

Consultative Committee Circular – 3/2006



To Consultative Committee Members
From Ann Byrne, CEO
Date 16 June 2006

Dear Consultative Committee Members,

It is with pleasure that I provide you with an update on a number of issues.

1. Defined Benefit Plan

To ensure the ongoing prudent management of the Defined Benefit Plan (DBP), particularly in minimising the risk of the vested benefit index falling below 100%, the Board has made changes in the underlying management of the UniSuper DBP.

Over the full life of the DBP (now approaching 25 years), the general experience has been for the Plan's assets to comfortably exceed its liabilities, based on a constant contribution rate of 21% and a relatively aggressive allocation of investments to growth asset markets such as shares, property and infrastructure. Indeed, during the 1990s, the financial experience of the Plan was so positive that the Trustee was able, on actuarial advice, to make surplus distributions to members and pensioners on a number of occasions.

However, the downturn in investment markets in the years 2002 and 2003 presented a significant challenge to the DBP, with the requirement imposed by regulations for UniSuper to disclose an "unsatisfactory financial position" for the Plan during those years when its Vested Benefit Index (VBI) fell to below 100% of liabilities.

The Trustee and Actuary affirmed at the time that an alternative measure, the Accrued Benefit Index (ABI) was in fact a more suitable measure to consider, in the case of a large multi-employer plan like UniSuper. Nevertheless, even though the ABI did not fall below 100%, the experience of the market downturn did give pause to the Trustee to consider a range of initiatives to ensure the on-going prudent management of the Plan including a decision to invoke Clause 34 (a) of the UniSuper Trust Deed.

A further, medium-term initiative was to commence a comprehensive review of the asset and liability structure of the DBP, having regard to the changed investment environment and outlook that have a bearing on the DBP's long-term viability. Among the issues addressed by this review were:

- Whether there were any structural changes in the global investment environment that might warrant a re-consideration of the Plan's investment objectives, asset mix and benefit structure; and
- Whether a suitable balance existed in the DBP's asset portfolio between maximising the likelihood of meeting the Plan's liabilities at an acceptable level of investment risk on the one hand, and making further potential windfall gains from market upturns on the other.

This review has resulted in two significant changes to the management of the DBP as follows.

i) Surplus Distribution Policy

The Board's previous surplus distribution policy, adopted in 2000, was that the Trustee could consider surplus distributions when the VBI exceeded 110% of liabilities. The Board has now formally cancelled that policy. In its place, the Board has adopted a surplus distribution policy consisting of the following components:

- A surplus distribution threshold equal to a VBI of 130%;
- Distribution of half the surplus above this threshold, when it is available, with the balance carried forward;
- Yearly reviews (as at 30 June) of distributable surplus for the active member component; and
- Three-yearly reviews (also at 30 June) for the pensioner component.

ii) Change to DBP Asset Allocation

As you would expect the Board considers one of its major roles to be the continual monitoring of the risk within the DBP and so when the VBI reached 113% at 31 December 2005 the Investment staff revisited the asset liability study to reassess the risk appetite of the Plan.

As a result of this further review the Trustee in February this year reduced the level of the DBP's exposure to growth asset markets from a total of 85% of the portfolio to 70%.

In investment terms, this transition involved considerable implementation logistics and the utmost confidentiality. The transition involved the transfer of roughly \$1.3 billion of assets from Australian and international equities, to Australian and international fixed interest assets within a period of only a few weeks, without disturbing the markets or allowing other market participants to foreshadow our moves and seek to exploit them for their own purposes. This transition exercise commenced in mid February 2006 and was completed in early March 2006.

It is important to emphasise that this change in asset allocation should in no way be seen as being a short-term 'tactical' move reflecting a particular view about the immediate-terms risks inherent in investment markets. Rather, it is a strategic change driven by a re-assessment of the underlying drivers of the DBP's benefit structure, its liability profile, and the need to align the asset allocation more closely with the Plan's primary objective, which is to deliver on its liabilities to members.

