UniSuper

Friday, 5 October 2012

Dr Richard Grant
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Dr Grant,

Submission third tranche of MySuper legislation

On behalf of the Board and Management of UniSuper, we welcome the opportunity to comment on Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012.

Over the past year, UniSuper has been actively planning for the substantial policy and product changes that are necessary to comply with the Stronger Super requirements. We have established three projects to work on the MySuper, SuperStream and Governance changes. We have also spent a considerable amount of time meeting with APRA and key Treasury officials working through some UniSuper-specific issues. Attached is a copy of the submission we made during the consultation on the exposure draft. We ask that you read it along with the additional points raised in this submission.

UniSuper's additional comments on the Exposure Draft and Explanatory Memorandum
Chapter 1: Fees, costs & intrafund advice
Performance based fees

The proposed requirements for performance-based fees are of particular concern. They impose prescriptive requirements which are simplistic and overlook the sophistication and flexibility of performance-based fee arrangements which are typically tailored to the relevant portfolio or asset class covered by the arrangement. Although it is proposed that there be an exemption for cases where a non-complying arrangement is nevertheless in the best interests of members, this poses an uncomfortable compliance risk (i.e. in the event that the regulator takes a different view) for trustees which have developed a sophisticated approach to calculating performance-based fees which might not technically meet the new criteria. Trustees of large superannuation funds naturally err on the side of compliance and take comfort from statutory requirements which make it clear what must be done in order to comply, rather than having to rely on generic exemptions which are open to challenge by the regulator. The comments in our earlier submission to Treasury generally apply to the Bill, although we have since identified further concerns arising from the proposed requirements.

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- The proposals require performance to be calculated "after-tax" and "where possible". This suggests that a precise adjustment for taxes may be required and, while this may theoretically be "possible", there is a separate question of whether this would be impracticable and whether it would be more practicable to make an adjustment on account of estimated Australian taxes, using such simplifying assumptions and proxies as the trustee considers reasonable.

- Calculating out-performance on an after-tax basis requires consideration to be given to the performance of the relevant portfolio (after tax) as well as the performance of the relevant benchmark (after tax). This involves two fictions. Firstly, superannuation funds pay tax on a whole-of-fund basis, rather than on a portfolio basis. The tax borne by a superannuation fund with regard to gains within a particular portfolio will inevitably depend on factors external to the relevant portfolio. It is unclear how the legislation expects this to be reflected in the calculations or whether trustees will have discretion in that regard. Secondly, benchmarks are not taxpayers and therefore making an adjustment for the tax which would have been paid by the benchmark (assuming it was a taxpayer) is an exercise in judgment based on simplifying assumptions, rather than being a precise calculation.

- It is also unclear whether the Bill is intending only for tax on realised gains to be taken into account, or whether accrued tax in respect of unrealised gains is also intended to be factored into consideration.

- In light of the above, a range of assumptions must inevitably be made when adjusting for taxes. For example, assumptions must be made about how long particular assets were held prior to being sold (for CGT purposes) and whether the 45 day holding period was satisfied (for franking credit purposes) and whether or not share buy-backs were participated in and whether or not there are any carried forward tax losses from prior years that should affect the calculation. This applies to both the relevant portfolio and the relevant benchmark. It is unclear to what extent trustees would have discretion in this regard (for example, by making simplifying assumptions or by excluding certain components altogether) in attempting to comply with the legislation.

- Adjusting for foreign taxes will pose a major challenge, especially where the benchmark has exposure to jurisdictions in which the trustee itself has not invested. In those cases, estimating the after-tax return of the benchmark would require the trustee to be aware of the taxes which apply in countries in which the trustee has chosen not to invest. If regard must be had to foreign taxes, the proposed requirements would be a significant fetter to entering into performance-based fee arrangements with respect to portfolios including international securities.

- We submit that these are complex adjustments to make. It is not simply a case of netting out a flat 15% in respect of the Australian taxes paid by superannuation funds. This would overstate the tax impacts (for example, in relation to long term capital gains) and would therefore be seen by managers as an unfair penalty, and they would seek to address this by insisting on a higher rate of fee. In order to facilitate the kinds of calculations contemplated by the Bill, it is likely that trustees will need to engage an external benchmark manufacturer, for a fee, to provide an after-tax benchmark. The proposed requirements would therefore lead to increased costs in this regard.

- We reiterate our earlier concerns about requiring performance to be measured against the performance of investments of a similar kind. It is often entirely appropriate to assess performance with regard to investments of a different kind which may have been an alternative to the investment which was in fact made, or by reference to some pre-agreed hurdle (perhaps over CPI or the bond rate).

- We also reiterate our earlier observation that performance-based fees could legitimately be calculated on a "before-fees" basis, where this has been factored into the setting of the hurdle return which must be surpassed before a performance-based fee becomes payable.

