Superannuation Legislation Amendment Regulation 2013: MySuper and governance reforms

The Commonwealth Treasury
Submission by UniSuper
15 May 2013
1. Introduction

1.1 ABOUT UNISUPER

1.1.1 UniSuper is the industry superannuation fund dedicated to people working in Australia's higher education and research sector – the thought leaders of Australia. With more than 479,000 members and $35.5 billion in net funds under management (as at 31 March 2013), UniSuper is one of Australia's largest superannuation funds and has one of the very few open defined benefit schemes. Appendix 1 provides more details about UniSuper.

1.1.2 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).

1.1.3 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. In the first instance, please contact Luke Barrett, Head of Investment Law and Compliance on 03 9910 6145 or luke.barrett@unisuper.com.au, or Benedict Davies, National Technical Adviser on (03) 9910 6671 or benedict.davies@unisuper.com.au.
2 General comments

2.1
UniSuper welcomes the opportunity to comment on the draft Regulation.

2.2
Broadly speaking, UniSuper supports the draft Regulation, including:
   (a) strongly endorsing the use of CPI in describing performance objectives; and,
   (b) the policy that funds will not be required to accept contributions sourced from
       other jurisdictions.

2.3
We do have some reservations with particular regard to:
   (a) Disclosing portfolio holdings;
   (b) Aspects of product dashboard disclosure; and,
   (c) The requirement to include product dashboard(s) with periodic statements.

These concerns, along with others, are outlined in further detail within the submission.
3 Portfolio holdings disclosure

3.1
While UniSuper understands the policy aims behind increased disclosure of portfolio holdings, we feel that it is inconsistent with the observation that many members are disengaged with their super. We are concerned that all members, including MySuper members, will ultimately pay for this through administration fees and we question whether this is the best way to increase member engagement and whether the additional expense is justified.

We urge Government to exercise the power which was specifically included in the legislation to prescribe a materiality threshold so that portfolio holdings can be disclosed in a meaningful, targeted and accessible way. For example, a materiality threshold might focus on the top 50 holdings of an option, or on those holdings that represent more than say 1% of the portfolio, and only require the percentage weighting to be disclosed (rather than the number of shares and the price per share).

3.2
The disclosure requirements will put superannuation funds at a significant disadvantage when dealing in the secondary market for unlisted assets. The proposed disclosure requirements will give other domestic and foreign institutional investors an unfair informational advantage over Australian based superannuation funds. In a commercial negotiation, it is very valuable to know how much the other party values the relevant asset. For example, when buying an asset from a superannuation fund, it is very useful to know how much the superannuation fund values the asset – it might be difficult, for example, for the superannuation fund (as seller) to argue that an asset is worth more than they themselves have valued the asset in their books.

3.3
As such, superannuation funds will be at a tactical disadvantage when endeavouring to sell their unlisted assets, since the purchaser will be able to ascertain the book value from the superannuation fund’s website. The converse will apply when a superannuation fund is attempting to acquire further holdings in an unlisted company in which it has already invested. Typically a buyer may seek to drive down the purchase price but, again, it will be difficult for a superannuation fund to push down the price when it will be apparent from their website that they in fact value the asset more highly.

3.4
The draft regulations focus on disclosure with regard to MySuper products and choice products. It is unclear how the requirements are intended to apply to defined benefit funds, if at all. Clarification in this regard is necessary.
3.5

It is completely unclear how derivative exposures are expected to be disclosed, if at all and whether those positions should be disclosed on the basis of effective exposure or on a profit / loss basis. Sophisticated funds utilise a wide range of derivatives and different considerations arise depending on the type of derivative concerned for example, currency hedging, interest rate swaps, stock-specific call and put options, as well as share price index futures, to name a few. We assume that derivative exposures to particular stocks and currencies are not expected to be taken into account when calculating the direct exposure to the relevant stock or currency.

3.6

We encourage Treasury to contact us to discuss how derivatives may be disclosed, and the operational and systems difficulties associated with the alternative disclosure methods.
3.3

There is no relief for trustees who will be compelled to breach third party confidentiality obligations in order to comply with the disclosure requirements. This is an issue that we have identified in earlier submissions which still has not been addressed. There are two situations where this could occur:

(a) Some investment options are managed on a passive or indexed basis. This means that the portfolio of shares held by the investment option matches (or substantially matches) the shares making up the relevant market index. In order to operate these investment options, superannuation funds must enter into strict benchmark licensing agreements and these agreements forbid trustees from revealing the constituents of the market index. When trustees disclose the holdings of these investment options, they will breach their benchmark licensing agreements. This will expose those trustees to the risk of substantial claims for damages, because the constituents of a market index are commercially valuable intellectual property of the benchmark manufacturer. Note that these benchmark licensing agreements are often governed by US law, rather than Australian law, meaning that the Corporations Act does not override the restrictions in the agreement.

