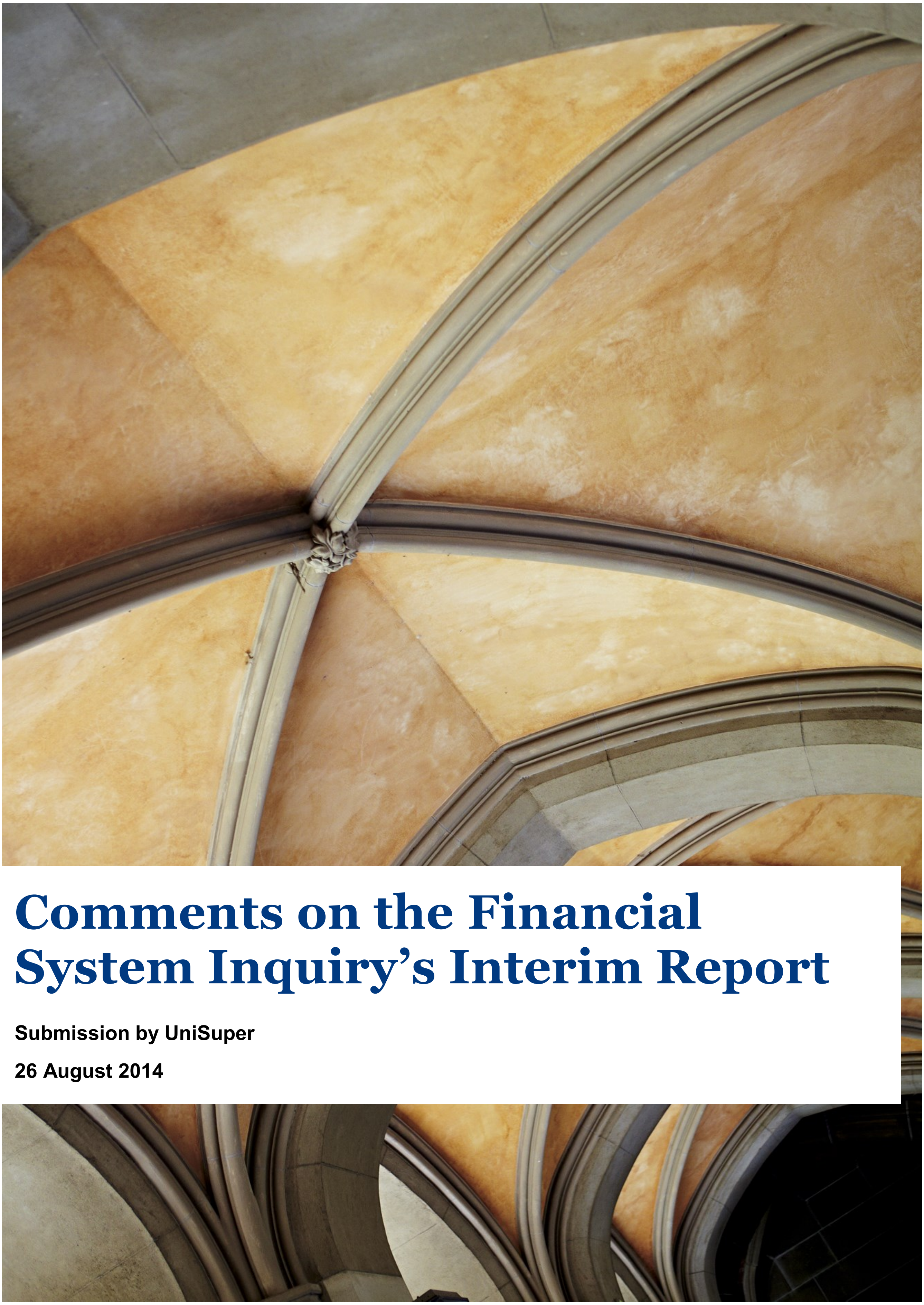
UniSuper



Comments on the Financial System Inquiry's Interim Report

Submission by UniSuper

26 August 2014

About UniSuper

UniSuper is the superannuation fund dedicated to people working in Australia's higher education and research sectors. With more than 448,000 members and $41.3 billion funds under management (as at June 2014), 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 its Interim 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) 9910 6670 or benedict.davies@unisuper.com.au

Overview

UniSuper congratulates the Committee for highlighting a number of key issues facing Australia's financial services industry. UniSuper staff have worked closely with key industry bodies to formulate an industry view on many of the issues highlighted. We are broadly supportive of comments made by the superannuation peak bodies addressing the fee and cost issues raised in the Interim Report.

