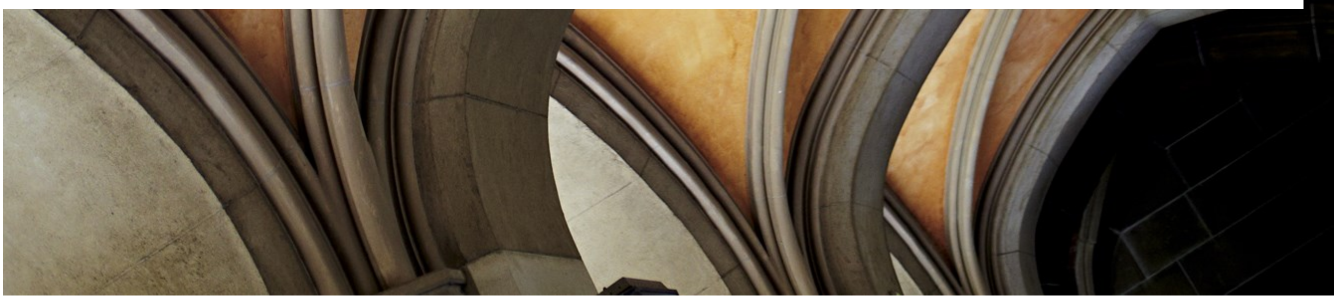
Financial System Inquiry: Final Report

Submission by UniSuper

31 March 2015



About UniSuper

UniSuper is the superannuation fund dedicated to people working in Australia's higher education and research sector. With approximately 400,000 members and $50 billion in net funds under management (as at February 2015), UniSuper is one of Australia's largest superannuation funds and has one of the very few open defined benefit schemes.

UniSuper is delighted to participate in the Financial System Inquiry, and is pleased to provide this response to the issues raised in the Final Report. UniSuper made two earlier submissions to the Financial System Inquiry and our staff have worked closely with key industry bodies to formulate an industry view on many of the Recommendations in the FSI's Final Report.

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 on (03) 8831 6670 or benedict.davies@unisuper.com.au

Recommendations from the Final Report

Recommendation 9: Objectives of the superannuation system

UniSuper supports seeking broad agreement that the primary objective for the superannuation system is *to provide income in retirement to substitute or supplement the Age Pension.*

We have a long history of paying pensions to our members and we would welcome such an objective. We believe that it would then give the industry and policy makers clear guidance that our primary focus should be on the provision of income in retirement for members.

We note recent ongoing public debate about using superannuation for purposes other than retirement. While it's hard to comment on speculation, we would like to highlight there are a number of practical complications that would arise from such a policy for defined benefit schemes which are typically designed to deliver an income in retirement rather than periodic lump-sums.

Recommendation 10: Improving efficiency during accumulation

Recommendation 10 would create a formal competitive process to allocate new workforce entrants to MySuper products.

We do not support this Recommendation because we believe it is far too early to judge the success of MySuper. The superannuation industry has only recently been through significant regulatory change under the Stronger Super initiatives of the former government, and most MySuper products are less than 12 months old. Therefore, judging the effects on fees of these reforms is premature.

We do, however, support a review of the MySuper reforms, undertaken either by the Productivity Commission or by Treasury. This review, however, should look at more than MySuper's effects on costs. It should also look for further efficiencies to be achieved through reductions in regulation and red-tape. The constant changes to the superannuation system impose significant costs on funds – and as a profit-for-members fund, these costs are ultimately borne by our members.

This Recommendation also raises a broader issue about the appropriateness of a "generic" MySuper product for new workforce entrants. We note the following observation in the FSI's Final Report:

A potential downside of this option is less tailoring of life insurance policies and investment strategies to specific demographics of fund members; for example, if members work in the same industry. Some superannuation funds have been able to tailor insurance and other product features because of the homogeneous nature of their membership.

Final Report, 110

We believe the above statements highlight what is at stake in any move to a generic product i.e. products tailored to match member needs. We maintain that Trustees acting under a best interest duty are best placed to develop appropriate superannuation, investment and insurance offerings tailored to their membership. Further, we are concerned that such a policy that would lead to more “commodification” of superannuation and less tailoring which will not address the broader and diverse needs of superannuation fund members.

If this Recommendation were adopted and a formal competitive process were to be introduced, the issue of defined benefit funds would need further consideration. In the case of the higher education and research sector, an open defined benefit fund - and consequently a higher level of employer superannuation support - has been a feature of the sector for over 30 years. If this Recommendation were adopted, we submit that the outcome for new entrants to the higher education sector would arguably be a *lesser* product (i.e. SG only and generic insurance).

The FSI’s Final Report makes the following observation:

Existing corporate funds could be allowed to continue to receive new default fund members from new entrants to the workforce provided the fund gives members comparable benefits to funds successful in the formal competitive process.

