocation to developed market equities
- a small reduction in the targeted allocation to property
- an increase in the allocation to emerging market equities and infrastructure; and
- a new allocation to emerging market debt.

Asset allocation at 31 March 2012



The SAA review also considered the use of external managers. In line with the scheme's investment beliefs, a decision was made to focus this investment resource in areas where USS does not have proven investment capability. As a result, the global equities mandate managed by Capital International has been terminated. These assets will be used, over time, to fund the new investments in infrastructure and emerging market debt. In contrast, the emerging market debt allocation will be managed by external managers, selected and appointed by USS, as it is not considered cost-effective or efficient to build internal expertise in this area at this time.



Responsible investment

USS continues to strive to integrate environmental, social and governance (ESG) issues across the investment portfolio and be a leader in Responsible Investment (RI). Active ownership of invested assets will lead to better returns over the long term.

USS's RI policy applies to all assets, including those managed externally. USS believes it is critical to encourage those who invest on our behalf to act as responsible investors.

Following the financial crisis, there has been a strong regulatory focus on improving corporate governance. Regulators are encouraging institutional investors to increase their commitment to active ownership of the companies in which they invest, a process which USS has had in place for several years. Over the last year, the fund has responded to regulatory and government consultations from the UK, EU, US, and other markets. The issues addressed include: listing rules, executive remuneration, EU corporate governance standards, a code of stewardship for investors, corporate reporting, long-term investing, Japanese company law and class actions in the US. Engagement with policy makers is an effective way to generate change in corporate behaviour, improve standards and protect investors' interests.

USS also continues to focus on how the fund's internal portfolio managers can better integrate RI into their investment practices. The RI team works to engage with companies where there are material ESG risks, and to integrate this information into investment decisions.

“The fund retains a strong reputation globally on its RI approach...”

The fund retains a strong reputation globally on its RI approach, and regularly works with other pension funds to engage with companies, fund managers and policy makers.

Voting

As part of an ongoing commitment to being an active and responsible shareowner, USS votes on the majority of its holdings at investee company meetings.





Implementation of the USS voting policy, available on www.uss.co.uk, is an important tool for engaging with companies and encouraging better standards of corporate governance. We also participate in company consultations, one-to-one meetings with chairmen and board directors, and collaborative engagements on board-related issues throughout the year.

“... the USS voting policy is an important tool for engaging with companies...”

A topical issue this year has been executive remuneration. USS expects executive pay to be linked to performance and to be aligned with the company's strategic objectives. It should be designed to incentivise management to create long-term shareholder value. USS will vote against remuneration reports of companies which do not meet these standards.

Occasionally USS will also vote against the chairman or members of the remuneration committee when the company has not responded to shareholder engagement and has not adequately

addressed shareholder concerns. For example, as a result of persistent concerns regarding remuneration practices, USS voted against all members of the remuneration committee at the Barclays plc 2012 AGM, and against the chairmen of the remuneration committees at Xstrata plc and Carnival plc.

When USS votes against management at a shareholder meeting, the fund usually writes to the company to explain USS's decision and to encourage them to address concerns regarding, for example, board composition and performance targets that were inappropriate or insufficiently stretching. When voting at UK companies, we aim to voice voting intentions in advance to allow for engagement and dialogue with the board. Further details regarding the fund's voting in 2012 will be available on the website later in the year.

Additional information on our approach to voting, responsible investment, stewardship and USS's policy submissions to recent Government consultations on executive remuneration are currently available on the investment section of www.uss.co.uk

Alternative investments

USS believes that a portfolio of alternative assets can provide attractive investment returns whilst reducing risk through greater diversification. Over the past five years USS has continued to build and develop dedicated legal and alternative investment



teams which allow USS to internally manage our alternative assets, increasing our independence from third party managers.

The past year has seen some notable developments for the alternative investment team. USS made the first investment as part of its new infrastructure strategy to be a direct acquirer of assets. As a direct acquirer, USS can select assets that match its objectives more closely and avoid the third party manager fees it would normally incur. USS was the lead investor in the acquisition of the publicly listed Australian toll-road company ConnectEast and has two seats on the company board.

USS has also materially increased its direct investment activities within private equity, having made 12 direct private equity investments over the past 12 months. The direct approach is starting to bear fruit for the scheme as USS had the first Initial Public Offering (IPO) from its co-investment portfolio earlier this year.