This submission's focus is the Committee's observation that retirement products are largely underdeveloped in Australia. We agree that there are regulatory and policy impediments to developing new products that would be of benefit to retirees. As it currently stands, the superannuation system is largely a savings system and is not yet a fully functioning retirement system. We therefore encourage the Committee to make bold recommendations that allow Trustees, acting under a best interests duty, as much flexibility as possible to respond to this challenge and to develop new retirement products to address the needs of their members.

The needs of retirees are diverse and there is no "one size fits all" approach to retirement products. We believe that Trustees should be surveying not only what currently happens in Australia; but also, surveying what happens overseas for new ideas to meet the challenges of an ageing population. In our earlier submission, we encouraged the Committee to take note of the retirement systems of the Netherlands, Denmark and Canada because we believe these countries have well-functioning, collective, risk-sharing retirement schemes that could fill a gap in Australia's retirement income system.

In this submission, we also highlight recent developments in the Canadian province of New Brunswick that allow for shared risk pensions which the provincial government argues are "more secure, transparent and affordable".[1] We also note that since our earlier submission, the UK government itself has gone down the path towards legislating new forms of collective, risk-sharing, retirement plans with the Pension Schemes Bill 2014 presented to the Parliament at Westminster on 26 June 2014.[2]

We do not believe the Committee needs to – or indeed should – endorse particular retirement schemes or products put forward in submissions. Instead, we believe the outcome should be recommendations for a framework that would facilitate the development of a whole range of retirement products by giving the industry more flexibility. This would be in all likelihood a better approach than getting government and policy makers to "pick winners".

Ultimately, the responsibility for developing new products should rest with Trustees – acting under a best interests duty – to understand and respond to the changing needs of their membership. We would therefore support a framework, similar to the Insurance Management Framework, that would put Trustees at the forefront of developing appropriate retirement income strategies and products for their membership rather than government-set defaults or the mandating of one form of retirement income product over others.

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[1] http://www2.gnb.ca/content/gnb/en/corporate/promo/pension.html
[2] http://services.parliament.uk/bills/2014-15/pensionschemes.html

Observations in the Interim Report

Dividend Imputation

The dividend imputation system creates a bias for individuals and institutional investors (including superannuation funds) to invest in domestic equities, and it may be a contributing factor to the lack of a deep domestic corporate bond market in Australia.
Interim Report, 1-15

UniSuper's approach to investing starts with determining the most appropriate asset allocation to meet its objectives. 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, both the yield and capital growth prospects for an asset class are far more important factors than their tax treatment. While we cannot attest if the imputation system has had the suggested impact on the domestic corporate bond market, we can attest that the 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.

Superannuation fees & costs

Some submissions argue active investment strategies contribute to superannuation fund costs & fees
Interim Report 2-107

UniSuper is strongly of the view that active investing has a key role to play in delivering the best net returns for members. We would not pursue a passive investment strategy purely to lower costs unless it made sense value-wise by delivering a greater net return to members. While we do passively invest across some asset classes, we remain convinced that active investing is appropriate in delivering on our return targets to members. Not only do we believe so, our actual investment performance demonstrates this. Our members have been the beneficiaries of strong net of fee returns over all measured time periods.

MySuper

Does, or will, MySuper provide sufficient competitive pressures to ensure future economies of scale will be reflected in higher after-fee returns
Interim Report 2-115

The superannuation industry has committed a great deal of time and resources to develop MySuper products and to respond to the broader Stronger Super regulatory requirements. Given that most MySuper products are less than 12 months old, we believe it is far too early to judge the immediate effects of the reforms. If Treasury were to undertake a post implementation review, it should be done after two full years of operation and then repeated after years three and five. This would enable a much more appropriate and reasoned analysis of MySuper's success and it would enable more considered recommendations for efficiencies and red-tape reductions.

Post retirement framework

Retirement income market is highly competitive

We believe that the market for retirement income products is highly competitive and contestable. Our members are extremely engaged, and we find that engagement levels increase as member approach retirement. Many members actively plan for their retirement, attending pre-retirement seminars or seeking assistance from a financial adviser with an appropriate retirement plan.

We are concerned, however, that the predominant retirement income option (i.e. account-based pensions) cannot address all the needs of retirees and does little to address the twin challenges of sequencing risk and longevity risk. We submit that more innovative products should be developed.