(b) The proposed ‘Table 2’ would require trustees to disclose the assets held by each “investing product” in which an option has invested. These pooled products may be subject to contractual confidentiality restrictions which do not necessarily have a carve-out for disclosures required by Australian law. There should be provisions which protect trustees in these cases. This would arise in the following contexts:

(i) Private equity funds, and
(ii) Investing products which are managed on an indexed or passive basis – in these cases, issues analogous to those referred to above would arise. If the superannuation trustee were to reveal the constituents of the benchmark index, this could put the manager of the pooled fund in breach of its benchmark licensing agreement (and, as such, the benchmark manufacturer may claim damages from the manager of the pooled fund), which could in turn give rise to claims for consequential loss being made by the manager against the superannuation trustee.

This issue could be mitigated (in part) if the interposed investing products did not have to be named.
4 Product dashboard disclosure

4.1
We gather that the Government is now comfortable with performance objectives being described by reference to CPI, and that it will no longer be mandatory to describe investment objectives by reference to AWOTE. We strongly endorse this change, as CPI is a far more common basis on which to set investment objectives.

4.2
Several concepts in the draft regulations will in due course be defined in SRS 700.0, which is not currently available. It is therefore difficult to express a concluded view on the draft regulations without access to all of the relevant definitions.

4.3
For example, it is unclear how the line-graphs illustrating the net return objective and the moving average returns over the last 10 years are intended to be calculated. Taking the simple case of a dashboard showing returns and the return objective for the 10 year period between 2003 and 2013:

(a) Is the CPI-plus target for the first year (i.e. 2003) meant to be calculated by using actual CPI in 2003? Or is it meant to be calculated using annualised CPI for the 10 years between 1993 and 2003?

(b) Some MySuper products may be re-badged versions of predecessor products. In some cases, the predecessor product may not have had a 10 year performance target (the 10 year requirement was introduced by MySuper-related legislation). In these cases, for the years prior to being re-badged as a MySuper product, should the moving average net return, and the net return target, be calculated for the time period that applied before a 10 year investment return objective was adopted? The drafting would seem to require calculations to be done for the 10 year period, even though performance over a 10 year period may not have been targeted in the past.

(c) If the investment performance objective changed during the last 10 years, this should be reflected as a point of discontinuity in the line representing the net return objective. It is potentially misleading if funds were to adopt a lower performance objective so as to be able to issue dashboards which suggest that they have historically achieved objectives. This should ideally be clarified in the final regulations or, at a minimum, in a revised explanatory memorandum.

4.4
We note that the concept of “net returns” is intended to exclude administration fees. Some funds have an investment objective that aims to achieve a particular rate of investment return after investment expenses, without referencing administration fees. The proposed product dashboards could therefore become source of tension vis-à-vis the investment objective that would otherwise have been disclosed elsewhere.
4.5
Along similar lines, we query how a net return target is intended to be calculated, after administration fees, for products which have a dollar-based administration fee. It is difficult to deduct a dollar-based administration fee from a rate of investment return (in percentage terms) unless some assumption is made about the size of a member’s account balance, which would allow the dollar-based administration fee to be converted into percentage terms and deducted from the target investment return. Guidance in this regard would be appreciated.

4.6
The Government has foreshadowed further consultation in connection with the development of the product dashboard requirements for choice products. To that end, we make the following observations so that they can be taken into account when developing the template product dashboard for choice products.

(a) Some investment options may not have an investment objective which is defined by reference to CPI. For example, some investment options may have an objective to achieve a particular yield and/or to outperform a particular benchmark index. It is conceivable that some options may target an absolute return objective. The product dashboard requirements for choice products will need to accommodate that flexibility.

(b) Some investment options may aim to achieve a return over a period of time which is longer or shorter than 10 years (for example, CPI + 2% over 2 years). In these cases:

   (i) The target net return graph should be calculated using the time period applicable to the particular product (in this example, 2 years),
   (ii) The moving average should also be calculated over the time period applicable to the particular option (in this example, over 2 years), and
   (iii) If the relevant time period (ie that is built into the investment objective) changes, the graphs should be prepared using the investment objective and the time period that was applicable at each historical point in time.
5 Product dashboard(s) and periodic statements

5.1 The proposed Regulation would require the inclusion of product dashboard(s) along with a member’s periodic statement. This Regulation complements the new obligation in section 1017BA in the Corporations Act which the EM states will have effect from 1 July 2013.

