INVESTMENT & PENSIONS EUROPE

USS warns of 'substantial' deficit as fund returns 7.6%

4 September 2014 **By Taha Lokhandwala (URL=/taha-lokhandwala/2568.bio)**

The £41.6bn (€50.3bn) Universities Superannuation Scheme (USS (URL=/searchResults.aspx?searchCode=1041)) saw a 7.6% return in its last financial year as it continued to consult on resolving its funding shortfall.

The scheme, which provides benefits to the UK's higher education sector, had a deficit of £7.2bn at the end of March 2014, a fall of £4.3bn from a year previous as liabilities reduced on the back of rising Gilt yields and relatively successful investment performance.

However, the 319,000-member scheme is now undergoing its triennial review which is expected to reveal a more substantial deficit, according to USS chairman Sir Martin Harris.

"We anticipate that, once the formal valuation is complete, we shall continue to report a substantial deficit," Harris said in the fund's annual report.

"This continuing deficit and the volatility which exists within the scheme funding position mean that there are some difficult decisions to make in the coming year."

USS said it is currently working with scheme stakeholders to "develop an appropriate response" to the expected deficit, which included a wholesale covenant analysis of the scheme's sponsors.

The open fund is also looking at closing off its final salary section and moving all members to career-revalued earnings (CARE) benefits (URL=http://www.ipe.com/news/uss-looks-to-scrap-final-salary-over-deficit-concerns/10001930.article) – which it began providing in 2011 – after the final salary section shut to new members.

Over the last financial year the fund's investments, 85% of which are managed in-house, performed relatively well, backed by rising equities.

Its 7.6% investment return was demonstrated by a £3bn rise in the value of the fund as USS' internal team delivered a 7.9% return on investments, 1.4% above its benchmark.

Despite positive returns from equities, the fund continued its divestment of the asset class in favour of longer-term alternatives.

It reduced its equity exposure from 50.3% to 43.8% over the year, continuing a decline that saw it reduce holdings by almost 30 percentage points since 2009.

Infrastructure saw its share of the fund rise from 3.6% to 5.1% as USS continued its investment belief by purchasing holdings in Heathrow Airport (URL=http://www.ipe.com/uss-buys-8-stake-in-heathrow-airport/10000255.article) and air traffic control business NATS (URL=http://www.ipe.com/uss-buys-stake-in-air-traffic-control-business-nats/10000439.article) .

USS also bumped up its fixed income exposure by 8.3 percentage points, shifting assets towards sovereign debt and increasing its liability-hedging portfolio – which looks to reduce inflation and interest rate risks.

Its longer-term investment strategy could change after consultation of the fund's stakeholders is completed, Harris said.

Due to auto-enrolment, the fund increased its membership by 4% over the year, adding in 31,000 members to the CARE section, which now accounts for a third of the fund.