It should also be emphasised that, with a 70% exposure to growth assets, the DBP is still positioned to participate strongly in the upside of current and future market movements, and to retain a significant exposure to alternative assets such as infrastructure and private equity, which have contributed to the returns achieved over the past few years.

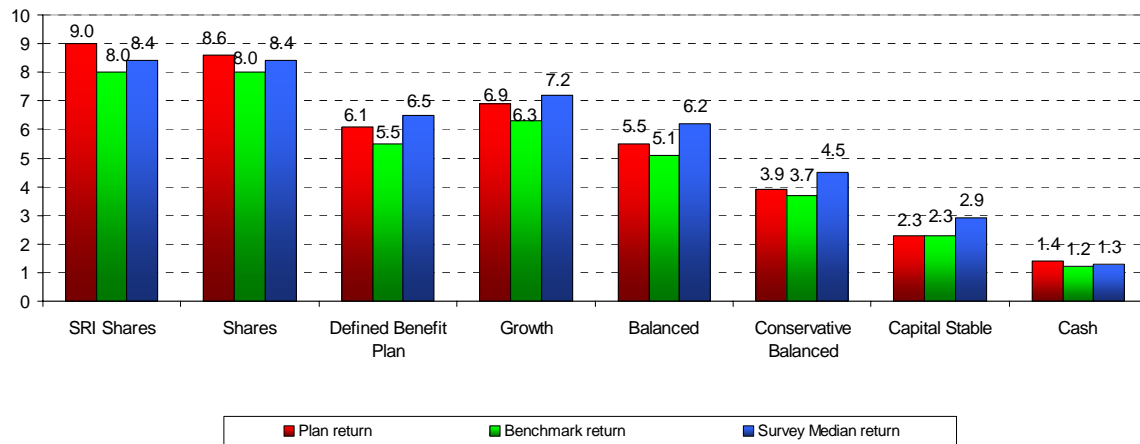
The two actions detailed above have all been taken in pursuit of the underlying objectives of ensuring that the Defined Benefit Plan has the greatest chance of delivery on the promise to members.

2. Investment Performance

International share markets experienced some volatility over the March 2006 quarter as investors reacted nervously to interest rate rises in both Europe and the US. Concerns were, however, short lived and strong profit growth and robust merger activity drove markets higher over the period. The MSCI World ex Australia Index rose by 6.5% on a hedged basis, while the unhedged equivalent returned 9.7% over the period.

Record commodity prices and solid corporate reporting results also pushed the local share market to record levels over the March 2006 quarter, with the S&P/ASX 300 Accumulation Index increasing by 9.1% over the period. Emerging markets, with a return of 15.3%, was the best performing asset class for the period.

The graph below summarises Option performance (after tax and fees) for the quarter ending 31 March 2006.



Footnote: The surveys used for each Option are identified in Sections 2.2.2 to 2.2.9 of this report.

Buoyed by favourable share market conditions, all Options delivered positive absolute returns for the March 2006 quarter. In addition, all Options either exceeded or matched their respective benchmarks for the period. Performance in comparison to relevant medians was, however, less favourable due primarily to the generally lower exposure to shares (and higher alternative investments and direct property exposure) of UniSuper's investment strategies relative to the median manager. The lower shares exposure has also impacted the positioning of UniSuper compared to peers in the SuperRatings survey.

Appendix 1 shows the performance over 3 and 5 years.

3. Flexibility of Employee Contributions

You may recall that you approved changes to UniSuper's Trust Deed in late 2005 to provide for greater flexibility in the aggregate superannuation contributions required for members of the Defined Benefit Plan and Accumulation 2 (formerly known as the Investment Choice Plan).

This initiative will commence on 1 July and we are in the final stages of communication to members and University Superannuation Officers. An "e-learning" module will also be available on UniSuper's website to assist in educating members who wish to consider this flexibility.