Issues canvassed in the Interim Report

Maintain the status quo with improved provision of financial advice and removal of impediments to product development
Interim Report xxxix

The status quo should not be maintained. There is significant scope for new products that could meet the needs of retirees. To this end, the government should remove impediments to product development by revisiting the complex SIS Regulations 1.05 and 1.06 as well as encouraging a more principles-based approach by allowing trustees to develop appropriate products for their membership.

Financial advice is equally as important as product development, particularly given the "portfolio approach" to products where retiring members often take more than one income stream e.g. allocate some of their retirement savings to a lifetime pension and some to an account-based pension. Portfolio strategies can be complex and need to contemplate both tax and social security issues and are generally best undertaken with expert guidance.

Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks
Interim Report xxxix

We believe that long term income streams should receive policy incentives in recognition of the fact that members generally forego access to capital i.e. they cannot generally commute these products outside of the first six months. Access to capital is one of the key distinctions between product types, and those products that require members to forego access to capital (or defer access to it) have a stronger claim to receiving concessionary treatment.

While the nature of the policy incentives could be a combination of tax and social security rules, in all likelihood, the main policy lever available today would appear to be the income stream rules under Division 1C of the Social Security Act 1991. It remains appropriate for non-commutable income streams to be treated under these rules rather than to be deemed like bank accounts and account-based pensions (from 1 January 2015).

Introduce a default option for how individuals take their retirement benefits
Interim Report xxxix

We support the principle of defaults set by Trustees, but not compulsory defaults by legislative force. The challenge of developing a single default option that would work for all Australians is too great and we believe there should be no requirement for a MyPension or MyRetirement product. Instead, we believe that Trustees, acting under a best interests duty are best placed to develop appropriate retirement products and strategies for their members.

Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement)
Interim Report xxxix

The government should not mandate the use of particular products. As previously stated, this should be addressed by Trustees acting under a best interests duty. We believe that mandating products through prescriptive SIS Regulations would likely lead to poor outcomes and reduced product innovation.

Take a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the Age Pension means-tests.
Interim Report xl

Yes, this is an admirable aim. As stated earlier, access to capital (i.e. commutability) is a key determinant of whether an income stream ought to receive concessionary status. Exactly who or how this is determined is up to policy makers but any rules should be transparent so that industry participants developing new products understand in advance the tax and social security treatment of new products.

For product providers, streamline administrative arrangements for assessing the eligibility for tax concessions and Age Pension means-tests treatment of retirement income products.
Interim Report xl

In our experience, a single policy maker, such as Treasury, would seem to be an equally good option. Ultimately, this would reduce the number of policy makers which those developing new products will have to deal with, explain their ideas, how their fund works, its current products and history etc.

Would deferred lifetime annuities or group self-annuitisation be useful products for Australian retirees? Are there examples of other potentially suitable products?
Interim Report 4.25

Deferred retirement income products – annuities paid by a life office or pensions paid by superannuation funds – do have a role to play. While they are not a panacea for all the risks faced by members, they do address longevity risk better than account-based pensions. To this end, we submit that deferred retirement income products (i.e. both annuities and pensions) should be a priority. Further, regulations to give effect to these changes will need to ensure that both superannuation funds and life offices can develop these products.

The principle of group self-annuitisation – or put more simply, risk sharing – is worth exploring. While the Singaporean approach might not be best suited to Australia, an approach taken in the Netherlands, Denmark and Canada could be suitable for certain industries and sectors in Australia. We believe that the Defined Ambition or Collective

Defined Contribution schemes offered overseas provide an innovative way to share risk between cohorts and improve overall benefits to members, and should be seriously considered as appropriate to sit alongside existing default products i.e. MySuper and defined benefit superannuation.

Attached to this submission is a copy of a paper presented to the 22nd Colloquium of Superannuation Researchers that further develops this point.

If part of retirees' superannuation benefits were to default into an income stream product, which product(s) would be appropriate?
Interim Report 4.25

A whole range of products could be suitable and very much depends on the superannuation fund and its membership. We submit that Trustees, acting under a best interests duty, are best placed to develop an appropriate retirement offering rather than setting legislated defaults.

Will the private sector be able to manage longevity risk if there is a large increase in the use of longevity-protected products? How could this be achieved?
Interim Report 4.25

Yes. While the government already provides significant longevity protection through the Age Pension, the superannuation industry can manage longevity risk well, provided it gets its pricing and product design right. Material increases in the numbers of Australians accessing longevity-protected products will enable the industry to make better use of collective risk sharing than with the much lower numbers currently accessing these products.

Should Government increase its provision of longevity insurance? How would institutional arrangements be established to ensure they were stable and not subject to political interference?
Interim Report 4.25

No. The government already provides significant longevity protection through the Age Pension. The super industry is well placed to develop products and strategies that meet the needs of its members and additional government provision of longevity insurance is not warranted.

