



Tuesday 26 September 2006

Dear Consultative Committee members

I am writing to bring to your attention some important issues surrounding the management framework for the UniSuper Defined Benefit Division (DBD), including a proposed Trust Deed amendment to be considered at the next meeting of the Consultative Committee on Friday 3 November 2006.

*Commitment to Transparent Stakeholder Communication*

The Board of UniSuper is committed to providing product transparency to members thus ensuring a high level of understanding of UniSuper. As UniSuper has an open defined benefit plan it is important that members are aware of the excellent benefits provided by the Plan as well as any risks it entails.

Part of this commitment is to ensure that members understand the operations of Clause 34.

As you would be aware, Clause 34 designates the process to be followed if the UniSuper's assets were, at some future stage, deemed to be insufficient to provide the benefits payable under the Deed and the insufficiency remained for some years. The current wording of the clause is attached for your reference (*Attachment 1*).

In its present form, Clause 34 requires a multi-stepped process to be followed in the event of a sustained shortfall in the assets of the UniSuper Defined Benefit Division. The key steps are summarised as follows:

- First, the Trustee would need to conduct a number of actuarial investigations over a period of up to eight years before it could formally conclude that the assets were insufficient to provide benefits under the Deed.
- If at the end of this period the relevant financial conditions continued without adequate improvements, then the Trustee would then be required to call on each employer to contribute such additional amounts as the Trustee considered necessary to provide the benefits.
- Then, within three months of the Trustee's notification, employers would be required to jointly notify the Trustee in writing as to what, collectively (if anything), they were prepared to pay in additional contributions.
- After the employers' notification of an amount they were collectively prepared to pay, members would in turn be required to contribute an amount equal to one half of the rate that the employers were prepared to contribute.

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- Alternatively, if the employers failed to jointly and collectively agree upon the extra amounts they were prepared to contribute (or they collectively agreed that they were not prepared to pay any additional contributions), then the Trustee would be required to resort to a reduction in members' benefits on a fair and equitable basis.

### *Employer Consultations*

Over recent months UniSuper has consulted extensively with UniSuper employers on the Defined Benefit Division and the operation of Clause 34.

In the course of this consultation, we have established that there would be no prospect, in practice, of all participating employers agreeing in unison to increase their contributions in the event that the Clause 34 process ever advanced to that stage. Quite to the contrary, a number of employers have informed us that they would *not* increase their contributions in this situation. The Trustee is also aware that agreement by employers will require members to increase contributions. Anecdotal responses from members suggest that they, too, would not be happy to increase their contributions, especially when they would not have any choice to decide otherwise.

Consequently, the reality of Clause 34 is that if such a situation were ever to arise, the only option available to the Trustee in practice would be to reduce members' benefits on a fair and equitable basis.

### *Proposed Trust Deed Amendment*

In view of this situation, the Trustee considers the current Trust Deed wording to be unclear for members as it gives an impression that employers *may* make additional contributions if the VBI was in an unsustainable situation, even though the Trust Deed imposes no obligation and the Trustee knows that this outcome is not a realistic possibility. It also assumes that members would willingly increase contributions.

In view of this likely misconception, and in the interests of clarity and transparency for all stakeholders, the Trustee therefore believes that the current wording of Clause 34 should be amended to reflect the actual implications that would stem from a significant and prolonged shortfall in the DBD's assets in the future.

In recent weeks I have informed both APRA and ASIC of the outcome of the Trustee's consultation with employers and its proposal to change Clause 34. They do not express an opinion on the actions of the Trustee apart from expressing a view that we must ensure that we meet our obligations under the SIS Act and the Trust Deed, which between them enshrine certain processes and protections for members in the event that the Trustee proposes to change their benefits.

In light of the regulators' views, following the consultation process with employers, the Trustee sought legal advice concerning the nature and extent of members' entitlements under Clause 34 in light of the SIS Act requirements and general trust law. Their advice confirmed as follows:

*"At best, the current provisions of Clause 34 provide an expectation that Employers might agree to increase contributions, but they do not affect a right to or a claim to a benefit in a legal sense.*

*Accordingly, in my opinion, provided that the Trustee is satisfied that the proposed amendment is in the best interests of the Members, I do not believe the Trustee is precluded from effecting the change by reason of Regulation 13.16 or the restriction imposed on the Trustee's power to amend the Deed by Clause 53.4(a) of the Trust Deed."*

It is the unanimous view of the Trustee that it is clearly in the interests of members to inform them of what the Trustee knows would occur in the unlikely event of the assets being insufficient to fund the benefits – that is, that this situation would ultimately lead to some form of reduction in their benefits on a fair and equitable basis, rather than being addressed through additional contributions from employers and members.

