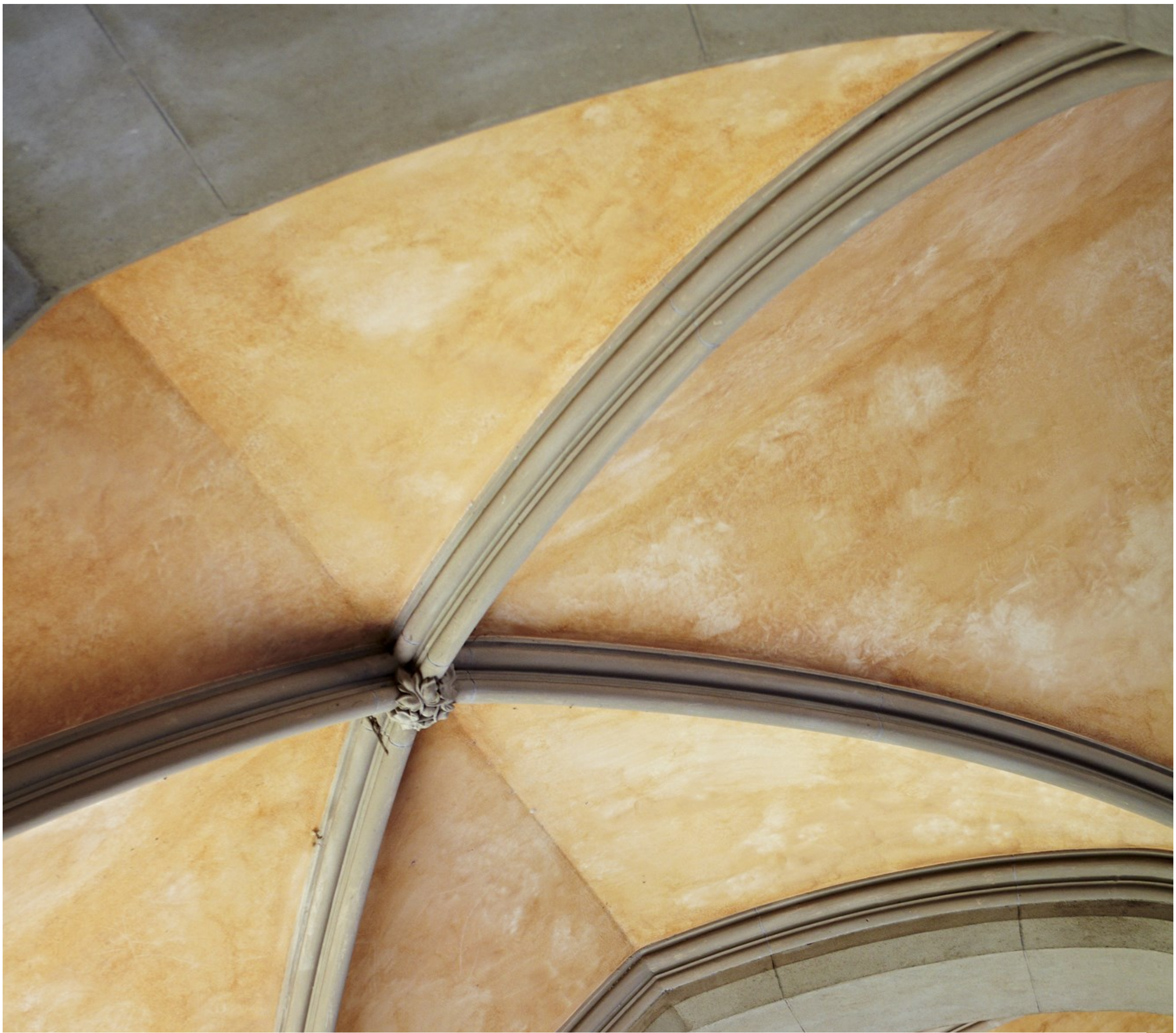
UniSuper



Alternative Default Models: Comments on Draft Report

Submission by UniSuper

28 April 2017

About UniSuper

UniSuper[1] is the superannuation fund dedicated to people working in Australia's higher education and research sector. With approximately 400,000 members and $58 billion in assets under management as at 31 March 2017, UniSuper is one of Australia's largest superannuation funds and has one of the very few open defined benefit schemes.

