

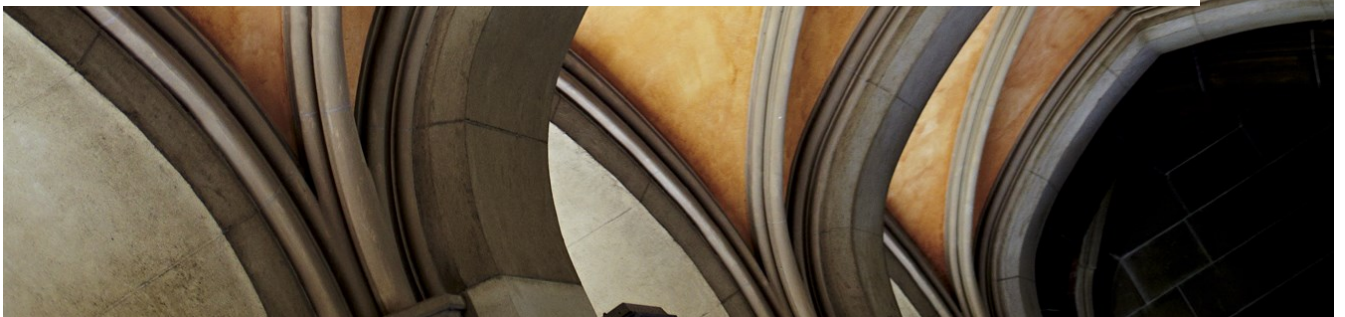


Better regulation and governance, enhanced transparency and improved competition in superannuation

The Treasury

Submission by UniSuper

12 February 2014



Introduction

ABOUT UNISUPER

UniSuper is the superannuation fund dedicated to people working in Australia's higher education and research sectors. With more than 440,000 members and \$40.0 billion funds under management (as at December 2013), UniSuper is one of Australia's largest superannuation funds and has one of the very few open defined benefit schemes.

We would like to draw to your attention some particular aspects of our history included in the Appendix which we believe will provide essential background to our comments on the Discussion Paper.

This submission has been prepared by UniSuper Management Pty Ltd (ABN 91 006 961 799), which acts as the administrator of the Trustee, UniSuper Limited (ABN 54 006 027 121).

UniSuper Management Pty Ltd would welcome the opportunity to discuss the submission further and to provide additional information in respect of the comments made in this submission. Should you have further queries, please contact Benedict Davies, National Technical Adviser on (03) 9910 6670 or benedict.davies@unisuper.com.au or Luke Barrett, Head of Investment Law & Compliance on (03) 9910 6145 or luke.barrett@unisuper.com.au

Part 1: A better approach to regulation

Focus question 1

Since the Cooper Review in 2009, UniSuper has committed significant time and resources to implementing the large swathe of Stronger Super reforms. UniSuper is a ‘profits-for-members’ fund, meaning that it is not part of a larger financial conglomerate. As such, the cost of complying with regulatory change is ultimately borne by our members. Therefore, we support the government’s measures to identify and offset the impost on the industry of new regulation.

We submit that a good way to reduce the burden of regulatory change is for government to provide clear direction on any future reforms at the outset. We believe that future industry reforms should be done in close partnership with industry and with significant guidance. Without significant guidance from government and its agencies, the void of uncertainty is often filled with specialist external advisers. We submit that policy makers instead should be empowered to provide more and detailed guidance on a reform agenda and to work in closer partnership with industry and individual funds to ensure that the regulatory intent is clearly understood. This also has the added benefit of immediate industry feedback on the practical issues arising from regulatory change as well as allowing for an agreed approach to the timeframe for implementing change.

Along similar lines, it is important to emphasise that regulatory relief needs to be finalised well in advance of compliance deadlines in order for funds to be able to benefit from the relief. This even applies to relief in the form of postponements to commencement dates.