It is also the unanimous view of the Trustees that it is in the members' interests to propose to the Consultative Committee that Clause 34 be amended to reflect that reality. A marked-up version of the current proposed amendment is attached for your information and will be put to the UniSuper Consultative Committee for approval at the 3 November 2006 meeting (*Attachment 2*).

#### *Re-Cap on Other DBD Management Initiatives*

Alongside this proposed Trust Deed amendment, it should be borne in mind that, as discussed in my report to you in June, the Board has also recently made two significant changes in the underlying management of the DBP to ensure its ongoing prudent management, particularly in minimising the risk of the vested benefit index falling below 100% for a sustained period.

These changes were: firstly, a change in the surplus distribution policy, such that future distributions of surplus will only be considered when the VBI reaches 130% (and that only half of the surplus above this threshold would be distributed, with the balance carried forward); and secondly, a change on the DBD's asset allocation to reduce its overall exposure to growth assets from 85% of the portfolio to 70%.

These two actions were taken in pursuit of the underlying objective of ensuring that the DBD has the greatest chance of delivery on the promise to members. Their combined effect is to significantly reduce the likelihood of the benefit reduction scenario contemplated by Clause 34 ever arising (while acknowledging that this risk cannot be eliminated altogether).

#### *December 2005 Triennial Actuarial Review*

I am also pleased to inform you that the 2005 Triennial Actuarial Review has recently been completed. In a summary of his findings the Actuary confirms the following

*"In respect of the long-term financial condition of the Defined Benefit Division, the assets as at 31 December 2005, together with current contribution rates, including those applicable under contribution flexibility, are expected to be sufficient to provide for the current benefit levels for both existing members and anticipated new members if experience follows the "best estimate" assumptions".*

For your information I attach a more detailed Summary of the Actuarial Review (*Attachment 3*).

### *Member Communication Strategy*

I have also attached a pdf copy of the report that is being sent to DBD members explaining the management framework of the DBD and foreshadowing the proposed Trust Deed amendment (*Attachment 4*).

Please note that this document should be treated as strictly confidential until it is distributed to DBD members as an insert to the June Benefit Statements/Annual Report mailing (scheduled to occur late this week, on or around Friday 29 September). As you will see from this document, we are also planning to manage member communications on this topic through a special section of the UniSuper website, to be deployed in the same timeframe.

UniSuper believes that it has sufficient controls and safeguards in place to manage the risks inherent in the benefit design of the Defined Benefit Division, whilst remaining fully transparent to all of the Fund's stakeholders through appropriate communications and Trust Deed amendments.

In the next few weeks you will receive the agenda papers for the Consultative Committee and I look forward to your participation at the meeting.

Yours sincerely



Ms Ann Byrne  
**Chief Executive Officer**

#### Attachments:

1. Current wording of Clause 34, UniSuper Trust Deed
2. Marked-up version of the proposed wording of Clause 34, UniSuper Trust Deed
3. Report to Members and Participating Institutions in Relation to the Actuarial Investigation of the UniSuper Defined Benefit Division as at 31 December 2005 (M. Burgess FIAA & K. Maartensz FIAA, Russell Employee Benefits)
4. Management on UniSuper's Defined Benefit Division – Supplement to 2006 Report to Members for DBD Members, September 2006

## Attachment 1

### PROVISIONS OF CLAUSE 34 OF THE TRUST DEED

Clause 34 of UniSuper's Trust Deed states the following:

- a) *If, after an actuarial investigation and valuation of UniSuper, the Trustee considers that UniSuper is or may be insufficient to provide benefits payable under the Deed, the Trustee must notify each Employer.*
- b) *If, after the next two succeeding actuarial investigations and valuations of UniSuper (made in a period of not less than 4 years), the Trustee still considers that UniSuper is or may be insufficient to provide benefits payable under the Deed, the Trustee must call on each Employer to contribute such additional amounts (expressed as a percentage of Contributing Members. Salaries) which the Trustee considers necessary to provide the benefits specified under the Deed.*
- c) *Within 3 months of being called upon by the Trustee pursuant to paragraph (b), Employers must jointly notify the Trustee in writing as to the rate (expressed as a percentage of Contributing Members. Salaries) at which the Employers are prepared to contribute to UniSuper.*
- d) *Each Contributing Member in respect of whom Division A or Division B applies must contribute to UniSuper at a rate (expressed as a percentage of their Salary) equal to one half of the rate at which the relevant Employer is prepared to contribute.*
- e) *If Employers fail to give the notice required by paragraph (c), the Trustee must reduce the benefits (including benefits in the course of payment) payable under Division A and Division B on a fair and equitable basis.*
- f) *Notwithstanding anything in this Clause 34, if the Trustee believes that UniSuper is or may be technically insolvent, the Trustee must comply with Superannuation Law.*

