

22 February 2012

Mr Shon Fletcher
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Email: corporations.joint@parliament.gov.au

Dear Mr Fletcher,

INQUIRY INTO THE SUPER ANNUATION LEGISLATION AMENDMENT (MYSUPER CORE PROVISIONS) BILL 2011

Dimensional appreciates this opportunity to submit a paper to the Parliamentary Joint Committee (“PJC”) on the MySuper Core Provisions at this late stage.

Overview

As a global asset manager at the forefront of innovation in retirement solutions, Dimensional applauds the federal government’s intention to reform superannuation to create a more efficient system that maximises the chances of an adequate income in retirement for millions of Australians.

This submission makes three broad points:

- 1. Seeking to maximise the value of a superannuation portfolio at retirement is not the best objective for an individual investor. This approach significantly increases the downside risk of having insufficient income in retirement.**
- 2. Dimensional has pioneered in Europe and the US a solution that focuses on generating an inflation-protected income for members. This solution dynamically manages the risk around this goal and does so irrespective of the level of engagement of individual members.**
- 3. In drafting regulations around the design features of MySuper default products, flexibility should be built into the system to provide for solutions that give greater consideration to the circumstances, experiences, goals and existing assets of individual members.**

About Dimensional

Dimensional, which was established in 1981, is a wholesale funds management firm with approximately \$207 billion in assets under management globally, including about \$18 billion on behalf of Australian and New Zealand investors. Our clients are institutional investors and fee based advisers who access our funds through an administration platform. Our approach is structured, non-forecasting and our fees are low. We are not traditionally active in the sense of making forecasts or timing the market. But neither are we traditionally passive in the sense of trying to match commercial indices. Recently, Dimensional has expanded its offering to include a retirement planning and investment solution developed by Nobel laureate and Harvard Business School University Professor Emeritus Robert Merton. He is currently Resident Scientist at Dimensional.

The Dimensional Approach to Retirement Income

The idea behind our solution is to provide many of the benefits of a defined benefit plan (targeted, inflation-protected retirement income) within the context of a defined contribution plan.

Our evidence-based approach seeks to manage individuals' assets to produce a desired and tailored income stream for those individuals in retirement, rather than trying to maximize portfolio value for a cohort of people. We see this as a simple, transparent and effective solution for members in a superannuation fund who are either overwhelmed by choice in retirement savings options, do not feel comfortable or skilled in making investment decisions or are just not sufficiently engaged to make the important decisions.

At each step the focus is to maximise the probability that members will reach their retirement income goals and to minimise the risk of the member ending up below a certain minimum income. The real risk in an open superannuation scheme is the risk that there will be too little income in retirement, and that the fund fails to take into account the unique circumstances of individual members.

The solution outlined above is already being implemented in Europe. Within Dimensional it is referred to as 'Managed DC' (as in Managed Defined Contribution). It is similar in concept to existing lifecycle or target-date funds, but with significant improvements that reduce the investment risks to individuals that can be inherent within these funds.

We see existing lifecycle funds as limiting the prospect of successful investor outcomes. This is because they focus on the volatility of returns, which is not a good measure of shortfall risk. As well, they ignore the impact of other assets, thus overlooking individual circumstances and experiences. Similarly, we see target date funds as limited because they aggregate individuals' assets according to only one factor - their retirement date. They target a glide path for the investment profile, but not the goal of a specified income in retirement. Importantly, they do not consider inflation, changed market conditions or the impact of other assets owned by the individual.

Lifecycle Exception

Dimensional strongly supports the federal government's approach to its review of superannuation and the aims of making the system stronger, more efficient and better able to ensure members receive an adequate income in retirement. Making the superannuation system more effective in providing retirement income streams is also at the core of Dimensional's thinking.

With respect to the MySuper core criteria, Dimensional believes that there is a strong case that default funds provided to members – irrespective of their individual level of engagement with their super – have the following features:

- a single diversified investment strategy,
- be universally available to members of a fund, and
- use consistent administrative and fee processes.

Dimensional is particularly supportive of the ‘lifecycle exception’ contained at section 29TC(2) of the draft Bill reproduced below:

29TC Characteristics of a MySuper product

- (2) A ***lifecycle exception*** is a rule under the governing rules of the fund that allows gains and losses from different classes of asset of the fund to be streamed to different subclasses of the members of the fund who hold a MySuper product:
- (a) on the basis, and only on the basis, of the age of those members; or
 - (b) on the basis of the age of those members and other prescribed factors; or
 - (c) on the basis of the age of those members and other prescribed factors in prescribed circumstances.

Dimensional understands that the PJC is currently considering the form that the regulations should take in regards to defining what “prescribed factors” and “prescribed circumstances” should be taken into account under the lifecycle exception.

Dimensional strongly believes that trustees should not be exempt from seeking to personalise the investment process just because a member elects for the default option. That MySuper is primarily designed for disengaged members should in our view heighten, not lessen, the need to manage the risk that members do not achieve their individual retirement income goals.

A simple lifecycle fund based solely on the age of individual members ignores the fact that members still have individual retirement goals in terms of the level of income they will require at the end of their working lives. Rather than a simple ‘set and forget’ investment strategy, our solution is designed to take account of a member’s pre-established goals and requires the trustee to monitor both investment strategy and each member’s basic circumstances, to ensure that necessary adjustments are made to the ‘flight path’.