4. Trust Deed Changes Approved

I am also pleased to inform you that the Trust Deed changes were approved via the recent circular resolution. However, in light of the changes announced in the Federal Budget we will not offer spouse splitting as at 1 July 2006. As the main drive behind splitting was members reaching their Reasonable Benefit Limit (RBL) threshold, with the abolishment of RBL there will no longer be any need for couples to split their contributions to maximise these factors. Therefore UniSuper will wait until the budget changes are final to assess whether this service is required by members. The delay will not affect the ability of members to split as at 1 July if it is introduced later in the year.

5. Federal Budget Report

For UniSuper members and employers, the significant issues from the Federal Budget were increases in the thresholds for higher marginal tax levels and proposals for a major overhaul of the superannuation system. What is proposed is the most significant change to the superannuation environment since the introduction of Super Guarantee. The proposals, which industry and other interested parties can comment on before 9 August, are proposals that the Federal Treasurer has requested feedback on. However, when asked about the status of the proposal he responded by saying, "We're going to do it."

The Treasurer announced a series of proposals that would significantly impact superannuation from 1 July 2007 if they are implemented. The main elements of the proposal, titled "A Plan to Simplify and Streamline Superannuation", are:

- *Superannuation benefits paid as a lump sum or as a pension to a person aged over 60 would be tax free. This would also apply to pensions paid to pensioners over age 60 but commencing prior to 1 July 2007;*
- *Benefits paid to a person aged under 60 would continue to be taxed, but on a slightly different basis;*
- *Benefits paid from untaxed funds (mainly public sector schemes) to a person aged over 60 would continue to be taxed, but at lower rates;*
- *Reasonable Benefit Limits (RBLs) would be abolished;*
- *Rules governing the compulsory payment of superannuation benefits after age 65 would be relaxed;*
- *The age-based deductible contribution limits would be removed. All employer contributions would be tax deductible;*
- *Contributions tax would increase from 15% to 45% for employer contributions (including salary sacrifice contributions) over \$50,000 p.a.;*
- *Undeducted contributions would be limited to \$150,000 p.a. The cap may be averaged over a period of three years;*
- *Self-employed persons would be able to claim a full deduction for contributions, and could also claim the co-contribution (but not on deductible contributions);*
- *The 50% assets test exemption for complying income streams would be removed from 20 September 2007 and the assets test would be modified;*
- *The period within which portability transfers must be processed would be reduced to 30 days; and*
- *Improved procedures for locating and consolidating lost super would be put in place.*

A full report on the budget is on the website at:

http://www.unisuper.com.au/resources/News/bulletin_board_item.cfm?oid=650E238D-8503-4752-9C8EC816C8045900

6. Administration System Transition

As you would be aware, UniSuper recently converted to a new computer system for all its member records and transaction processing operations.

This system conversion was undertaken to ensure UniSuper:

- Remains at the forefront of the superannuation industry in its administration capability and cost-efficiency; and
- Retains the flexibility to introduce new product and service enhancements required by our members and participating employers.

We have provided an update to members on the website on the progress of the system conversion at:

http://www.unisuper.com.au/resources/News/bulletin_board_item.cfm?oid=348DB848-9E5F-4CD8-900A523EF8D4796D.

7. Fee Review

In late 2005 we concluded an extensive review of the underlying costs associated with each of UniSuper's products and will implement a new fee structure from 1 July 2006.

The new fee structure encompasses some adjustments that have been made to ensure that UniSuper's fees are levied as much as practicable on a cost recovery basis. A significant result of the review is that most contributing members will experience a reduction in their fees and charges, while inactive members and some pension members will experience an increase.

Details of the new fees and charges were included in the recent SuperInformed newsletter that was mailed to all members in May, and will be reflected in the new Product Disclosure Statements and accompanying website information.

8. Change of Date for the 2006 Consultative Committee Meeting

The 2006 Consultative Committee meeting will now be held on Friday 3 November at the Melbourne Hilton Airport Hotel.