## Attachment 2

### PROVISIONS OF CLAUSE 34 OF THE TRUST DEED

The proposed changes to Clause 34 of UniSuper's Trust Deed states the following:

- a) *If, after an actuarial investigation and valuation of UniSuper, the Trustee considers that UniSuper is or may be insufficient to provide benefits payable under the Deed, the Trustee must notify each Employer.*
- b) *If, after the next two succeeding actuarial investigations and valuations of UniSuper (made in a period of not less than 4 years), the Trustee still considers that UniSuper is or may be insufficient to provide the benefits payable under the Deed, the Trustee must reduce the benefits (including benefits in the course of the payment) payable under Division A and Division B on a fair and equitable basis. call on each Employer to contribute such additional amounts (expressed as a percentage of Contributing Members' Salaries) which the Trustee considers necessary to provide the benefits specified under the Deed.*
- c) *Notwithstanding anything in this Clause 34, if the Trustee believes that UniSuper is or may be technically insolvent, the Trustee must comply with Superannuation Law. Within 3 months of being called upon by the Trustee pursuant to paragraph (b), Employers must jointly notify the Trustee in writing as to the rate (expressed as a percentage of Contributing Members' Salaries) at which the Employers are prepared to contribute to UniSuper.*
- d) *~~Each Contributing Member in respect of whom Division A or Division B applies must contribute to UniSuper at a rate (expressed as a percentage of their Salary) equal to one half of the rate at which the relevant Employer is prepared to contribute.~~*
- e) *~~If Employers fail to give the notice required by paragraph (c), the Trustee must reduce the benefits (including benefits in the course of payment) payable under Division A and Division B on a fair and equitable basis.~~*
- f) *~~Notwithstanding anything in this Clause 34, if the Trustee believes that UniSuper is or may be technically insolvent, the Trustee must comply with Superannuation Law.~~*

## Attachment 3

# Report to Members and Participating Institutions in relation to the Actuarial Investigation of the UniSuper Defined Benefit Division as at 31 December 2005

In accordance with the UniSuper Trust Deed and Superannuation legislation requirements, the Fund's Actuary, Russell Employee Benefits, completed the eighth triennial actuarial investigation into the UniSuper's Defined Benefit Division (DBD) as at 31 December 2005. The results were presented to the UniSuper Limited Board meeting held on 7 July 2006.

This report summarises the Report's finding and the actions that the UniSuper Limited Board has taken in response to those findings.

### Actuarial Assumptions

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The investigation commenced with the Actuary defining the underlying assumptions to be used in the investigation. These assumptions relate to three broad areas:

- a) Demographic experience of the membership of the DBD (i.e. expected patterns of commencements, resignations, deaths, disablement, retirements, and the proportion of retirees electing pensions compared to lump sums).
- b) Sector experience (i.e. the choices members make when they select between the Accumulation 2 (Accum2) and the DBD during their first year of membership, and whether this impacts on the DBD's viability).
- c) Financial experience in the investment markets and other variables that influence the DBD's benefit structure (i.e. investment returns, salary increases, inflation, pension increases and expenses).

Over and above these base assumptions, additional sensitivity analysis was conducted by the Actuary in relation to key assumptions including:

- the proportion of retirement benefits taken as life time pensions; and
- the absolutes of, and the differential between, investment returns and salary inflation.

In relation to all of these factors, the actuarial investigation then makes projections on two distinct bases, as follows:

- *"Funding" assumptions.* These are designed to provide a greater than 50% probability of being achieved. Funding assumptions are used to assess the DBD's ongoing funding needs, in particular to assess the adequacy of contributions of 21% of salary.
- *"Best estimate" assumptions.* These provide a 50% probability of being achieved. They are used for accounting purposes, projections, stochastic modelling and to indicate the probability of achieve the "funding" assumptions.

## Accrued and Vested Benefits – A Distinction

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The most important measure of the DBD's financial position at any given point in time is the adequacy of assets to provide members' Accrued Benefits (benefits which have accrued as a result of membership up to the date of calculation, including current pension liabilities).

These accrued benefits are determined using the Actuary's current expectations of earnings on the Fund's assets, future inflation, salary levels and other relevant assumptions. The ratio of assets to Accrued Benefits is known as the Accrued Benefit Index (ABI).