5.2 Subsection 1017D(2)(c) of the Act includes a provision that looks back such that the reporting period starts at the end of the preceding reporting period; typically, at the start of the previous financial year. We seek clarification that the obligation to include product dashboard(s) with a member’s periodic statement while effective from 1 July 2013 will only have effect for the reporting period commencing on 1 July 2013 thus first applying for the period ending 30 June 2014.

5.3 We are also concerned that the explanatory memorandum suggests that funds will only be required to send product dashboards with periodic statements for those investment options in which a member has actually invested. However, there is nothing in draft regulation 7.9.20(1)(o) to limit the obligation in this way; the draft regulation would appear to require the dashboard for every available investment option to be distributed with periodic statements, which would be costly, confusing for members and unfeasible.

5.4 Given the complexity involved in integrating the product dashboard(s) with periodic statements, we submit deferring the provision of product dashboard(s) with periodic statements until choice requirements are finalised. We believe this would reduce implementation costs borne by members while achieving substantially the same policy outcome.
6  PDS fee disclosure in a post-MySuper world

6.1  OVERLAP IN FEE DISCLOSURE

6.1.1
We endorse the general proposal to update the templates used for disclosing fees and providing worked-examples in PDSs and shorter PDSs.

6.1.2
However, we note that there is potential for overlap and double-disclosure under the new requirements. This is because some funds may elect to fund their operational risk financial requirement (ORFR) for the purposes of APRA’s prudential standards by deducting the ORFR amounts indirectly from the assets or investment returns underpinning a MySuper product and other investment options.

In such cases, those deductions will potentially have to be disclosed as an administration fee (being costs that relate to the administration or operation of the fund within the meaning of section 29V(2) of the SIS Act) and, if they are deducted indirectly, draft subclause 218(6) of Schedule 10 of the Corporations Regulations requires those fees to be incorporated in the indirect cost ratio.

6.1.3
The problem is that Schedule 10D of the Corporations Regulations is drafted on the basis that each investment option only has one indirect cost ratio. The indirect cost ratio may potentially contain amounts that are in the nature of administration fees and also amounts in the nature of investment fees. As such, if funds were to calculate the administration fees using the indirect cost ratio (as required by the new drafting), this will require administration fees to be calculated using a figure that also includes investment fees. (Conversely, investment fees would have to be calculated using a figure that includes administration fees).

6.1.4
To address this issue, the drafting of subclause 218(6) of Schedule 10D of the Corporations Regulations should require the indirect administration fee to be calculated using only that part of the indirect cost ratio that relates to administration fees; and indirect investment fees should be calculated using only that part of the indirect cost ratio that relates to investment fees.

6.1.5
Alternatively, to ensure consistency amongst MySuper products that will fund their ORFRs through different mechanisms, clarity could be provided that ORFR related costs are not intended to be captured by the definition of “administration fee”. At present, there is a risk that some funds will disclose their ORFR costs as an administration fee and that others will not.
6.2 REQUIREMENT FOR ADDITIONAL DISCLOSURE

6.2.1 Item 13 of the ED replaces the existing Item 3 of Schedule 10D. This will impose additional disclosure requirements in the ‘About UniSuper’ section of the Shorter PDS core document including statements directing the member to the section of the trustee’s website containing the:

(a) Portfolio holdings disclosures,
(b) The product dashboard for MySuper and choice products, and
(c) Executive remuneration disclosure.

6.2.2 The additional content required in the inserted Item 3(1)(b) and (c) will also place additional pressure on the 8 page limit for the shorter PDS. Currently, super funds are reasonably restricted in their ability to include more content into a shorter PDS. The requirement to include specific references to these new disclosure items in a PDS will present a serious challenge in terms of disclosure owing to the limits already imposed on the length of a PDS. We submit that consideration ought to be given to allowing either consideration to allowing more flexibility in the length of shorter PDSs or greater use of incorporation by reference.

6.2.3 The Corporations Act requirement to publish the choice product dashboard(s) will not take effect until 1 July 2014, however, this Regulation will include a requirement to direct members to the product dashboard(s), including the choice product dashboard(s). This will impose a requirement to insert a directing statement into a PDS on 1 July 2013 to a website disclosure that is not required until 1 July 2014.

6.3 REPLACEMENT TEMPLATE FOR MULTIPLE FEE STRUCTURES

6.3.1 Item 7 of the ED intends to insert a replacement Division 1 of part 2 of Schedule 10. This will replace the existing generic template for multiple fee structures, which applies for all products (ie super and MIS) with a new template for ‘Superannuation products’ and applying the existing template to all ‘Products other than superannuation products’.