There have been numerous examples in the last 24 months of regulatory relief and regulatory changes being finalised too late in the process. When confronted with fast approaching commencement dates, funds are effectively put in a position of having to choose between two alternative courses of action.

On the one hand, funds could choose to implement processes to comply with the regulatory requirements as in force at that time, even though revisions or delays may have been informally foreshadowed. If funds take this approach, those efforts and the associated costs could be thrown away if the regulatory requirements are subsequently changed, abandoned, delayed or the subject of regulatory exemptions.

Alternatively, funds could choose to rely on – or hope that - informally foreshadowed developments are in fact forthcoming. However, if funds take this approach, there is a risk that the relief may not be provided, or may be provided in a form which is not as generous as

expected, in which case those funds would be at risk of not being able to comply with the regulatory requirements when they come into effect.

A recent example is the relief provided in December 2013 with regard to the inclusion of MySuper product dashboards with periodic statements and exit statements. That relief was provided only two weeks before the requirements took effect.

Another (current) example is the portfolio holdings disclosure regime. Blanket disclosure obligations are currently in place in the legislation and the commencement date is approaching. However, there is a distinct lack of detail around how the disclosure is to be made and, indeed, this is something which the Government is, fortunately, still consulting with industry about as part of this very consultation process. In the meantime, the fact that the commencement date for the (unabridged) disclosure requirements is approaching is a source of real discomfort. There is a desire to commence preparations, but substantial uncertainty as to what preparations can efficiently be undertaken, given the potential (and need) for significant change.

As a general proposition, industry would benefit from Government and regulators ensuring that regulatory relief and modifications are provided reasonably in advance of commencement dates.

Part 2: Better governance

UniSuper agrees that good governance arrangements are fundamental to the stability and efficiency of the Australian superannuation system. While we have no specific comments on the Focus Questions in Part 2, we believe it is important for us to provide an outline to Treasury of our Board structure and Consultative Committee for your consideration before making any final recommendations.

UniSuper Board of Directors

Independent directors	Directors representing members	Directors representing employers
Chris Cuffe (Chairman) Ian Martin Melda Donnelly	Elected by the Consultative Committee: Professor Michael Skully Keith Tull	Elected by Vice-Chancellors: Professor Paul Johnson Professor Jane den Hollander
	Appointed by national unions: Grahame McCulloch Neville Kitchin	Elected by the Consultative Committee: Dr Susan Gould Warren Snell

* Plus independent non-directors on Board Committees



UniSuper's Board

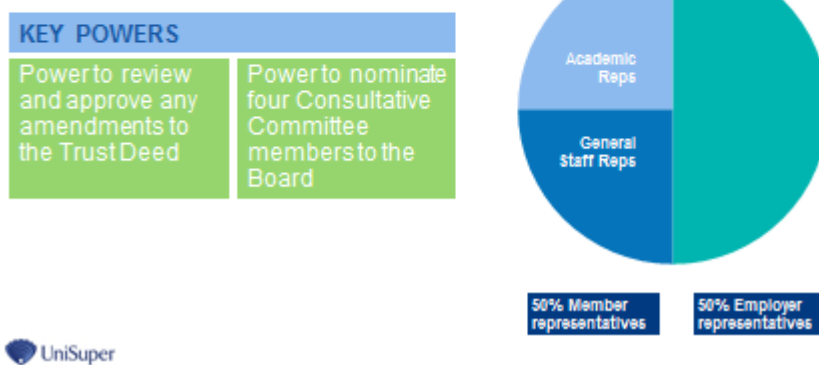
UniSuper's Board comprises three independent directors, four employer representative directors and four member representatives. The Chair position on the Board has always been filled by an independent director and UniSuper took a number of active steps in 2005 to supplement the skills and professionalism of its Board by adding two further independent directors. The initiative was approved by APRA on certain conditions relating to quorum and voting requirements in the event of any disputed Board decisions.