An alternative measure of the DBD's financial position is the ratio of assets to Vested Benefits, known as the Vested Benefit Index (VBI). Vested Benefits measure the financial position of the DBD on the hypothetical assumption that it had to pay all members' total resignation or retirement benefits at once.

## Key findings and Conclusions

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Based on the above assumptions the report provided the following key conclusions:

- Experience over the three years has been favourable and has resulted in the return of UniSuper to a satisfactory financial position in terms of the Superannuation Industry (Supervision) Act. Investment returns were well above those assumed and this acted to increase the surplus. However, salary increases and price inflation were also higher than assumed which reduced the surplus. Overall the DBD's deficit of \$683.7 million as at 31 December 2002 has become a surplus of \$919.9 million as at 31 December 2005.
- The DBD's assets and future contributions of 21% of salary were expected to be adequate to provide the future benefits of all existing members on both "best estimate" and "funding" assumptions.
- On "funding" assumptions the average cost of benefits for new members is approximately 20.4% of salary.
- As at 31 December 2005, the ABI and the VBI were both above 100% based on both "best estimate" and "funding" assumptions.
- Analysis of the potential impact of contribution flexibility on the DBD's long term funding position confirmed that funding is not sensitive to the contribution rate elections made by members (including elections by new members).
- Analysis of elections made by new members in choosing between joining the DBD and Accumulation 2 also confirmed that there is no evidence that new members' choices are placing a strain on the funding of the DBD.
- The membership of the DBD (including lifetime pensioners) increased by 22.7% over the 3 years.

## Certification by Actuary

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In the investigation the Actuary certified that, as at 31 December 2005:

- In his opinion, the value of the assets of the UniSuper's DBD were adequate to meet the liabilities of the Plan in respect of accrued benefits of members. For this purpose liabilities were valued using "best estimate" assumptions and accrued benefits were not subject to a minimum of members' vested benefits;
- In respect of the three-year period immediately following the investigation date, it is recommended that participating institutions should contribute to the Defined Benefit Division

(DBD) in accordance with the prescribed contribution rates set out in the UniSuper Trust Deed. Contributions in respect of the Defined Benefit Division are:

- (i) at a rate of 14.0% of salaries in respect of members who contribute 7.0%, 6.55%, 5.55%, 4.55%, 3.55% or 2.55% of salary;
- (ii) at a rate of 17.0% of salaries in respect of members who contribute 4.45%, 4.00%, 3.00%, 2.00%, 1.00% or 0.00% of salary; and
- (iii) at a rate of 7.0% of salaries in respect of members who contribute 3.5% of salary.

Contributions should be made to the Accumulation 1 and Accumulation 2 Divisions in accordance with the Trust Deed; and

- The Fund's financial position is "satisfactory" in terms of Regulation 9.04 of the Superannuation Industry (Supervision) Act 1992.

In accordance with these findings, Funding and Solvency Certificates for UniSuper covering the period 31 December 2002 to 31 December 2005 have been provided, as required by the Superannuation Industry (Supervision) Act.

In the Actuary's opinion, the continued solvency of the DBD is also likely to be able to be certified in any Funding and Solvency Certificate required under the Superannuation Industry (Supervision) Regulations during the three-year period to 31 December 2008.

Finally, in the Actuary's opinion, at 31 December 2005, it is highly improbable that UniSuper would not be able to continue to pay pensions as required by the Trust Deed.

### Significant Improvement in Financial Position

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As at the 31 December 2002 the Fund's financial position was deemed to be unsatisfactory as defined by SIS Regulation 9.04. An "unsatisfactory financial position" for a defined benefit fund exists when the value of the assets of the Fund is inadequate to cover the value of the liabilities of the fund in respect of benefits vested in the members of the Fund. The Trustee and the Actuary believed that this position was caused by short term fluctuations in asset values and that, based on "best estimate" investment earnings, the Fund would return to a satisfactory financial condition without requiring any additional action to be taken.

At 31 December 2002, in light of the unsatisfactory financial position at that time, the Trustee agreed to initiate the procedure outlined in Clause 34(a) of the UniSuper Trust Deed to notify participating employers that following at least four years and two further actuarial reviews which report continuation of an unsatisfactory financial position, additional contributions may be requested from participating employers (and by extension members) if the Trustee considers that UniSuper is or may be insufficient to provide the current benefits.

Since 31 December 2002 the experience of the DBD has been favourable and as at 31 December 2005 it was in a strong financial position. Therefore, the assets of the DBD are currently expected to be sufficient to provide benefits. However, under the Trust Deed the existing notification continues to apply until expiry of at least one further actuarial investigation. This means that if the DBD's financial position deteriorates by the next actuarial investigation, a request for additional contributions could then be made immediately.