The IPO generated a return of over three times USS's initial investment cost, equivalent to around a 50% annualised return.

“USS is active in a number of initiatives to promote improved investor rights and management accountability.”

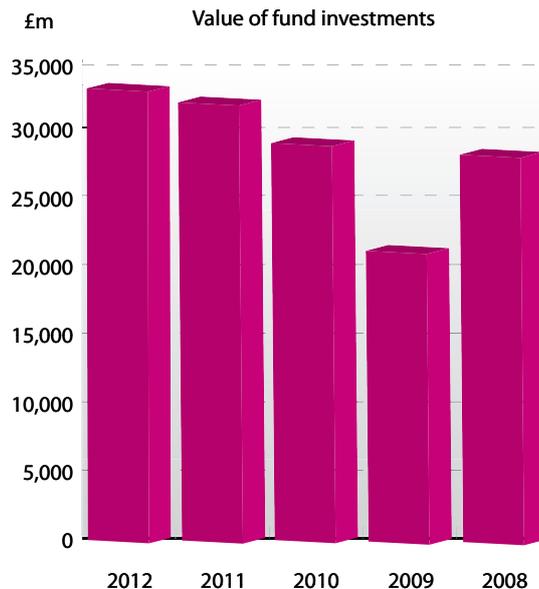
USS is active in a number of initiatives to promote improved investor rights and management accountability. Rigorous transparency and governance requirements have been placed on USS hedge funds, and the London investment office have worked with external managers to ensure an alignment of interest between them as managers and us as investors. USS is a strong campaigner for improved hedge fund governance; we advocate for the boards of hedge funds to be majority independent and consist of directors with experience in the investment, legal and operational aspects of a hedge fund business. We also advocate directors to be transparent regarding the number of directorships they hold, and regulatory authorities to enforce and provide such transparency to investors.



Investment performance

The fund's position has continued to recover from the adverse market conditions experienced in 2008. The five-year returns are below both RPI and average earnings, however, the 10-year returns are above both measures. During the calendar year to 31 December 2011, the total value of the fund's assets increased by 0.32%, outperforming its strategic asset allocation benchmark by 0.9%. Over the last five years, the fund has returned 1.1% a year, in line with its benchmark over that period.

The fund's investments have risen to £34.2 billion as at 31 March 2012 from £32.8 billion in 2011 and from £28.8 billion in 2008.





Largest listed bond and equity holdings

	£m value	%
Royal Dutch Shell	457	1.3
HSBC	358	1.1
Vodafone Group	345	1.0
BP	301	0.9
US Treasury 0.625% IL 22/03/2040	294	0.9
UK Treasury 0.75% IL 22/03/2034	284	0.8
GlaxoSmithKline	280	0.8
British American Tobacco	213	0.6
Rio Tinto	203	0.6
BHP Billiton	192	0.6

A full list of all the fund's holdings, along with information about corporate governance issues, is available from the USS website at www.uss.co.uk/ussinvestments

Membership statistics

19,113 new members joined USS in the 12 months to 31 March 2012.



Active
141,093



Deferred
93,591



Pensioner
52,910



Beneficiaries
9,426

As at 31 March 2012, USS had 374 participating institutions.



Management of the scheme

The directors of the trustee company during the year were as follows:

Appointed by UUK

Sir Martin Harris (Chairman)

David McDonnell CBE DL

Professor David Eastwood

Professor Dame Glynis Breakwell

Appointed by UCU

Dave Guppy

Bill Trythall

Joseph Devlin

Independent

Professor John Bull CBE (Deputy Chairman)

Michael Butcher

Howard Jacobs

Virginia Holmes

Appointed by the Funding Councils*

Steve Egan

*Appointment relinquished with effect from 29 March 2012

The principal officers and advisers of the trustee company at 1 August 2012 were:

Chief Executive: Tom Merchant

Chief Investment Officer: Roger Gray

Chief Financial Officer: David Webster

Pensions Policy Manager: Brendan Mulkern

Pensions Operations Manager: Bernadine Steventon

Company Secretary: Ian Sherlock

Head of IT: Steve Grady

Chief Operating Officer – Investments: Howard Brindle

Actuary: Edwin Topper of Mercer, Manchester, M2 4AW

Solicitors: DLA Piper LLP, Liverpool, L2 0NH

Auditors: KPMG LLP, Manchester, M2 6DS

Bankers: Barclays Bank Plc, Manchester, M2 1HW



Summary Funding Statement as at 31 March 2012

The USS Summary Funding Statement is issued to all scheme members and beneficiaries with information on the financial position of USS updated to 31 March 2012.