The three independent directors are all highly experienced finance industry professionals having wide-ranging experience as well as all having held finance industry Chief Executive Officer positions. UniSuper's Board Committees are enhanced by independent expert members who are not Trustees but who have specific expertise relating to the Committees' mandate.

These measures mean that UniSuper is leading the industry by ensuring that the interests of members are being served at the highest governance level of our fund.

What is the Consultative Committee?

- Representatives of Employers, Academic members and Non-Academic members
- Established by the Trust Deed in 1983



The Consultative Committee

The Consultative Committee is an integral part of the Fund’s governance and decision-making process. The Committee comprises four representatives from each participating employer (University), of whom two represent employees (one each from academic and general staff) and two represent employers. Assuming a full complement (i.e. no vacancies) the Committee has 136 members, who are selected through a variety of institution specific election / nomination processes and generally serve for terms of four years.

The Consultative Committee is not simply a “sounding board” but has real authority, being the one body that can approve changes to UniSuper’s Trust Deed. That is, the UniSuper Board cannot approve Deed changes on its own authority (except in very limited circumstances).

Finally, the Consultative Committee functions as an “electoral college” with authority to elect from its ranks four of the eight representative trustees on the Board of UniSuper Limited. The other four representative positions are nominated by the peak bodies for each constituency viz: the Vice Chancellors of Australia’s universities on the employer side and the National Tertiary Education Union (NTEU) on the member side.

This combination of measures means that UniSuper has genuine participation in its governance framework by each of its key stakeholder groups, and a significant additional layer of accountability for its Board and Management beyond what is mandated by regulation.

Part 3: Enhanced transparency

Focus Question 13

If the content requirements for a MySuper product could be perfected, it would be logical for the same requirements to apply to the product dashboard for a choice product. This would promote consistency and ease of comparability across products.

However, we have significant concerns and objections to the requirements relating to dashboards for MySuper products – in particular, the definition of ‘return target’ and the various measures of investment performance. Those requirements create a real risk of members being misled about the nature of a MySuper product. These concerns are shared by others within industry.

The pursuit of consistency should not come at the expense of extending these problems to choice products.

Ideally, these problems should first be addressed in the context of MySuper products and, once the requirements have been bedded down, the same requirements could then be extended to choice products.

However, if Government is not inclined to revisit the requirements applying to MySuper products, the problems we have alluded to ought to be addressed by adopting different rules for dashboards for choice products (i.e. at the expense of consistency).

The problems alluded to above are outlined in our responses to Focus Question 14 and Focus Question 15.

Focus Question 14

It is not appropriate to require choice products to have a return target which is tied to CPI.

We would go further and say that it is inappropriate for MySuper products to be required to have a return target which is tied to CPI, as is currently the case.

The Investment Governance Prudential Standard imposes an obligation on trustees to formulate investment objectives, but leaves trustees with a broad discretion as to what investment objectives they can adopt.

In our view, it is not appropriate for a data collection or disclosure requirement to constrain the manner in which trustees formulate their investment objectives. If the best interests of members and the prudential standards call for a particular type of investment objective to be adopted, the rules relating to product dashboards should not prevent a trustee from adopting the investment objective which is best suited to its members.

It is entirely conceivable that the most appropriate investment objective might be one which is not linked to CPI. For example, the most appropriate investment objective might be one which targets an absolute rate of return, or one which aims to track the returns of some market index, or to out-perform a market benchmark. Further still, a trustee may wish to adopt an investment objective which aims to generate a particular yield. If confronted with this situation, trustees would have to choose between the following courses of action, neither of which is desirable:

- (1) The trustee might adopt the investment objective which is most appropriate (i.e. the objective which is not linked to CPI), in which case they would have to disclose a CPI-linked return target to members through the product dashboard. This would be undesirable because the disclosure requirements would preclude the product from being 'true to label'. It is misleading to suggest that the trustee is targeting an investment return which is fundamentally different from the true investment objective.
- (2) Alternatively, in the spirit of being true to label, the trustee might adopt a sub-optimal investment objective which is linked to CPI (instead of a more appropriate objective which might be unrelated to CPI), simply so they can prepare product dashboards which are true and not misleading.