Final Report, page 115

We strongly support this observation and believe that this principle should also apply to defined benefit funds, such as UniSuper, which offer more than comparable benefits to our members.

Recommendation 11: The retirement phase of superannuation

The Report recommends that government should require superannuation fund trustees to pre-select an option for members to receive their superannuation benefits in retirement.

UniSuper strongly supports putting the onus on trustees to develop a retirement income strategy for their suite of products and services to members, focusing on their members’ needs for income in retirement. This would involve consideration of all types of income streams, including pooled arrangements that protect members from longevity risk.

We believe it’s important to point out that super funds can and do pay lifetime pensions and that the language used in the report focusses heavily on annuities.

While we strongly support the development of deferred retirement income products, we submit that superannuation funds and life offices should be permitted to offer these products to their members and customers. Therefore, we encourage Treasury to be “product neutral” in its thinking, focussing not only on deferred lifetime annuities (DLAs) paid by life offices but also deferred lifetime pensions (DLPs) paid by superannuation funds.

We encourage Treasury to consider our comments in this submission along with our earlier submissions to the FSI as well as our submission to Treasury’s Review of Retirement Income Stream Regulation (September 2014). In that submission, we highlighted a number of regulatory impediments to the development of new products that would be of benefit to retirees. We believe those comments need to be considered when formulating a response to this Recommendation.

Recommendation 12: Choice of Fund

The Choice of Fund rules, as they currently stand, have a fairly narrow focus on a particular type of compulsory employer superannuation arrangement viz employers paying the minimum superannuation guarantee (currently 9.5%). Consequently, the choice rules generally do not adequately address other employer arrangements e.g. where employers make superannuation contributions in excess of the SG minimum, which is typical of defined benefit funds. An extension of choice to all employees in Australia, therefore, raises a number of special issues, particularly relating to defined benefit funds. Regrettably, the Final Report makes no mention of defined benefit funds or these issues.

Under current law, there are restrictions on choice of fund where a member is a defined benefit member or where an industrial arrangement, such as an EBA, applies. The rules of UniSuper's defined benefit fund – along with relevant industrial agreements – have resulted in most permanent employees in the higher education sector receiving superannuation entitlements well above the minimum required by law. UniSuper's Defined Benefit Division remains the default option for new permanent employees upon their commencement of employment, and a full-time academic typically receives 14% employer contributions to either our Defined Benefit Division (DBD) or our Accumulation 2 options *plus* an additional 3% (i.e. for a total employer contribution of 17%) to an associated accumulation account.

Even though UniSuper enjoys default status[1] in the higher education and research sector, we strive to offer our members significant product choice. For example, all new members have up to 24 months to choose between the defined benefit option and accumulation option. Further, where members have moved to an accumulation option, there are also fund rules in place to allow members at most universities to have their compulsory Superannuation Guarantee (SG) contributions paid to a fund of their choice with the difference (making up the mandated 17%) paid to UniSuper.

An examination of the choice rules also gives rise to the related issue of portability. Both choice and portability have over many years required specific rules or exemptions, particularly for existing defined benefit members. The issue of portability was subject to significant industry consultation in 2002, where it was concluded that:

> *…there are grounds to limit access to portability for defined benefit members with a defined benefit interest in a funded scheme, relative to members of defined contribution funds.*[2]

We submit, therefore, that if there were to be an extension of choice of fund to cover employees under industrial agreements or employees who are members of defined benefit funds, there will need to be further industry consultation to deal with the issue of existing defined benefit members as well as those employees who receive over-and-above the SG minimum level.

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[1] UniSuper is named in the two higher education awards and in a third award on post-secondary education. Despite having default status in awards and EBAs, many new employees can still "opt out" of being a member of UniSuper. We have established rules, supported by enterprise agreements, that allow new employees the choice to join another fund and not UniSuper, particularly where an employee is already a member of another similar defined benefit scheme, such as the CSS or PSS, or is a visiting academic from overseas.

[2] Minister for Review & Assistant Treasurer, Media Release, http://archive.treasury.gov.au/documents/414/HTML/docshell.asp?URL=Portability.asp 19 September 2002

Observations on tax from the Final Report

Dividend Imputation

The case for retaining dividend imputation is less clear than in the past.

Final Report, page 17

We submit that dividend imputation has served Australians well. It has removed the problem of double taxation that arises under the “classical system” of taxing dividends.

As a large professional institutional investor, our approach to investing starts with determining the most appropriate asset allocation to meet the Fund’s objectives. In fact, when determining the appropriate allocation between individual asset classes, taxation is one of many factors considered and is typically not the most important consideration. For example, as the yield and capital growth prospects for an asset class are far more important factors than their tax treatment, we can attest that the dividend imputation system does not create a bias for professional institutional investors who work from first principles and regard tax as only one of many factors when giving effect to an investment strategy.