UniSuper, established in 1983 as a defined benefit (DB) scheme, was modelled broadly on then contemporary DB schemes in the Australian public sector and overseas peer funds. 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 UniSuper 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% of salary p.a. for contributing members;
- by covering the whole university sector, members can maintain defined benefit membership when transferring between employers within the sector;
- 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, UniSuper succeeded in obtaining broad coverage of permanent employees in the Australian university sector and "folded in" a large number of legacy DB superannuation and pension schemes from individual institutions on a successor fund and/or optional transfer basis.

Today, 37 universities and roughly 200 related bodies are participating employers.
The Defined Benefit Division (DBD) remains funded by a 14% employer contribution and 7% default member contribution (which members can reduce with appropriate benefit adjustments). Many members also receive an additional 3% "award" contribution paid into an associated accumulation account, making a total employer contribution of 17%.

We also manage two defined contribution, accumulation-style accounts. Accumulation 1 is for members who are not entitled to DBD membership, and Accumulation 2 is based on the same 14%/17% employer contributions paid by participating employers for those who exercise a form of choice and opt out of DBD membership.

[1] 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 is proud to be recognised as one of Australia's most awarded super funds. Over the years we have received a string of awards and high ratings from independent ratings and research agencies. We strive to offer our members an exceptional offering, from quality customer service through to a streamlined online experience and of course a competitive product suite. We have been recognised by SuperRatings, an independent superannuation research company, as a 'value for money' fund for 10 consecutive years (2006 - 2016). We were named 'Super Fund of the Year' in both 2015 and 2016 by Chant West and received 5 apples ratings for our Accumulation 1 and Accumulation 2 products. Our Accumulation products were also awarded a 10-year Platinum Performance rating by SuperRatings. These awards reflect our ongoing commitment to providing members with the highest quality products and services, along with our competitive investment returns.

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 at benedict.davies@unisuper.com.au

Draft Report: Alternative default models

In our previous submission we highlighted that:

- default super plays a key role in the higher education sector and is important for a viable defined benefit scheme;
- well-considered defaults will not be homogenous;
- employees eligible to become members of a defined benefit scheme raise special issues; and
- from a risk perspective, our defined benefit (DB) scheme is the default membership for new members to reduce selection risk that may compromise the viability of the scheme for both existing and new members.

On our reading, the Draft Report is silent - or light in details - on a number of important issues, notably:

- What role (if any) there would be for defined benefit schemes under each of the alternative default models?
- The consequences of each of the alternative default models on existing DB schemes and their ongoing viability?
- The consequences of each of the alternative default models on the nascent market for new forms of collectively pooled pensions, in particular collective defined contribution (CDC) schemes?

We are concerned that the Draft Report does not adequately address the specific challenges associated with applying policies that have been designed largely for defined-contribution (DC) superannuation to the still large section of Australia's superannuation system that is either defined benefit or hybrid.

It is important to note that defined benefit superannuation cannot be thought of as nothing more than a legacy issue. UniSuper offers an open, viable and successful defined benefit scheme to approximately 10,000 new members each year. The total pool of defined benefit superannuation is also large. According to APRA's Annual Superannuation Bulletin (June 2016), there are 922,000 members with defined benefit accounts plus another 307,0000 with both defined benefit and defined contribution interests. For entities with more than four members, the total liabilities associated with defined benefit member are $346 billion totalling more than 20% of the overall liability for member benefits.

Collectively-pooled arrangements, such as DB schemes, are not an historical oddity. In fact, future directions for product development across the superannuation industry suggest a return to many of the principles of collective-risk sharing which are central to DB schemes. Solutions to address the proposal emanating from the Financial System Inquiry (2014) for a Comprehensive Income Product for Retirement (CIPR) are likely to involve some risk-pooling to address longevity risk. Further, Treasury is consulting on new rules for innovative income streams, including Collective Defined Contribution (CDC) and Group Self

Annuitisation (GSA). In virtually every other retirement income market in the world where these products exist, there are elements of default.

We note that future directions for product development across the superannuation industry suggest a return to many of the principles of collective-risk sharing. The proposal for a Comprehensive Income Product for Retirement is likely to involve some risk-pooling to address longevity risk. While changes to default arrangements would not necessarily preclude collective risk pooling, it is easier and more efficient to pool risks between a well-understood and readily definable class or group of members in a particular sector, particularly where a trustee has a long-established relationship to a sector and has deep and extensive data on employment patterns, resignation and retirement ages, along with reliable mortality and life expectancy data.