Forcing trustees to publish CPI-linked return targets therefore creates real problems for industry.

However, there is a deeper and more fundamental problem with the 'return target' concept. APRA has defined 'return target' in one of its reporting standards in a very prescriptive fashion. In essence, the return target must be the rate of return which the trustee has exactly 50% confidence in achieving. This is a low level of confidence, since it implies that there is just as much chance of 'falling short' as there is of achieving the return target.

UniSuper has traditionally maintained far higher levels of discipline when setting its investment objectives. UniSuper has traditionally adopted investment objectives which it is 60 – 70% confident of achieving. By making it compulsory to have lower confidence levels, trustees have been forced to disclose return targets which are significantly higher than the true investment objective. This has the real potential to mislead members as to what return is being targeted and creates unrealistic expectations. To give an example, UniSuper's MySuper product had a long standing investment objective of CPI + 3%. However, the requirements applying to MySuper dashboards (in particular, the definition of 'return target'), forced UniSuper to publish a return target of CPI + 4.8%. This makes UniSuper's MySuper

product appear almost as aggressive as its High Growth option, which could be misleading to members.

The definition of 'return target' needs to be revisited in the MySuper context and the current definition should certainly not be used in the context of dashboards for choice products.

Focus Question 15

Trustees should be permitted to include the net investment return (i.e. investment return net of investment expenses only) in the product dashboard. This comment applies to dashboards for choice products, and dashboards for MySuper products.

The problem with disclosing net returns (i.e. investment return net of all expenses) is that this often involves converting dollar-based administration fees into a percentage on the assumption that a member has an account balance of exactly \$50,000.

This results in the dashboards systemically over-stating and under-stating returns to virtually all members (i.e. all members whose account balances are not exactly \$50,000). For example, if a member has an account balance of less than \$50,000, their returns will be overstated. Conversely, returns will be understated for members with account balances over \$50,000.

The net return (as defined) will be misleading for almost all members. In contrast, the net investment return figure would be correct for every member. In our view, it would be better for funds to disclose the net investment return and then to separately note that this figure does not take into account dollar-based administration fees. In any event, as a general philosophical proposition, investment returns and investment expenses are fundamentally distinct from administration expenses and we would therefore go further and say that, even if all funds charged percentage-based administration fees, the disclosure of investment performance should still not be blurred by incorporating administration fees.

Focus Question 16

The problem with the current risk classification methodology is that it only focusses on how often negative returns are expected to occur within a 20 year period. This approach disregards the very important question of how severe those negative returns might be. It creates anomalous situations whereby investment options which are low-risk products can be classified as being more risky than other products which are actually more risky.

For example, an investment option which might have negative returns of -0.2% four times in 20 years ends up with a higher risk classification than an option which might have negative returns of -10% two times in 20 years.

To address this issue, we believe it would be preferable for members to be given a sense of how severe the negative years may be (i.e. in addition to informing members of how often negative returns may occur). An additional risk measure could be developed based on the 'tail conditional expectation' vis-à-vis the distribution of returns for the relevant products. In lay terms, this type of measure would give members a sense of 'how bad the bad years could be, on average'.

We believe this would be more meaningful than a new risk measure which focusses on the risk of underperforming AWOTE. If dashboards include a CPI-linked return target, members will already be receiving information (in the form of the mandatory graph) as to how often that CPI-linked target has been achieved over rolling 10 year periods.

