SUPERANNUATION TRANSFORMATION & CONSOLIDATION 2021

Transformation in the Superannuation Industry 2021: An Industry Stakeholder Perspective

KPMG

CONTENTS

SECTION 1:

INTRODUCTION

Ongoing merger activity and change related scale are dominant trends impacting the Superannuation industry resulting in material transformation across the sector. This is evident by large change programs being undertaken across the profit-for-member, public sector and retail funds. Indeed, much recent commentary, including our own, has focused on the drivers and key challenges many funds are facing into.

This report follows our series of Super Insight publications and endeavours to provide some perspective on merger activity. As the sector continues to navigate large change and transformation, at a velocity never experienced before, it may be some time yet until we are able to fully quantify expected benefits and outcomes of this investment and activity… until then, the drivers, challenges and desired outcomes remain.

This report provides a fresh perspective on merger activity, providing insight into what we are learning directly from engagements across all superannuation industry stakeholders, including Funds, Administrators, Insurers and Investment custodians. We have actively engaged in the market to ensure our narrative is not merely a house view but a genuine sector view.

We hope this report provides insights that in some small or material way help inform the journey your respective fund or sector-based organisation embarks on over the coming years.

David Bardsley,
Partner, Operations Advisory

Linda Elkins,
National Sector Leader, Asset & Wealth Management

SECTION 2:

WHAT WE HAVE SEEN

Transformation in the Superannuation Industry over the period 2011 - 2021

Merger and consolidation activity in the Australian Superannuation industry can be characterised in several different ways. Transactions can range from the execution of a successor fund transfer (SFT), a joint venture, a consent transfer, or even retirement and replacement of a trustee. The divestment of superannuation funds by many retail banks has also created a number of significant transactions in the sector. For the purposes of this report, our data and insights will be considering all these transaction types.

Mergers and consolidation in Australia's superannuation industry, despite the recent abundance of activity, is not a new concept for participants in the industry. Capturing the last ten years of merger activity identifies an early flurry of consolidation at the beginning of the decade, followed by a period of relative inactivity. In 2017 the level of system consolidation started to gather momentum in response to increasing regulatory, competitive and sustainability pressures, with transaction sizes (Funds Under Management) significantly larger than many sector commentators anticipated and the number of annual mergers occurring continuing to increase.

Notes to analysis:

The below timeline of activity details material merger / corporate superannuation announcements and strategic alliance announcements

The above representation of sector activity excludes transactions < $500 million in size

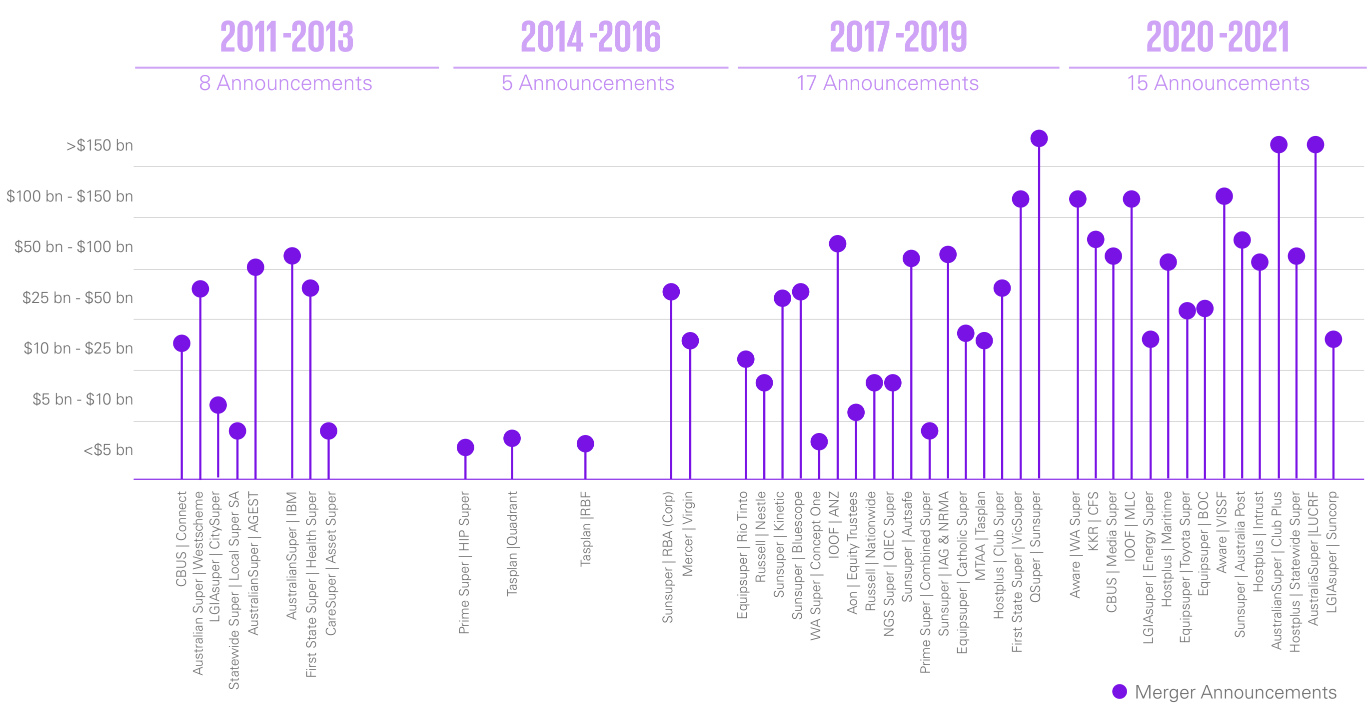
The announcement timeline and combined fund sizes are indicative in nature due to varying approaches of funds signalling merger intent and subsequent transaction execution