The trustee board has recently completed the scheme's valuation, which takes place every three years, and the results are explained in this statement. This latest triennial valuation took place as at 31 March 2011, when the funding level of the scheme on its technical provisions basis was 92%.

By March 2012, the funding position had deteriorated to 77% due to a 24% increase in the liabilities, which had not been matched by a 4.4% increase in the assets. The liabilities of the scheme, that is the present value of the benefit payments to be made in the future, is calculated by 'discounting' the future payments by a factor based on the yield on long-dated UK government bonds (gilts). When gilt yields rise, the discounted value of the liabilities of the scheme reduces. However, the gilt yield is currently at an historically low level because of the current economic climate and the Bank of England's policy of buying gilts, known as 'quantitative easing'.

Whilst members and beneficiaries can take comfort from the fact that their benefits are secure in the UK's second largest pension scheme, backed by a substantial covenant, these are undoubtedly challenging times for pension schemes generally.

USS is a long-term scheme and the trustee board has a long time horizon over which funding can be planned, given the status and longevity of the scheme's sponsoring employers. USS provides secure benefits to almost 300,000 active, deferred and pensioner members, and the trustee board will continue to manage the scheme diligently and, where necessary, to revise scheme funding in conjunction with the scheme's sponsoring employers and other stakeholders to ensure that it continues to meet its commitments both now and in the future.

This statement contains a number of key questions and answers which I trust you will find helpful. A copy of the complete 'Scheme Funding Report' is available on the USS website (www.uss.co.uk).

T H Merchant

Chief Executive

Universities Superannuation Scheme Ltd



Summary Funding Statement continued

How does USS work?

USS delivers a defined set of benefits as set out in the scheme rules. The financing of these benefits is provided by 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 or to their dependants, as well as operating costs for the scheme.

How is the financial position of the scheme measured?

The current financial position is determined by comparing the value of the assets of the fund with an estimate of the current value of the scheme's liabilities, which are the total of all benefits that members have accrued to date and which are to be paid in the future.

Whilst the current value of the scheme's assets is relatively easy to determine, there are always uncertainties inherent in estimating the current value of the accrued liabilities, for example, for what duration a pension might be paid, what level of survivor's benefits might be paid, what rate of return will be received on investments in the future etc. This last factor is used to determine the assets that would be required today to enable the scheme to meet the projected future benefits already accrued by scheme members.

The starting point for determining the assumed rate of return on investments is the yield on UK government bonds, or gilts. This is known as the risk-free rate and a margin is added to this to reflect the trustee board's expectations of future returns given the asset mix in the scheme.

The gilt yield is currently at an historically low level because of the current economic climate, which results in a higher than otherwise value of the scheme's liabilities. Looking over the longer term, a gilt yield averaged over, say, the last twenty years would result in a much improved funding position.

The scheme actuary carries out a full valuation of the scheme every three years. This 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 requires the trustee board to adopt a prudent set of assumptions and it is this basis that is used to determine the funding level and, where appropriate, the extent of any deficit or surplus. The buy-out basis assumes that all of the liabilities of the scheme are to be secured through an insurance company, which would as you might expect be a very expensive way to provide pensions. The fact that we are required to report the position if the scheme were wound up does not, of course, mean that consideration is being given to doing so.

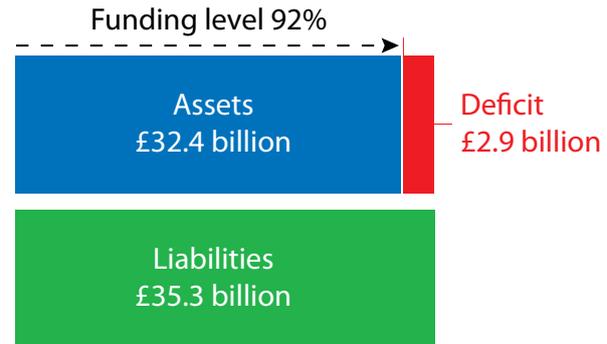
In calculating the value of the scheme's liabilities on any basis, the trustee board must make a number of assumptions about the financial and demographic factors that have an effect. These assumptions, which are explained in greater detail in the Scheme Funding Report, are critical to the valuation process and a great deal of care is taken in deciding upon them. For calculating the value on the technical provisions basis, one of the most important factors is the estimate of future returns from the fund's investments. In calculating the funding on the technical provisions basis, the scheme actuary has assumed that the long-term investment returns for the fund overall will be 1.7% per annum above the return that could be achieved on UK government bonds.