Focus Question 17

Given the idiosyncrasies of defined benefit funds, we would assume that the product dashboard requirements would not apply to defined benefit funds or, if they are to apply, that substantially different content requirements would be developed. For example, given that the investment objective for a defined benefit fund will often focus on maintaining its overall funding position at an appropriate level, it would not be appropriate to compel trustees to disclose a CPI-linked return target. Equally, long-term graphs of investment returns could be misleading and open to misinterpretation as it will not be apparent to members whether or not the investment strategy had changed substantially over the relevant period or whether the returns achieved were adequate (or not) to maintain funding levels at an appropriate level.

Focus Question 19

Industry will need significantly more time to implement product dashboards for choice products, as many funds will potentially have a large number of choice products. In UniSuper's case, more than 45 product dashboards will have to be maintained.

In our view, the commencement date should be six months after all the content requirements have been finalised. This is because funds will need about six months to comply with the requirements, starting from when they know what those requirements are. Many of the figures included in the dashboard (e.g. return targets and the particular kinds of return data) require detailed actuarial and mathematical calculations to be performed. In many cases, the particular kinds of data would not have been calculated before.

On a separate but related note, industry would benefit if the dashboard requirements allowed multiple products to be included in a single dashboard, especially where there are significant similarities between the products. For example, UniSuper has an accumulation and a

pension version of each of its investment options. Each version is effectively the same product, although they may have different fees and different investment returns due to their different tax treatment and the fee differential. It would be efficient if one dashboard could be issued to both accumulation and pension members, rather than having separate dashboards for the same investment option depending on whether or not the recipient is an accumulation member or a pensioner.

Focus Question 20

UniSuper reiterates the significant concerns which it has raised in numerous earlier submissions on portfolio holdings disclosure.

UniSuper is an advocate of transparent disclosure of relevant information to members. However, earlier proposals concerning portfolio holdings disclosure go far beyond what is relevant, useful or practical.

In UniSuper's case, some options will potentially have exposure to over 15,000 securities. This will require the publication of reports which run for several hundred pages, for each option. In UniSuper's case, reports may have to be prepared for 15 investment options or, at worst, for 30 investment options if separate reports are required for the pension version of each investment option.

That said, it will be completely meaningless to members to publish a blended report which discloses holdings on a whole of fund basis. If the disclosure is to be made, it should be done on an option-by-option basis in order to be relevant and meaningful to members.

UniSuper supports the proposal which would excuse funds from having to disclose investments which are held by (unrelated) collective investment vehicles. However, this reform would not be enough on its own. A materiality threshold is required, as canvassed below in relation to Focus Questions 23 – 25.

We also point out that the disclosure requirements will put superannuation funds at a significant disadvantage when dealing in the secondary market for unlisted assets. The proposed disclosure requirements will give other domestic and foreign institutional investors an unfair informational advantage over Australian based superannuation funds. In a commercial negotiation, it is very valuable to know how much the other party values the relevant asset. For example, when buying an asset from a superannuation fund, it is very useful to know how much the superannuation fund values the asset – it might be difficult, for example, for the superannuation fund (as seller) to argue that an asset is worth more than they themselves have valued the asset in their books. As such, superannuation funds will be at a tactical disadvantage when endeavouring to sell their unlisted assets, since the

purchaser will be able to ascertain the book value from the superannuation fund's website. The converse will apply when a superannuation fund is attempting to acquire further holdings in an unlisted company in which it has already invested. Typically a buyer may seek to drive down the purchase price but, again, it will be difficult for a superannuation fund to push down the price when it will be apparent from their website that they in fact value the asset more highly.

The draft regulations focus on disclosure with regard to MySuper products and choice products. It is unclear how the requirements are intended to apply to defined benefit funds, if at all. Clarification in this regard is necessary.

It is completely unclear how derivative exposures are expected to be disclosed, if at all and whether those positions should be disclosed on the basis of effective exposure or on a profit / loss basis. Sophisticated funds utilise a wide range of derivatives and different considerations arise depending on the type of derivative concerned, for example, currency hedging, interest rate swaps, stock-specific call and put options, as well as share price index futures, to name a few. We assume that derivative exposures to particular stocks and currencies are not expected to be taken into account when calculating the direct exposure to the relevant stock or currency.