Announcements that have subsequently failed / not progressed are excluded from this analysis

Time to execute / finalise a transaction is not considered in the below timeline.

Source(s): APRA Annual Fund Level Statistics; KPMG Analysis

FIGURE 1: TEN YEARS OF MERGERS & TRANSFORMATION IN AUSTRALIA'S SUPERANNUATION INDUSTRY:



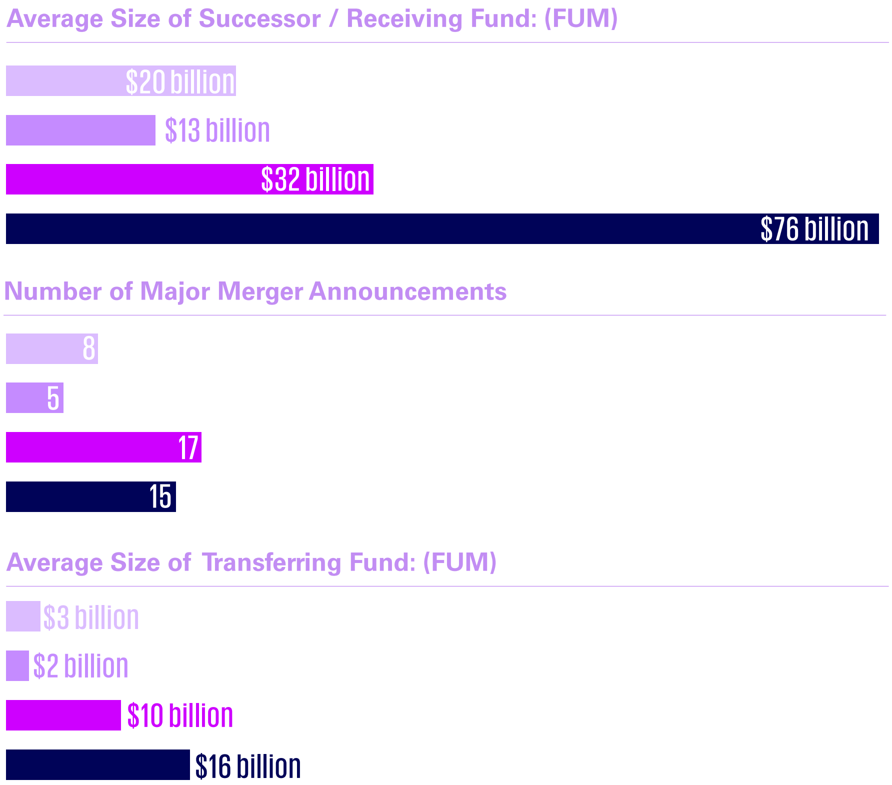
A quiet period before the recent activity

Between 2011 and 2013, there were a handful of significant mergers; with AustralianSuper playing a lead role in reported transaction activity. It was this early consolidation activity that created a platform for AustralianSuper to establish the scale it enjoys today and to be recognised for many years as Australia's largest superannuation fund.

Over the four-year period of 2013 to 2016, the industry experienced relatively few major consolidation events. However, as outlined in earlier KPMG Super Insights reports the landscape fundamentally evolved immediately before and following the Financial Service Royal Commission. Regulatory scrutiny, an enhanced competitive environment and a heightened focus on risk and sustainability of fund business models, has culminated in the industry focusing intently on delivering tangible outcomes for members through the levers of greater scale and more efficient operating models. A pursuit of scale within a traditionally fragmented sector, together with the consequent realisation of benefits from early consolidation activity has seen a real increase in merger announcements since 2017.