Regardless of the basis adopted, the financial position of the scheme is measured by the funding ratio, which shows what proportion of the scheme's future liabilities, in respect of past service, are covered by the scheme's assets.

What was the position at the last actuarial valuation?

The latest full valuation, as at 31 March 2011, indicated that the funding level was 92% on the technical provisions basis. The assets of the scheme fell short of the total amount required to meet all liabilities, by £2.9 billion.

Funding position as at 31 March 2011 (technical provisions basis)



The funding level on the buy-out basis was 57%.



Summary Funding Statement continued

What has happened since the last statement?

Since the last statement, a number of changes to the benefits provided by the scheme came into force from 1 October 2011. These changes, which will help control the cost of future benefits, but do not affect the liabilities already accrued, include:

- The scheme benefits for new entrants, other than in specific, limited circumstances, are now provided on a Career Revalued Benefits basis rather than a Final Salary basis. This change has created two sections of the scheme, the Final Salary section (generally for those who joined the scheme before 1 October 2011) and the Career Revalued Benefits section for new entrants after 1 October 2011.
- The Normal Pension Age was increased for the future service of existing members and new entrants to age 65. This is likely to increase further in the future in line with increases in state pension age.
- A flexible retirement option was introduced.
- Member contributions increased to 7.5% of salary for Final Salary section members and were set at 6.5% for Career Revalued Benefits section members.

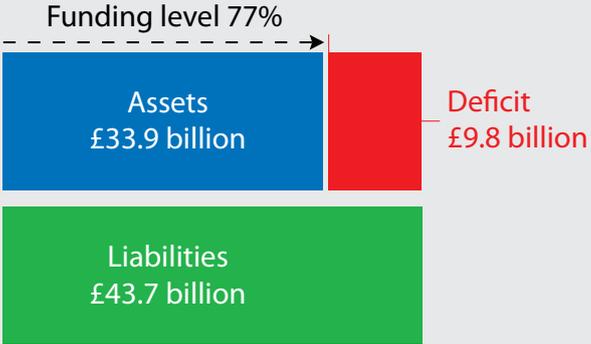
- Cost sharing was introduced so that, in the event that the total contribution level exceeds 23.5% of salary, changes to future benefits may be agreed by the JNC or, failing that, the employers will pay contributions to fund 65% of the additional cost and members would pay a 35% share.
- Increases to pensions in payment or in deferment have been capped for service after 30 September 2011. USS will match increases in 'official pensions' i.e. the pensions payable to members of the public service pension schemes, for the first 5%. If official pensions increase by more than 5% then USS will pay half of the difference up to a maximum increase of 10%.

What is the position of the scheme as at 31 March 2012?

The funding level of the scheme on its technical provisions basis has fallen significantly due to a large increase, 23.8%, in the liabilities, which has not been matched by the 4.4% increase in the assets over the year. The increase in liabilities has primarily been brought about by the historically low yield on gilts resulting from the current economic climate and the Bank of England's policy of buying gilts, which is also known as 'quantitative easing'. This fall in the discount rate means that the present value of future liabilities has increased. It does not mean that the future cashflows are significantly different from those predicted at the last valuation.



Funding position as at 31 March 2012
(technical provisions basis)



The funding level on the buy-out basis was 50%.

The buy-out basis is just one of the alternative bases upon which scheme liabilities can be measured, and historically, the trustee board has used an additional benchmark, the gilts basis, for measuring the financial position of USS compared to the technical provisions basis.

If, instead of assuming a 1.7% per annum return above gilts, we apply a tougher benchmark (a basis that the trustee board has used previously), and assume that we will achieve investment

returns equivalent to the whole of the fund being invested in gilts, the funding position had moved from 68% as at the triennial valuation to 56% as at 31 March 2012.

What is the trustee board’s funding plan?

