Lord Grimstone of Boscobel
Minister for Investment
Department for International Trade

Your ref	
Our ref	BG/JMR
Date	21 January 2021

By email only : Grimstone@trade.gov.uk

Dear Lord Grimstone

Thank you for inviting us to the roundtable with regulators and investors on 3rd December which we found very useful. I apologise for the delay in writing to you.

I thought to share more of our perspective, as I believe that as a long-term 'buy and hold' infrastructure investor that takes our ownership responsibilities very seriously, our views would be of particular interest to you. Our aim is to partner constructively with government across a number of regulated sectors, and to bring our capital to bear in a manner that is in the long-term interests of the USS pension scheme, as well as society in general.

We are currently significantly invested in UK energy, aviation, water and communications sectors, among others. We are primarily concerned with a long term 'fair' return for our pensioners, not maximising short term outcomes. As responsible owners, we are committed to our ownership responsibilities through the economic cycle. We recognise the pressures that must be shared among stakeholders through challenging periods.

It is in this context that I look to raise a concern that in our experience, some Economic Regulators can interpret their duty to protect the interests of consumers too narrowly, resulting in an excessive short-term focus on reducing consumer bills and insufficient recognition of the longer-term consumer harm of under-investment. This has been and continues to be to the detriment of long-term investment in providers which results ultimately in poorer consumer service and insufficient long-term resilience. It can also work to undermine other objectives including decarbonisation – outcomes which ultimately run counter to consumers' best interests in the broader context.

We saw a recent example of this interpretation in the energy sector with Ofgem's final determinations for the 2021-2026 energy network prices which constrains the amount of allowed returns to the energy network companies despite moving quite significantly on costs. This decision is unlikely to attract much needed investment into these companies which could get in the way of unlocking the delivery of the transition to net zero. This announcement seems counter-intuitive coming shortly after two major government publications which set out a high-level ambition for the future of the energy sector (the Prime Minister's Ten Point Plan for a Green Industrial Revolution) and the National Infrastructure Strategy.

Head Office: Royal Liver Building, Liverpool L3 1PY Tel: +44 (0)151 227 4711 Local: 0845 068 1110 Fax: +44 (0)151 236 3173 Website: www.uss.co.uk
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More specifically, we continue to have significant concerns about the way in which the current regulatory framework in the aviation infrastructure sector results in asymmetric risk to investors, which will in our view disincentivise investment. The basis upon which we invested in both Heathrow and NATS was the expectation of a fair return as determined by the regulator, the CAA, with returns being limited both on the upside and on the downside. That regulatory framework has ensured that customers have benefitted both from billions of pounds of capital investment over the past decade and from significant declines in charges (once adjusted for inflation).

This asymmetry of risk to investors was evident in the CAA's recent publication of their RP3i consultation document, further to CMA's determination on NAT's price control review. Our concern relates specifically to the reference in the document that "providers of equity finance" may need to provide additional support, "so that its charges remain affordable and its business financeable". It is the responsibility of the CAA to ensure that the company can finance its activities, and a regulatory determination that is not financeable is a breach of the CAA's statutory duty. While CAA refers to this potential course of action in the context of many other possibilities, this is clearly a departure from the current regulatory framework which was one of the bases upon which we invested in the company.

On a positive note, USS recently announced a major investment in the London-based broadband company, G.Network, in which we agreed to invest £295 million and become a joint controlling shareholder in the company. https://www.uss.co.uk/news-and-views/views-from-uss/2020/12/12152020_uss-has-announced-a-major-investment-in-the-fast-growing-london-based-broadband-company.

For a pension scheme with the need to generate returns to pay pensions for many decades ahead, investing in new infrastructure like this is ideal. Moreover, we believe that the regulatory environment for investment in this sector is conducive to long-term investment with the chief executive of Ofcom, reiterating only last week the need for investors to receive "fair returns" for the money they put to work to help build the UK's gigabit future, something with which we would wholeheartedly agree.

This investment in G.Network should demonstrate that with the appropriate policy and regulatory environment, there can be strong synergies between government priorities and private capital provision. As we embark on an energy transition to low/net zero carbon, there will clearly be a need for significant amount of private capital from high quality investors with the right intentions - the provision of which is much more likely if the regulatory regime is deemed fair and appropriate by investors, and the necessary safeguards are put in place. USS currently has in excess of £1 billion in committed financing to UK renewables and is a longstanding investor in UK onshore and offshore wind.

We therefore note with interest in the recent Energy White Paper the possibility of raising private capital to finance a nuclear power station through a RAB model. USS considers this model to be the cornerstone of UK economic regulation as it gives finance providers - both equity and debt - significant confidence for the long-term about the ability to generate cashflow and earn a reasonable return. It is critical that this model can stand the test of time and the manner of its implementation means that it is viewed by investors as still fit for purpose – it came under significant strain during COVID in certain sectors such as aviation.

To summarise, it is our belief that in order to support long term investment in regulated sectors, the regulation needs to be predictable, transparent and stable and act in line with good regulatory principles. Some recent regulatory actions have undermined this predictability and significantly deterred investment.

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As we stated in our submission in advance of the roundtable there are, in our view, at least four actions that need to be undertaken to bolster investors' confidence in the UK regulatory regime:

i. Some recalibration of regulatory priorities – through a redressing in the balance of statutory objectives, if necessary.
ii. Clear direction from government on a small number of critical strategic priorities for the economic regulated sectors and unambiguous support for them.
iii. A rebalancing of incentives to enable investors/companies to retain a greater portion of the benefits from innovation in order to encourage additional investment.
iv. A longer-term perspective on regulation with potentially longer determination periods.

My colleagues and I stand ready to support you and your colleagues as you embark on the next stage of your deliberations in this area and we look forward to continuing our dialogue.

Please feel free to contact me should you wish to discuss any of the above points.

Yours sincerely

Bill Galvin
Group Chief Executive Officer