SINCE 2011 THE SECTOR HAS EXPERIENCED MATERIAL MERGER ANNOUNCEMENTS ACROSS ALL SECTORS OF THE INDUSTRY. THE AVERAGE CONSOLIDATION TRANSACTION HAS BEEN STEADILY INCREASING OVER THE LAST FIVE YEARS – FROM BOTH A SUCCESSOR / RECEIVING FUND AND TRANSFERRING FUND PERSPECTIVE. THIS IS LIKELY CONTRARY TO INITIAL SECTOR EXPECTATIONS THAT MANY SMALLER FUNDS WOULD LIKELY SEEK CONSOLIDATION OUTCOMES

FIGURE 2: KEY STATISTICS: 2011 - 2021



2011-2013
2014-2016
2017-2019
2020-2021

Notes to analysis:

The analysis to the left excludes SFTs <$500 million and includes only material corporate fund transitions

Successor / Receiving fund = fund that remains in existence post-merger

Transferring fund = fund that consolidates into the Successor fund

Interestingly, all fund types (Corporate, Industry, Public Sector and Retail) are seen to have participated in consolidation activity. Considering the announcements for both Successor / Receiving and Transferring funds it is evident that Industry funds represent the largest proportion of reported activity.

Corporate funds, understandably, have predominantly played the role of transferring fund – moving primarily into larger, high performing funds to mitigate the risks of operating at reduced relative scale compared to other funds in order to ensure an attractive value proposition to members persists. The analysis reported only considers material Corporate transitions (namely those transactions >$500 million); there has been significant consolidation, in addition to what is shown in this analysis, of smaller < $500 million Corporate funds over this period.

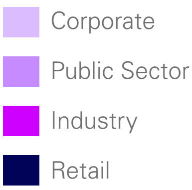


FIGURE 3: **FUND TYPE BREAKDOWN – SUCCESSOR / RECEIVING FUND**

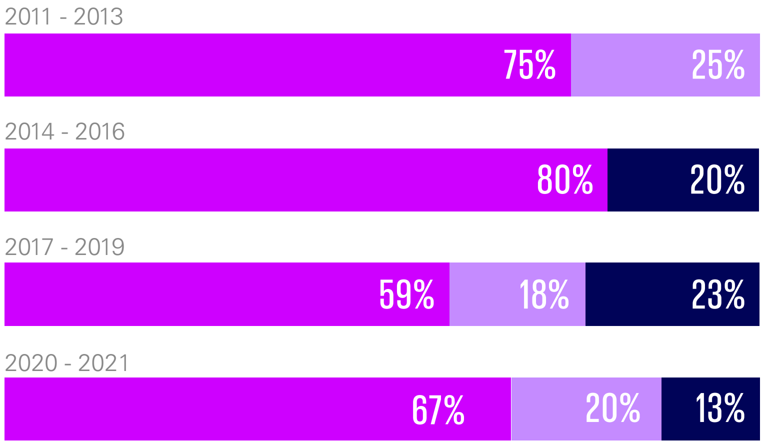
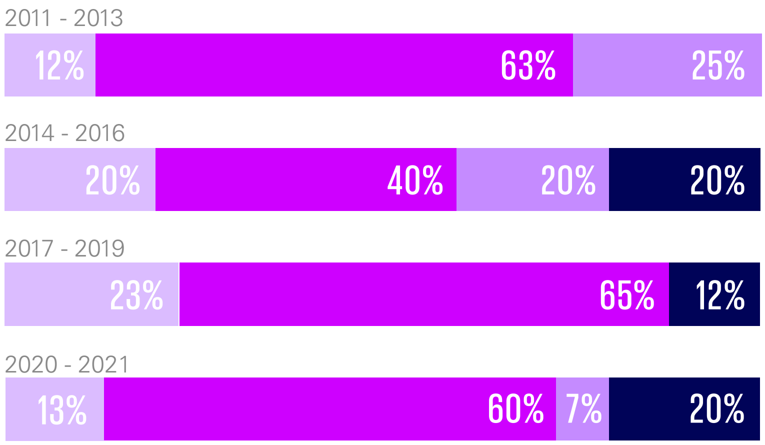