Our solution allows both individual members and trustees to quantitatively monitor individual flight paths, to see how they are tracking toward their pre-established retirement income goals. The trustee can then make the necessary adjustments to allow for movements in interest rates, markets and inflation, as well as for significant changes to the circumstances of each member. While our solution still supports the concept of ‘auto pilot’ and minimal member engagement, it is designed to more clearly reflect each member’s retirement destination and makes adjustments to the ‘flight path’ when economic or member circumstances dictate.

Dimensional's Recommendation

For the purposes of section **29TC(2)(b) and (c)**, Dimensional recommends that the regulations are drafted with sufficient flexibility so as to allow trustees to take into account important factors and circumstances such as:-

- **age,**
- **member salary and contribution rates,**
- **personal retirement income objectives,**
- **desired retirement age,**
- **members' personal investment experiences and**
- **the age pension.**

We would be happy to discuss our submission and its contents with you. Please do not hesitate to contact the undersigned to arrange any discussion you require.

Yours faithfully

Glenn Crane

Chairman and Chief Executive Officer

DFA Australia Limited

Appendix

About Dimensional

Dimensional builds diversified portfolios around known dimensions of risk. We focus on consistently capturing those risk premiums and adding value through efficient implementation and ongoing management. Our innovations have been developed on a global basis with the express aim of maximising investors' ability to have a good investment experience and mitigate capital loss.

Formed in 1981, Dimensional's foundations are in academia. Our investment strategies are informed by the research of such prominent financial economists as Professors Eugene Fama of the University of Chicago and Kenneth French of Dartmouth College. Our confidence in the capital markets frees us to think differently about investing. Over the past 30 years, we have translated financial science into real world investment solutions, and through our innovative approach, investors have captured what the market delivers in all its dimensions.

The firm inaugurated its strategies in 1981 with early research into the stronger performance of small cap stocks. Later, a comprehensive analysis of stock prices worldwide deepened the strategy repertoire and set a new standard for portfolio design. This evolution reflects an abiding belief in financial science and the efficacy of capital markets.

We see markets as an ally, not an adversary. Rather than trying to take advantage of the ways markets are mistaken, we take advantage of the ways markets are right--the ways they compensate investors. The firm designs portfolios to help our investors capture what the market delivers.

Dimensional is owned primarily by employees and directors, and manages assets exclusively for institutional investors and the clients of accredited fee based financial advisors. From offices in Austin, Santa Monica, London, Sydney, and Vancouver our professional staff supervises portfolios and services clients twenty-four hours a day.

DFA Australia Limited is the wholly owned Australian subsidiary of Dimensional Fund Advisors and is licensed to provide funds management services in Australia and the US. DFA Australia Limited was established in 1994 to trade securities listed on the Asia Pacific stock markets on behalf of Dimensional's US institutional investors and the clients of US financial advisors.

Research

A scientific priority runs deep through Dimensional. We have a high regard for research, process, and time-tested data. We do this through deep working relationships with leading financial economists. By acting as a conduit between scientists and practicing investors, Dimensional has pioneered many strategies and consulting technologies now taken for granted in the industry.

Dimensional's process explores every aspect of dynamic real-world markets, including portfolio architecture, trading methodology, and tax management. Our investment staff is involved in research efforts through its daily trading activities, resulting in market studies, and Investment Committee participation. Clients benefit when research and experience combine to solve new investment challenges. As often as a research innovation generates a new technology, a client need or investment problem drives a new solution.

Dimensional has forged deep working relationships with some of the world's leading financial economists to bring their latest theories and research to practice. Though bound to a

rigorous scientific process, we also have an instinct for knowing what works with investors. Financial science leads the way in understanding risk and return in securities markets. By maintaining a continuous feedback loop between the academic community, practitioners, and clients, Dimensional is always researching tomorrow's solutions today.

Academic Leaders

Professor	Affiliation	Expertise
George M. Constantinides , University of Chicago	Board Member of Dimensional's US Mutual Funds	Asset Pricing, Capital Markets Research
Eugene F. Fama , University of Chicago	Board Member of Dimensional Fund Advisors, Consultant for Dimensional's Fixed Income and Value Strategies	Efficient Markets Hypothesis, Random Walk Hypothesis, Capital Markets Research, Multifactor Model, Definitive Finance Text, Tax Research
Kenneth R. French , Dartmouth College	Board Member of Dimensional Fund Advisors, Consultant and Head of Investment Policy	Capital Markets Research, Multifactor Model, Tax Research
John P. Gould , University of Chicago	Board Member of Dimensional's US Mutual Funds	Applied Price Theory, Former Dean of University of Chicago Graduate School of Business
Roger S. Ibbotson , Yale University	Board Member of Dimensional's US Mutual Funds	Capital Markets Research, Comprehensive "SBBI" Database (with Sinquefeld), Data Consultant Firm
Edward P. Lazear , Stanford University	Board Member of Dimensional's US Mutual Funds	Labor and personnel economics
Robert C. Merton , Harvard University	Resident Scientist	Optimal Lifetime Consumption and Portfolio Allocation Theory, Asset Pricing Theory, Valuation of Derivative Securities
Myron S. Scholes , Stanford University	Board Member of Dimensional's US Mutual Funds	Capital Markets Research, Options Pricing Model
Abbie J. Smith , University of Chicago	Board Member of Dimensional's US Mutual Funds	Capital Markets Research, Financial Accounting Information, Corporate Restructuring, Corporate Governance
Sunil Wahal , Arizona State University	Consultant	Capital Markets Research, Transaction Costs Research, and Trading and Portfolio Management Practices