Kind Regards.



Ann Byrne
Chief Executive Officer

Appendix 1

Plan/Option (After tax and after fees)	Performance Measure	2006	2005				1yr	3yr	5yr	Calendar Years			
		Mar qtr	Dec qtr	Sep qtr	Jun qtr	% p.a	% p.a	% p.a	2005	2004	2003	2002	
SRI Investment Option ¹	UniSuper	9.0	4.2	7.4	4.3	27.3	20.8	n.a.	18.7	16.7	10.4	n.a.	
	Benchmark	8.0	4.4	8.0	3.4	25.9	21.4	n.a.	18.5	18.8	11.7	n.a.	
	Median	8.4	4.4	8.4	3.6	27.6	22.1	n.a.	19.5	19.2	11.6	n.a.	
Shares Option	UniSuper	8.6	4.8	8.4	3.8	28.1	23.0	9.3	20.2	19.7	13.0	-14.2	
	Benchmark	8.0	4.4	8.0	3.4	25.9	21.4	8.4	18.5	18.8	11.7	-14.5	
	Median	8.4	4.4	8.4	3.6	27.6	22.1	7.4	19.5	19.2	11.6	-14.2	
Defined Benefit Plan	UniSuper	6.1	4.1	6.0	4.5	22.3	19.9	9.9	17.7	20.1	12.0	-8.2	
	Benchmark	5.5	3.9	6.4	3.2	20.5	18.2	8.5	16.0	18.0	10.9	-9.2	
	Median	6.5	4.6	7.0	3.5	22.2	18.4	7.9	17.5	18.1	8.4	-10.8	
Growth Option	UniSuper	6.9	4.0	5.8	4.4	22.7	19.5	9.6	17.0	19.3	11.4	-8.2	
	Benchmark	6.3	3.9	6.4	3.2	21.4	18.5	8.6	16.0	18.0	10.9	-9.2	
	Median	7.2	4.6	7.0	3.5	22.9	18.7	8.0	17.5	18.1	8.4	-10.8	
Balanced Option	UniSuper	5.5	3.5	4.9	4.0	19.2	16.5	8.8	14.6	16.6	10.0	-5.3	
	Benchmark	5.1	3.5	5.2	3.2	18.2	15.6	8.2	13.7	15.4	9.6	-5.5	
	Median	6.2	4.0	5.9	3.2	20.9	16.5	8.4	15.0	16.1	7.7	-7.3	
Conservative Balanced Option	UniSuper	3.9	3.1	3.9	3.4	15.1	12.9	7.4	11.9	13.0	8.0	-1.8	
	Benchmark	3.7	3.0	3.7	2.9	14.0	12.1	7.0	10.9	12.2	7.7	-2.1	
	Median	4.5	3.1	4.4	2.8	16.1	12.9	7.3	12.0	13.0	6.5	-3.2	
Capital Stable Option ²	UniSuper	2.3	2.5	2.4	3.2	10.7	9.3	n.a.	8.9	10.4	5.8	n.a.	
	Benchmark	2.3	2.4	2.3	2.9	10.2	8.8	n.a.	8.4	9.4	6.0	n.a.	
	Median	2.9	2.3	2.9	2.4	11.3	9.4	n.a.	9.0	9.8	5.3	n.a.	
Cash Option	UniSuper	1.4	1.4	1.3	1.3	5.4	5.0	4.8	5.3	5.0	4.4	4.3	
	Benchmark	1.2	1.2	1.2	1.2	4.9	4.7	4.4	4.9	4.8	4.2	4.0	
	Median	1.3	1.2	1.2	1.2	5.1	4.8	4.6	4.9	4.9	4.2	4.0	

Footnotes:

The surveys used for each Option are stated in Sections 2.2.2 to 2.2.8 of this report.

1. Inception date 18/10/2002

2. Inception date 1/10/2002