The scheme’s investment strategy can lead to short-term volatility, but USS is a long-term investor and is able to look ahead 15 or 20 years because of the financial standing of the sponsoring employers, the strength of their commitment to the scheme, and the scheme’s positive cash flow.

To correct the shortfall in the funding level at the date of the valuation, the trustee board has determined, after consulting the employers, a plan to eliminate the shortfall of £2.9 billion over a period of ten years. There are two components to this deficit recovery plan; the payment of additional contributions and the assumption that the scheme’s investments will deliver a return 0.51% per annum greater than the assumption made in the triennial valuation. The first component will involve the employers making payments in the first six years of the recovery plan period at 16% of salaries, which is 3.4% above the cost of accrual determined in the valuation. For the remaining four years the employers will make payments at 2% of salaries in excess of the (then) estimated future cost of accruals.



Summary Funding Statement continued

The trustee board is aware of the need to take all possible steps to maximise the return on the scheme's investments for a given level of risk. The global economic factors, which continue to cause volatility in investment markets, and the response of the UK government to the current situation, which is keeping the yield on gilts very low, are affecting all forms of investment and are not matters which the trustee board can directly influence. However, USS has a broad portfolio of investments and has continued to diversify further, including investment grade bonds, emerging market debt and further investments in infrastructure. This strategy is designed to manage the volatility and risk associated with the funding level. The trustee board believes this is the most appropriate response to these extraordinary conditions and will continue to monitor the situation and adjust the strategy as necessary.

USS can meet all its current pension commitments because the fund continues to have a positive cash flow, in that the fund receives substantially more in contributions and income from investments in a year than it pays out in benefits, which leaves it in a better position to weather these difficult conditions relative to many other schemes in the UK.

More information about the policies of the trustee board can be found in the Statement of Funding Principles and the Statement of Investment Principles, available from the USS website.

What happens if the scheme is wound up and there is not enough money to pay all benefits?

The Government has set up the Pension Protection Fund (PPF) to pay benefits to members in the event that employers become insolvent and are unable to meet their pension commitments. USS is a 'last-man-standing scheme' for PPF purposes, which means that it would only become eligible for the PPF if the vast majority (if not all of) employers in the higher education sector were to become insolvent. Clearly, this is a remote possibility.

However, if such circumstances were ever to occur, the pension you would receive from the PPF might be less than the full benefit you had earned in the scheme, depending on your age, when your benefits were earned and the size of your benefits.



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

Where can you get more information?

If you have any other questions, or would like any more information, please contact the person at your employer who deals with USS matters. A list of documents which provide further information follows. If you would like a copy of any of these documents please refer to the USS website (www.uss.co.uk) or contact USS's Liverpool office. If you require advice about any choice you have to make in relation to USS you should consult a professional adviser.

Additional documents available on request

Statement of Investment Principles. This explains how we invest the money paid into the scheme.

Statement of Funding Principles. This sets out the policies of the trustee board for ensuring that the funding objectives are met and was published as part of the Scheme Funding Report dated 15 June 2012.

USS Investment Beliefs and Guiding Principles. These outline how USS addresses investment and risk management for the scheme.

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.

Report and Accounts for year ended 31 March 2012. This shows the scheme's income and expenditure in 2011/12 and the net assets at the year end.

Scheme Funding Report as at 31 March 2011. This contains the details of the actuary's calculation of the scheme's financial position as at 31 March 2011.

Guide for USS members. This is the members' handbook for the scheme. Members should have been given a copy when they joined the scheme, but any member can get a further copy from their employer.

Further information

Active members should contact their employing institution with any enquiries relating to their benefits.

Deferred members, pensioners and beneficiaries should contact USS directly at:

Universities Superannuation Scheme Ltd,
Royal Liver Building, Liverpool L3 1PY

t: 0151 227 4711 (Local rate 0845 068 1110)

f: 0151 236 3173

w: www.uss.co.uk

The Pensions Advisory Service (TPAS) and the Pensions Ombudsman can be contacted at:

11 Belgrave Road, London, SW1V 1RB

TPAS

t: 0845 601 2923

w: www.pensionsadvisoryservice.org.uk

The Pensions Ombudsman

t: 020 7630 2200

e: enquiries@pensions-ombudsman.org.uk

w: www.pensions-ombudsman.org.uk

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