The new template for ‘Superannuation products’ includes information with regard to new ‘Types of fees or costs’ including:

(a) A separation of ‘Management costs’ into sub categories of ‘Investment fees’ and ‘Administration fees’, and
(b) ‘Service fees’ comprising ‘Investment switching fees’, ‘Exit fees’ and ‘Buy-sell spread’.
6.3.2
These fee categories replace existing fee categories relevant to disclosure for superannuation products. With the exception of the ‘Buy-sell spread’ none of these new fee categories are defined in Schedule 10, the Corporations Regulations (reg 1.0.02) or the Corporations Act (s9 or s761A), nor does the ED insert any such definitions. We seek clarification that we can rely on existing definitions in the SIS Act to interpret these terms.

6.3.3
It also appears that these fee categories are intended to capture the new permissible fee categories for MySuper products under the new s29V of the SIS Act inserted via the Tranche 1 Stronger Super Amending Act. We seek clarification that there will be a linking provision between the terms described in the new template with the definitions provided in s29V of the SIS Act.

6.3.4
Item 14 of the ED replaces the existing subclause 8(3) of schedule 10D. This will replace the existing short form fee disclosure template with a new template/worked example. The replacement template/worked example will incorporate all the new fee categories referred to above (i.e. linkages to those defined terms in s29V of the SIS Act).

6.3.5
An additional concern arises where the existing schedule 10D requirement (8(7)) to include a worked example consistent with the requirements of Divisions 5 and 6 of Schedule 10 has not been repealed. As a consequence, it appears that after the implementation of the ED the shorter PDS will include both the new template/worked example (under inserted 8(3)) and the existing worked example (under 8(7)).

6.3.6
The examples will include different fee categories for the same MySuper product.

6.4 TRANSITIONAL ARRANGEMENTS

6.4.1
This also raises the broader issue; namely, that consideration should be given to a transition period, as the proposed regulations are only in draft form, creating unachievable deadlines to issue new PDSs with the proposed disclosures, including new terminology, by 1 July 2013. The existing fee table, for example, should be allowed to be used for any PDS issued up to, say, 1 January 2014, from which date the new fee table must be used.
7 Definitions relating to transfers from foreign superannuation funds

7.1
Regulation 9.48 would allow the governing rules of a regulated super fund to place limits on contributions if the transfer is from a foreign superannuation fund, defined in section 995-1 of the ITAA 1997.

7.2
UniSuper strongly supports the policy that funds will not be required to accept contributions sourced from other jurisdictions, particularly where that imposes additional international compliance obligations on the fund, often for the benefit of only a small number of members.

7.3
We are concerned, however, that the regulations rely on the concept of “foreign superannuation fund”. We submit that this will present problems to super funds in drafting a workable governing rule as well as presenting ongoing interpretation issues.

7.4
The definition of “foreign superannuation fund” is complex and has been the subject of debate within the industry over many years. The ATO has also been involved, and published a summary of a decision in ATOID 2009/67. The question of whether “retirement plan” is a “superannuation fund” is complex and requires analysis of the terms “indefinitely continuing”, “fund”, “provident, benefit, superannuation or retirement fund” etc. While this ATOID is helpful in providing guidance on interpreting the tax rules, the ATOID does not explain what happens if an overseas retirement plan does not meet the definition of “foreign superannuation fund”.

7.5
However, these regulations depend entirely on that definition. We submit that there will be confusion where a member wishes to transfer funds from a foreign jurisdiction but the source-fund does not meet the strict definition of “foreign superannuation fund”. For example, an Individual Retirement Account (IRA) under United States law allows access to the funds at any point in time. Therefore, it is arguable that an IRA would fail to meet the definition of “foreign superannuation fund” and an Australian superannuation fund would be required to accept a transfer from an IRA as well any compliance obligations imposed by the other jurisdiction.

7.6
We submit that the regulation needs to be drafted more widely to allow governing rules to place restrictions on “transfers from foreign superannuation funds and/or similar foreign funds”.

UniSuper submission:
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Appendix 1: About UniSuper

UniSuper is the industry superannuation fund for employees in Australia's higher education and research sector and was the result of a merger between the Tertiary Education Superannuation Scheme (TESS) and the Superannuation Scheme of Australian Universities (SSAU) in October 2000. Prior to the merger, UniSuper had been the trustee for the SSAU.

UniSuper offers both defined benefit and accumulation plans to its members. The Defined Benefit Division (DBD), 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 24 months to decide if they want to move from the DBD in to an accumulation plan in which they would receive the same level of contributions and insurance benefits. This is our Accumulation 2 product.

Other UniSuper members, usually casual employees and those employed by 'related bodies' that are not universities, join our Accumulation 1 plan. These members generally receive contributions at the Super Guarantee rate. These members receive a lower level of contributions than our Defined Benefit Division/Accumulation 2 members and the benefit structure and insurance arrangements differ as well.

For more information about UniSuper, please visit www.unisuper.com.au.