Focus Question 22

As noted above, it will be completely meaningless to members to publish a blended report which discloses holdings on a whole of fund basis. If the disclosure is to be made, it should be done on an option-by-option basis in order to be relevant and meaningful to members.

Focus Questions 23 & 25

As noted above, in UniSuper's case, some options will potentially have exposure to over 15,000 securities. This will require the publication of reports which run for several hundred pages, for each option. In UniSuper's case, reports may have to be prepared for 15 investment options or, at worst, for 30 investment options if separate reports are required for the pension version of each investment option.

We urge Government to exercise the power which was specifically included in the legislation to prescribe a materiality threshold so that portfolio holdings can be disclosed in a meaningful, targeted and accessible way. For example, a materiality threshold might focus on the top 50 holdings of an option, or on those holdings that represent more than say 1% of the portfolio, and only require the percentage weighting to be disclosed (rather than the number of shares and the price per share). This would reduce the list to a more

manageable size and would potentially enable the list to be included in the relevant product dashboard.

Focus Question 26

The commencement date for portfolio holdings disclosure should be postponed until at least 1 January 2015 and until at least 12 months after the disclosure requirements have been finalised. Only once the requirements have been finalised will funds be able to take meaningful steps towards complying with the requirements. This will be a major burden for funds and their custodians and will potentially involve lengthy discussions with external investment managers and collective investment vehicles. For large funds like UniSuper, this may involve discussions with several hundred external managers and vehicles. A logistical exercise such as this will require a substantial amount of time.

Part 4: Enhanced competition in the default superannuation market

UniSuper manages both defined benefit and accumulation superannuation on behalf of 440,000 members. There are two default options which ultimately depend on the employment arrangements between our members and their employers. Typically, full-time employees in the higher education and research sectors are defaulted into our defined benefit division but have 24 months to choose to move to an accumulation option (which since November 2013 contains a MySuper option). Those who are not eligible to join the defined benefit division (generally casual employees and those on short-term contracts) are defaulted by their employers into our Accumulation 1 product, and where no investment direction is given, the contributions are paid into our MySuper option. Therefore, we effectively manage default contributions in two different contexts viz: as a defined benefit fund and as an authorised provider of MySuper.

Focus question 27

The existing model is still in its infancy, having commenced on 1 January 2014. The first stage of this process, completed on 31 December 2013, saw the removal from modern awards of superannuation funds that do not have a MySuper authorisation. Importantly, at the same time, a term was added to ensure that default contributions could continue to be made to defined benefit funds and exempt public sector schemes on an on-going basis.

While we believe the process followed to-date by the Fair Work Commission has had a minimum of red tape, we are concerned that the next steps will involve funds in an altogether new process of applying to an industrial authority to have their MySuper products assessed for inclusion on the Default List of MySuper products.

The number of funds named in a Modern Award will not necessarily be a sign of a contestable market. We submit that a contestable system would actually be one that allows employers to choose from the diversity of default funds, provided that the fund has a MySuper option, a defined benefit option or is an exempt public sector scheme.

Focus question 28

It is our observation that the *Stronger Super* reforms have already delivered better outcomes across the industry for members and their employers by “*raising the bar for those managing*

our superannuation system, particularly for those managing default superannuation funds”¹

These reforms have clearly required substantially more from those managing default funds. Consequently, we would argue that it is too early to say whether the system should require additional criteria above-and-beyond those required to be authorised to offer a MySuper product.

Further, as stated above, UniSuper submits that employers should be able to choose a default fund from any eligible default fund provided it has a MySuper option, a defined benefit option or is an exempt public sector scheme.

Focus question 29

We make no comment on this focus question.

Focus question 30

We believe that having an additional “filter” in the form of an advisory list of high quality funds would add limited value.