The Actuary's projections over the next 10 years show that Unisuper's financial position is expected to continue to improve. Given the Fund's current strong financial position, a request for additional contributions is considered unlikely.

# Summary of the Actuarial Investigation of UniSuper at 31 December 2005

The latest actuarial investigation of UniSuper was conducted as at 31 December 2005, and the results presented in our report dated 13 July 2006. This attachment provides a summary of the report and our opinions as to UniSuper's financial position.

The report has been prepared in a manner consistent with the Professional Standards issued by the Institute of Actuaries of Australia.

## Value of Assets

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The net market value of assets as at 31 December 2005 was \$17,470.4 million. The net market value was used in determining the level of contributions required until the next actuarial investigation.

The net market value of assets as at 31 December 2005 in respect of the Defined Benefit Division including indexed pensions was \$7,953.0 million. The remaining assets of \$9,517.4 million relate to the accumulation account balances for Accumulation Super, the Defined Benefit Division, Allocated Pensions and Term Allocated Pensions.

## Assumptions

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The long term financial assumptions were:

	<b>Funding Assumptions</b>	<b>Best Estimate Assumptions</b>
	<b>% p.a.</b>	<b>% p.a.</b>
Investment Return – After tax	6.5	7.8
Investment Return – Before tax	7.0	8.3
Rate of Salary Increases long term (Non-Promotional)	3.5	3.5
Rate of Salary Increases next 3 years (Non-Promotional)	5.0	5.0
Rate of Price Increases	2.5	2.5

The demographic assumptions (eg. rates of resignation, retirement etc.) were based on the actual experience of Defined Benefit Division Members and are detailed in our report on the actuarial investigation.

## Accrued Benefits

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Accrued benefits measure the amount of assets expected to be required to pay members' benefits arising in respect of membership before 31 December 2005 as they fall due. For all members of UniSuper

(including indexed pensioners) the accrued benefits were calculated using the “best estimate” assumptions contained in my report. They have not been subjected to a minimum of the vested benefits which is consistent with the previous actuarial investigation as at 31 December 2002.

The total accrued benefits of UniSuper as at 31 December 2005 were \$15,730.9 million, of which \$9,517.4 million related to the accumulation account balances. The remaining \$6,213.5 million related to the Defined Benefit Division including indexed pensioners. Hence, the ratio of the Defined Benefit Division’s net market value of assets to its accrued benefits was 128.0%.

In our opinion, the value of the assets of UniSuper at the investigation date was expected to be adequate to meet the liabilities in respect of accrued benefits of members.

### Vested Benefits

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The vested benefits of contributing members are the total of the UniSuper benefits that would be payable if all members voluntarily left the service of the Participating Institutions on 31 December 2005. The vested benefits of UniSuper as at 31 December 2005 were calculated to be \$16,550.5 million using the “funding” assumptions, of which \$9,517.4 million related to accumulation account balances. The remaining \$7,033.1 million related to the Defined Benefit Division including \$1,424.8 million in respect of indexed pensioners. The ratio of the Defined Benefit Division’s net market value of assets to its vested benefits was 113.1%. As this ratio is greater than 100%, UniSuper’s financial position is satisfactory in terms of Superannuation Industry (Supervision) Regulation 9.04.

In our opinion, the value of the assets of UniSuper at the investigation date was expected to be adequate to meet the liabilities in respect of vested benefits of members.

As there are well over 100 participating employers, we believe that accrued benefits is a more relevant measure of UniSuper’s funding position than vested benefits because all members are not expected to voluntarily leave service at one time.

### Statement of Financial Condition

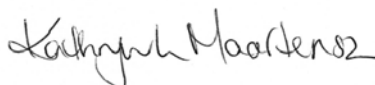
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The employer and member contribution rates to fund the Defined Benefit Division benefits are specified in the UniSuper Trust Deed. The actuarial investigation considered both the current contribution arrangements and the new arrangements introduced from 1 July 2006 whereby Defined Benefit Division members have flexibility in respect of their rate of contribution.

In respect of the long-term financial condition of the Defined Benefit Division, the assets as at 31 December 2005, together with current contribution rates, including those applicable under contribution flexibility, are expected to be sufficient to provide for the current benefit levels for both existing members and anticipated new members if experience follows the “best estimate” assumptions.



Matthew Burgess FIAA



Kate Maartensz FIAA

RUSSELL EMPLOYEE BENEFITS

26 July 2006