Intra fund advice

Proposed section 29V(8) outlines the definition of an *advice fee*. The proposed section contemplates situations where the cost of providing financial product advice is incurred by the trustee. We believe that this definition is unnecessarily limiting. A strict reading of this section would potentially prevent the cost of advice being deducted from a member's account where the advice is offered through another entity and it is that entity that directly incurs the cost of providing advice rather than the trustee. Such arrangements are very common across the industry; for example, UniSuper Limited (USL) is the trustee of the Fund and UniSuper Management Pty Ltd (USM) is the administrator. While USM is owned by USL in its capacity as trustee of the Fund, it is the administrator USM that holds an Australian Financial Services Licence (AFSL) and is responsible for the financial services provided by our employee representatives. In this situation, the trustee does not hold an AFSL and does not directly incur the cost of providing advice. This structure is favoured across the industry and often preferred by regulators. We submit that this section should be redrafted to make it clear that these arrangements will be permitted.

General fee rules

Proposed section 29V(9) outlines rules for the charging of insurance fees. The section refers to "insurance premiums" but makes no mention of the recovering the costs in providing other insurance-like benefits, such as self-insured death and disablement benefits. Many funds, who currently self-insure, will charge members a fee to cover the cost of self-insured "in-built benefits", although, strictly speaking the charge is not an insurance premium. While we recognise that self-insurance is to be phased out for all funds other than defined benefit funds, there will be funds seeking a transition period to unwind self-insurance arrangements. We submit, therefore, that in the interim, this definition will need to be drafted broadly enough so as not to disadvantage members of those super funds that currently offer in-built benefits and charge fees for the provision of those inbuilt benefits that are akin to premiums. These fees should be permissible.

Proposed section 99E will require Trustees to attribute costs in a manner that is fair and reasonable across classes of beneficial interest ie across all MySuper and Choice products offered by the fund. We believe that more information will be required about how this section will apply alongside the proposed fee charging rules in section 29VA of the Superannuation Legislation Amendment (MySuper Core Provisions) Bill.

Chapter 2: Insurance

Schedule 2 of the Bill outlines the rules relating to the provision of death and permanent incapacity benefits to MySuper members that are supported by an insurance policy. This gives effect to the Government's stated policy that trustees ought provide minimum levels of insurance to members. The proposed section 68AA of the *Superannuation Industry (Supervision) Act* and potentially the proposed section 32C(2)(d) of the *Superannuation*

Guarantee (Administration) Act will require the provision of both a permanent incapacity and a death benefit to MySuper members. While we are supportive of this requirement, we seek clarification of what happens to members who become Choice members upon joining the superannuation fund and then later switch to become a MySuper "member" as a result of switching all or a portion of their existing "Choice" balance to MySuper. We believe it should be clarified that a superannuation fund is not required to offer death and permanent incapacity insurance cover to a member every time they switch from being 100% choice to acquiring a partial interest in the MySuper offering. We are concerned that there would be a potential for adverse selection where members who were previously offered a default level of insurance cover on joining the fund, and declined to take up that cover, make a choice to switch into a MySuper product at a later date after the discovery of a health issue.
We submit that it would be a reasonable condition under the proposed section 68AA(3) that minimum levels of insurance are offered once and only once to members when they originally join the fund and not every time they switch back to MySuper. Further, we submit that additional rules will be required in Schedule 2, Part 2 such that:

- Members who have declined cover of the type specified in 68AA(1) (a) & (b) prior to being transitioned to MySuper are treated as having made an election made under section 7(2); &
- MySuper members who have declined cover and who acquire a MySuper product on any subsequent occasion are also treated as having made an election made under section 7(2).

We are concerned that without these changes there could be significant changes to existing default insurance arrangements across the industry owing to the increased selection risks and consequential higher insurance costs. We submit that this would be a poor outcome for members.

We also request that the proposed section 68AA of the *Superannuation Industry (Supervision) Act* be clarified to allow for death and permanent incapacity benefits to be provided by way of self-insured in-built benefits that are not provided by an insurance company. This is mentioned at paragraph 2.15 of the Explanatory Memorandum but is not sufficiently clear on the face of the proposed provision. This would allow for the phasing-out of inbuilt benefits as required by proposed legislation to be done in an orderly fashion.

Chapter 3: Collection and disclosure of information
Product dashboard and other disclosure

The Bill contemplates that product dashboards will quantify the average amount of fees and other costs, expressed as a percentage of the assets of the relevant product, and that this figure will be updated quarterly within 14 days after the end of each quarter. This will be problematic in practice and could potentially be misleading to members, for several reasons.

Some fees are flat-dollar amounts, regardless of a member's account balance, and ought not to be converted into a percentage. The higher a member's account balance is, the lower those fees will be in percentage terms. A worked example could be given to illustrate the total fees and costs as a percentage for a member with an assumed account balance (say, 50,000), but this will be no different to the worked example which must already be included in product disclosure statements. Alternatively, the product dashboard could include a listing of all relevant fees and costs, some of which will be percentage-based and others of which will be flat-dollar amounts, but this will be no different to the standardised fee table which must already be included in product disclosure statements. Depending on whether or not product dashboards are intended to largely supersede product disclosure statements, it would be feasible for dashboards to replicate the information which is already in the product disclosure statements.