Focus question 31

We make no comment on this focus question.

¹ Australian Government, ‘*Stronger Super*’ – Government response to the Super System Review, (2010) 1
http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf

Appendix 1: About UniSuper

UniSuper, established in 1983, was initially called the Superannuation Scheme for Australian Universities (SSAU), as a defined benefit (DB) scheme modelled broadly on then contemporary DB schemes in the Australian public sector and overseas peer funds such as the Universities Superannuation Scheme (USS) in the United Kingdom. The benefit design from its outset offered full portability of benefits across all participating employers and coverage of all permanent employees in the sector, including general, academic and professional staff.

The multi-employer nature of SSAU led to some important distinguishing features from its commencement, in particular:

- a fixed contribution rate of 14% of salary p.a. for employers and 7% for members;
- by covering the whole university sector, members can maintain defined benefit membership when transferring between employers;
- members can defer their benefits (so maintain membership) through periods when not employed in the university sector;
- a formula-based benefit related to member's salary, tenure and employment experience.

Over its foundation years, SSAU succeeded in obtaining close-to complete coverage of permanent employees in the Australian university sector and from “folding in” a large number of legacy DB superannuation and pension schemes from individual institutions on a successor fund and/or optional transfer basis.

In the late 1980s, with the advent of Award Superannuation, a second multi-employer scheme, the Tertiary Education Superannuation Scheme (TESS) was established as an accumulation fund to accept the new 3% award (and later SG) contributions of employees who were not eligible to join SSAU, such as casual and short-term contract staff. Existing and future SSAU members also became TESS members for this 3% award contribution.

Over the ensuing years, both SSAU and TESS operated side by side as dedicated superannuation providers to the university sector with a common administrator (UniSuper Management Pty Ltd), until the two funds formally merged in 2000 to form UniSuper Limited as it exists today.

Today, the original SSAU scheme lives on in the form of the UniSuper Defined Benefit Division (DBD), which remains funded by the original 14% employer contribution and 7% default member contribution (although now members can reduce their member contributions

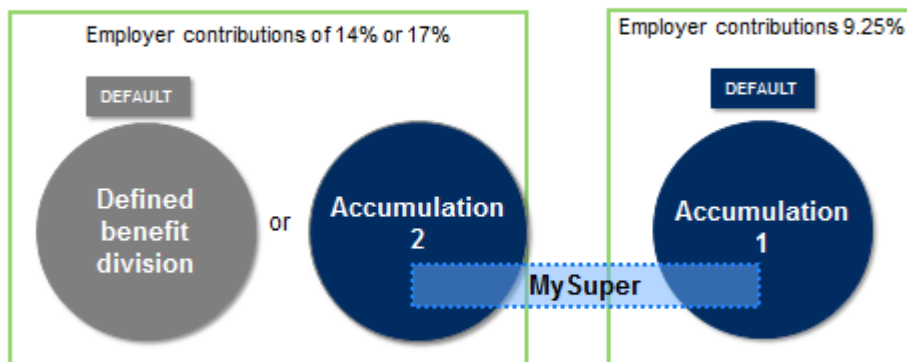
below 7%, with appropriate benefit adjustments). The original 3% TESS award employer contributions are either held in an associated DBD accumulation account or an Accumulation 1 account for members who are not entitled to DBD membership.

A defined accumulation option was also introduced in 1998 as an alternative to DBD membership. This is an accumulation based benefit division (“Accumulation 2”) based on the same 14% employer contributions paid by participating employers.

In 2013, UniSuper received authorisation from APRA to offer a MySuper product which now forms a default option for members who are not eligible to join the defined benefit division.

UniSuper membership categories

Membership category is determined by employers



- Members can choose between DB and Accumulation 2 categories within their first 24 months of membership
- Accumulation members who give no investment direction will be placed in UniSuper's MySuper offering

For more information about UniSuper, please visit www.unisuper.com.au