Current default arrangements

UniSuper is the default superannuation fund in numerous enterprise agreements across the higher education sector.[2] In our case, there are two defaults: most full-time employees in the sector are defaulted into the Defined Benefit Division (DBD), while casual and contract employees are defaulted into our MySuper product unless they make an alternative decision.

The designs of both of our default products have been based on a strong understanding of the particular needs of employees in the higher education and research sector. Further, the design of our main default product – the DBD – was the culmination of many years of negotiations between universities and their stakeholders to bring about a multi-employer, portable default arrangement.

Given the current design and rules of the DBD, it is important that it is offered as a default to new members to limit selection risks (age, salary or health selection). If the DBD was available on an opt-in basis only, rather than as the default product, its viability may be compromised due to the increased risk of adverse selection which would also affect existing members. In the inter-related case, there is also a potential scale issue over the long term if those eligible to become defined benefit members (e.g. via a default mechanism) were no longer eligible, as the impact of funding risk on the DBD would become more material as the membership size reduced.

Policy makers have long recognised that DB schemes require special consideration. Parallels can be drawn with the existing Choice legislation that includes a specific exemption from Choice for *existing* defined benefit members. If Choice of Fund or Default rules were changed there are likely to be consequences for those who remain in the scheme, having the potential to put pressure on the funding viability of the scheme because there could be:

[2] 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. These rules were also established to prevent members having duplicate superannuation accounts.

- Material numbers of DB members who choose to leave the DB and crystallise their defined benefits, which could lead to significant funding, asset valuation and liquidity issues

- A fundamental shift in the membership profile, creating future funding concerns for the benefits of remaining members

- Increased risk of adverse selection, exacerbated by a lower proportion of members remaining within the scheme

The occurrence of one or all of the above would, in all likelihood, place unacceptable strain on the DBD's funding level and endanger the ongoing viability of the scheme. In UniSuper's case, possible reductions in member benefits could be considered by the Trustee because the fund has neither a government (or employer) guarantee nor recourse to additional employer contributions.

We believe there continue to be very strong reasons why DB schemes need special consideration in developing alternative default models. Our preference would be for an exemption that would allow multi-employer DB arrangements – such as ours – to be exempted from any new default requirements i.e. employers and employee representatives continue to be able to choose or enter into industrial agreements that include a defined benefit scheme as a default.

UniSuper's DBD has an enviable record

Our DB scheme has been in operation for over 30 years. Under current default arrangements, we have been able to establish a successful, well-funded, innovative and *open* DB scheme – a rarity when compared to many other schemes around the world. In contrast to accumulation products (which are directly exposed to investment volatility), DB schemes aim to deliver a more predictable formula-based benefit. The DB structure offers members far greater certainty in planning for their retirement, achieving this through pooling members' assets to smooth investment experience, ultimately providing a stable (formula-based) benefit that is not directly exposed to the volatility of investment markets. Over three decades, and many economic cycles, no UniSuper DB member has had any reduction to their accrued defined benefit. Even after the Global Financial Crisis (GFC), defined benefits accrued by members were not affected. Many Australians have not been so fortunate.

We also have a default MySuper product for accumulation members, typically casual and contract employees in the higher education sector. In developing our accumulation MySuper offering, we undertook extensive modelling of the level of retirement benefit required to ensure that members have adequate replacement income. The objectives of our MySuper investment strategy are formulated on the outcome of that modelling.

We are proud that our default products are anything but homogenous and are based on an intimate knowledge of our members and the employment patterns, salaries and circumstances particular to the higher education sector.

Even with default arrangements, members receive many choices and sometimes greater choices

Under current default arrangements, full time employees in the higher education sector are defaulted into our DBD but have up to 24 months to choose between the DBD and our accumulation option. If a member chooses the accumulation option, there are fund rules in place which allow members at most universities to have an amount equivalent to the SG contributions paid to a fund of their choice, with the difference (making up the balance of the mandated 17%) paid to UniSuper.

The outcome of these arrangements is that our members have a number of choices. Not only is there a choice to cease being a defined benefit member within 24 months of joining, there is also a positive choice to *remain* a defined benefit member. We believe that this choice would be put at risk if default arrangements did not exclude employees eligible to become defined benefit members.