We presume that the requirement to update the fee and cost information on a quarterly basis is intended to keep members informed as to the actual fees and costs which were incurred in the most recent quarter. While this may seem a sensible proposition in the abstract, it will give rise to several difficulties in practice. For example:

a) Performance fees represent a significant proportion of investment management expenses and these are typically only payable at the end of a financial year and cannot be known (with precision) in advance – indeed, until the end of the financial year, a trustee would not necessarily even be certain whether any performance fees will be payable at all. As a consequence, investment management fees (in absolute terms) are typically lower for the first three quarters of a financial year and the fees for the final quarter are typically higher on account of performance fees becoming payable. The quarterly fee information would therefore convey a misleading impression (at least for the first three quarters of each financial year) of the true costs of being invested in an investment option over the course of a year.

b) If the intention is for product dashboards to include accurate figures for the fees and costs which were actually incurred during the relevant quarter, 14 days is unlikely to be sufficient time for trustees to ascertain those details. The relevant calculations would potentially take closer to 6 weeks. This is because trustees would need to wait until all external investment managers and other service providers had rendered invoices for the relevant quarter and until after all pooled investment vehicles had provided their quarterly reports with details of all fees and charges which had been deducted from the pooled vehicle during the quarter. Those invoices and reports would not typically be received within the first 14 days after the end of a quarter. In the case of performance fees, there may be an extended period during which the details of the calculation are reconciled.

For these reasons, in our submission, it would be preferable for trustees to publish indicative or estimated figures, rather than actual figures for the relevant quarter (that said, obviously fees which are fixed or capped could be disclosed with precision). In this regard, the basis of the indicative or estimated figures could be the fund's Indirect Cost Ratio (ICR) for the prior financial year. Product disclosure statements already include details of the ICR for each investment option for the prior financial year. If product dashboards were to be permitted to utilise the ICR for the most recent financial year, this would avoid confusion arising from the product dashboard disclosing fee information which is different from that which is included in the product disclosure statement. This would also ensure that members have access to a reliable estimate, rather than data which – while accurate and more recent – could potentially convey a misleading picture of the true costs of remaining invested in an option for the longer term.

Portfolio holdings

We reiterate our earlier comments regarding the disclosure of the volume of portfolio holdings data and the difficulties arising from the proposed drafting in so far as "double-counting", derivatives, foreign currency and hedging are concerned. Focussing on the top 20 or 50 holdings would seem to strike a reasonable balance. Further consideration needs to be given to the treatment of derivatives, foreign currency and hedging, as well as how to treat exposures to particular entities which might span different asset classes. In addition, we have identified several further concerns, which we have summarised below.

The proposed requirements seem to require disclosure on a whole of fund basis. We query whether it would be more meaningful to members if portfolio holdings were instead disclosed on an option-by-option basis.

We also note that the provisions requiring relevant third parties to provide trustees with the necessary portfolio holdings data do not require those third parties to provide the data to trustees within a time frame, or in a suitable electronic format, which will facilitate disclosure (by the trustee) within the 90 day period. Equally, while it appears there will be a statutory defence for trustees who never receive the data, there would be no statutory defence for a trustee who receives the data either too late or in an unhelpful format which precludes the trustee from cleansing and aggregating data from all the relevant sources within the 90 day period.

Conclusion

UniSuper asks that due consideration be given to the issues raised in both of our submissions and make appropriate recommendations in drafting the Committee's report. Should you need more information on any of these issues please speak to Benedict Davies who manages our policy submissions.

Yours sincerely,

Terry C. McCredden
Chief Executive Officer

Encls.

UniSuper

Wednesday, 16 May 2012

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Superannuation Unit
Financial System Division
The Treasury
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Dear Sir or Madam,

Submission to Treasury on third tranche of MySuper legislation

On behalf of the Board and Management of UniSuper, we welcome the opportunity to comment on Exposure draft – Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 (i.e. the third tranche of MySuper legislation).

Background on UniSuper

UniSuper is the superannuation fund for employees in Australia's higher education and research sector. The Fund in its present form came into being with the merger of the Tertiary Education Superannuation Scheme and the Superannuation Scheme of Australian Universities in September 2000.

UniSuper offers both defined benefit and accumulation plans to its members. The Defined Benefit Division, which remains open to all new permanent employees in the sector and is portable across all participating employers, requires a fixed 14% employer contribution and standard after tax 7% member contribution. On joining UniSuper, eligible members are automatically enrolled into the defined benefit division and have a period of twelve months to decide if they want to move to an accumulation plan in which they receive the same level of contributions and insurance benefits.

Other UniSuper members, typically casual employees and those employed by 'related bodies' that are not universities, generally receive accumulation contributions at the Super Guarantee rate, with the capacity to supplement their savings through voluntary contributions, salary sacrifice and, where applicable, access to the Government's co-contribution scheme.

At 31 March 2012 there were 456,926 members accounts of UniSuper of which 217,481 were active member accounts, including 76,660 who were members of the Defined Benefit Division.

There were 239,445 inactive member accounts; i.e. accounts with UniSuper that are not presently receiving employer contributions.

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