What are some appropriate ways to assess and compare retirement income products? Is 'income efficiency' a useful measure? 4.25

This is certainly a useful concept for public policy discussions but the concept might be challenging for members to understand.

Group self-annuitisation in Singapore

We note comments made in the Interim Report about Singapore's Group Self Annuitisation (GSA) scheme design. While in our view it is unlikely that such scheme would have widespread appeal across Australia, we believe that a Trustee should be free to develop something along these lines in Australia if it is appropriate for its membership.

While Singapore receives a B grade in the Mercer Global Pensions Index, and equal ranking to the UK and Canada, the study also gives high marks to the pension systems in the Netherlands and Denmark.

We come back to the fundamental point: no one scheme design should be privileged in law. Government policy should focus on creating a framework within which the features from Singapore, the Netherlands, Canada, the US, the UK or other countries could be developed by Trustees acting under a best interests duty to give effect to appropriate retirement strategies and products for their members.

Alternative risk models are emerging around the world

Pension systems around the world have been adopting a new approach to the sharing of risk. The UK, for example, will debate the *Pensions Scheme Bill 2014* (UK) in September[3] and the Bill includes a framework for new shared risk pensions, sometimes known as Defined Ambition Schemes.

Canada is also well down the path to shared risk schemes, having developed "the New Brunswick model" in 2012. The New Brunswick model builds on ideas that were initially developed in the Netherlands and the adoption of this new approach came after a recommendation by New Brunswick's Pension Task Force in 2011.[4]

As the model was being developed, Canadian pension plans, like many schemes around the world, had recently faced the challenges associated with low interest rates, changing demographics (i.e. longer life expectancy and a general aging population) and volatility in capital markets. This combination of factors had the potential to affect the long-term sustainability of some Canadian pension schemes. The shared-risk model appears to be better placed to address these issues because of its focus on robust risk management to promote benefit stability and scheme sustainability.

The new rules allow existing New Brunswick pension plans to offer shared-risk pensions with a target benefit, usually based on an enhanced career average earnings formula. Member benefits are based on a career average salary, with a base benefit that has an extremely strong probability of being achieved. In addition to the base benefit, additional 'ancillary' benefits may be provided, including indexation for cost of living changes. Indexation is not normally guaranteed; instead, it is applied to pensions each year subject to the position of the fund. It is this type of in-built "pressure release valve" that make schemes like this less subject to capital market shocks.

A raft of governance and regulatory requirements further strengthen the schemes. One important requirement assists with transparency to members: under the New Brunswick model, scheme providers are required to clearly communicate to their members that employer contributions are limited and that benefits may be reduced if the assets are insufficient.

The government of New Brunswick argues that this model is "more secure, transparent and affordable"[5]. We at UniSuper believe that similar schemes being adopted around the world are worthy of serious consideration in Australia by industry participants and policy makers.

[3] http://services.parliament.uk/bills/2014-15/pensionschemes.html
[4] http://www.gnb.ca/0062/pensiontaskforce/pensiontaskforce-e.asp
[5] http://www2.gnb.ca/content/gnb/en/corporate/promo/pension.html

Funds need more flexibility to develop retirement products

In our earlier submission, we highlighted the need for more flexibility to develop retirement products. We are pleased to see that, contemporaneously to the Financial System Inquiry, the Treasury is conducting a Review of retirement income stream regulation. While the Treasury review will focus on the detail, we believe that the FSI's review is an opportunity to focus on the framework.

We believe that there should be a framework within which new products and retirement strategies can flourish and that Trustees should be offered as much flexibility as possible to develop retirement products that are in the best interests of their members.

While we recognise that rewriting the complex SIS Regulations for pensions (SISR 1.06) and annuities (SISR 1.05) will take some time and require significant industry consultation, we suggest that immediate priority should be on deferred retirement income products (both annuities and pensions).

We also strongly believe that new forms of of collective risk-pooling, such as Collective Defined Contribution (CDC) schemes, should be permissible in Australia. We believe that these schemes can address sequencing risk better than annuities purchased with an accumulated sum at retirement i.e. sequencing shocks may already have occurred.

It is important to state that we do not believe Government should have a policy of "picking winners" under which it mandates specific retirement products. Ultimately, Australians would be best served by a retirement income framework within which Trustees can develop products that meet the identified needs of their members. We look forward to the Committee's final report and hope to see bold recommendations allowing Trustees, acting under a best interests duty, as much flexibility as possible to respond to this challenge.