While changes to default arrangements would not necessarily preclude collective risk pooling, it is easier and more efficient to pool risks between a well-understood and readily definable class or group of members in a particular sector. UniSuper, for example, has a long-established relationship with the higher education and research sector. This has allowed us to collect and analyse extensive data on employment patterns, resignation and retirement ages, as well as reliable mortality and life expectancy data. We use this information in developing new products to address the diverse needs for income in retirement, as well as continually assessing the suitability of existing product options.

If default arrangements were to change, large amounts of this sectoral-based expertise and knowledge could be lost which would make it harder to tailor products, insurance and lifetime income streams to a significant number of Australians. The potential changes in membership profile and scale caused by the change in default arrangement would also potentially place unacceptable strain on the DBD's funding level and endanger the ongoing viability of the scheme.

Comments on Alternative Default Models

UniSuper is singularly focused on the higher education and research sector, and it is unlikely that we would participate in a fee-based auction (Model 4) or a multi-criteria tender (Model 3). That is because our focus remains on servicing our existing membership base in the higher education sector with a unique product offering: a multi-employer DB scheme and an award-winning MySuper product, both of which have been developed to meet the needs of the employees in that sector.

For similar reasons, we would be unlikely to apply to be shortlisted under Assisted Employee Choice (Model 1).

While the Assisted Employer Choice (with employee protections) raises fewer issues for a fund like UniSuper, if Model 2 were to be introduced, it should apply only to defined contribution-style products.

Comments on the quality filters

There are a number of proposed quality filters in the Draft Report, some of which could bring about certain benefits. However, we believe any quality filters should only apply to defined contribution-style products. Defined benefit products are distinctly different and the scheme's rules and appropriate prudential oversight already have a similar (if not more stringent) effect to a quality filter.

One option, which fits into current legislation, would be for the Fair Work Commission to apply a quality filter to MySuper products as part of establishing a Default Superannuation List.

We note from the Draft Report that the Commission "is not assessing the current arrangements and will not draw conclusions on the merits of retaining responsibility for selecting default products within the Fair Work Commission."[3]

UniSuper made an application for our MySuper product to be listed in, and only in, the higher education awards. We are open to that process being revisited. We are also open to alternative processes involving different assessors.

Another alternative model which has been utilised in other markets is for price (fees) alone to be used as a filter as part of a "cap and compete" policy for default funds. Such a policy has been introduced in the UK, where fees for defined contribution pension plans are capped at 75 basis points. While we make no comment on what fee level would be appropriate in an Australian context, if such a policy were to be introduced, it would need to be matched with additional integrity measures to ensure that fees were not simply traded off for lower services and lower investment returns.

Even with a quality filter – however designed and applied – we still believe that employers must continue to have a key role to play in allocating default members (particularly where employers have acted together to bring about a multi-employer superannuation scheme).

[3] Productivity Commission, Draft Report: Approach to Developing Alternative Default Models, p 83

Default and Choice of Fund are closely related issues

Choice of Fund and Default superannuation are closely related issues, particularly for DB schemes. Changes to either Choice or Default rules have the potential to affect the ongoing viability of collectively-pooled arrangements, such as DB schemes.

The current Choice rules (as well as recent proposed changes) recognise that DB schemes face unique issues and include an important exemption. We believe that there is strong case for exempting employees eligible to become defined benefit members from both Choice and alternative default models. We are confident we can show from our experience that the stated concerns the Commission has with homogenous default products and a lack of member participation are not applicable in the case of our members.

In our earlier submission to the Productivity Commission we argued there is a need to exempt both current employees and those eligible to become defined benefit members from any proposed alternative default model. Such a policy would ensure that our members continue to have many choices, including a choice to *remain* a defined benefit member. Our view has not changed.

In summary, UniSuper believes that:

- owing to our focus on the higher education and research sectors, UniSuper would be unlikely to participate in a fee-based auction (Model 4) or multi-criteria tender (Model 3);
- for similar reasons, UniSuper would be equally unlikely to apply to be shortlisted under the Assisted Employee Choice (Model 1);
- while Assisted Employer Choice (with employee protections) raises fewer issues for a fund like UniSuper, if Model 2 were to be adopted, it should apply only to defined contribution-style products;
- employers must continue to play a key role in allocating default products; and
- there are very strong reasons why defined benefit schemes need further consideration. Our preference remains for an exemption that would allow multi-employer defined benefit arrangements – such as ours – to be exempted from any new default requirements i.e. employers and employee representatives continue to be able to choose to enter into industrial agreements that include a defined benefit scheme as a default.