FIGURE 4: **FUND TYPE BREAKDOWN – TRANSFERRING FUND**



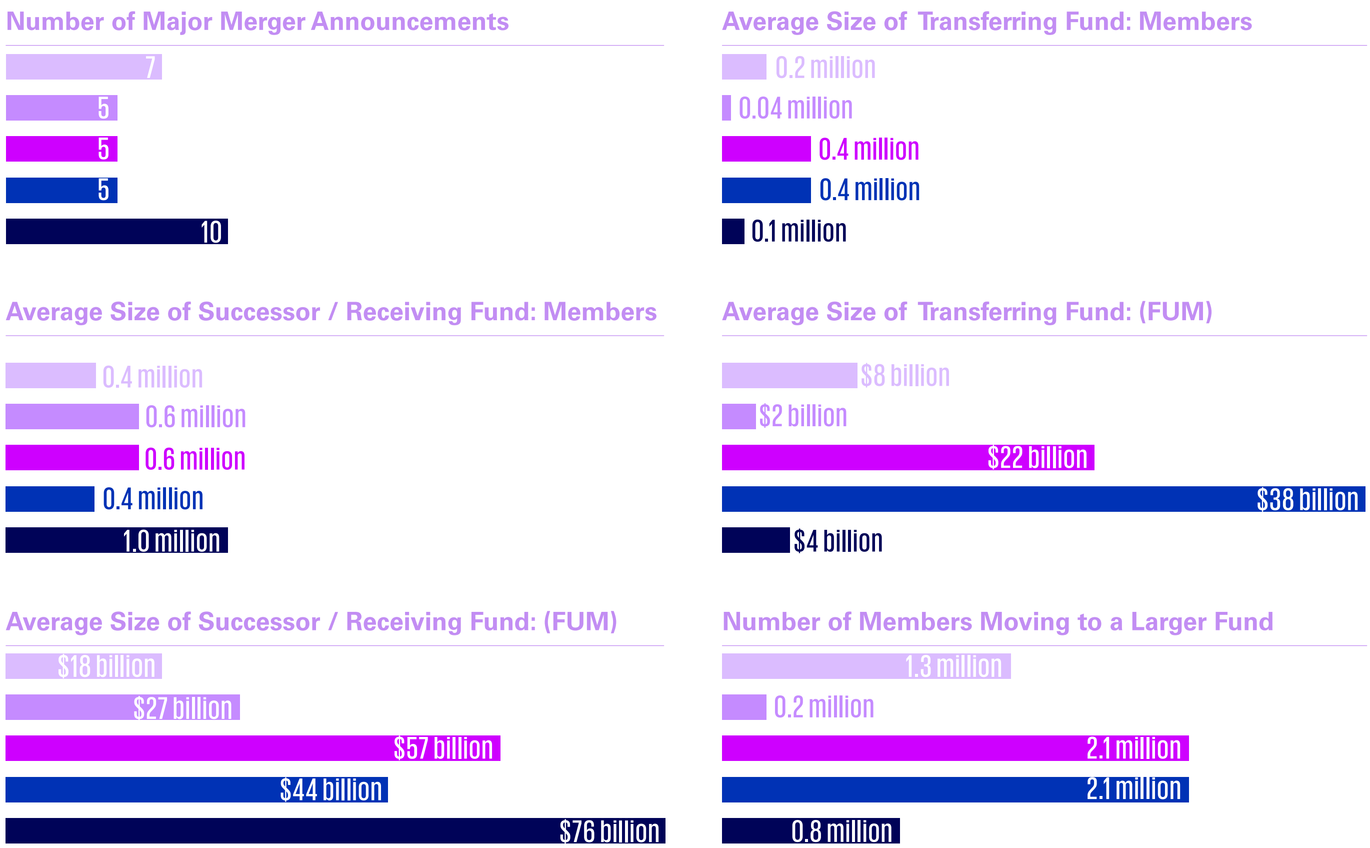
Key data and fund statistics over the past 5 years

The pace of industry consolidation has increased over the last 5 years and is not expected to abate in the immediate or near term. 15 mergers and/or alliances have been announced to the market – the most activity yet in a single year.

Following the activity of 2019 – 2020 (characterised by mega, like-for-like, fund merger announcements), 2021 has seen a greater number of smaller funds consolidate into Australia's largest incumbent superannuation funds. Increased visibility of fund and product performance as a result of APRA's MySuper Product heatmap (first published December 2019), the Annual Performance Test outcomes and other elements of the Your Future, Your Super legislation, has necessitated action from funds and encouraged the pursuit continuous improvement, and further consolidation across the industry.

This type of consolidation is what many in the industry had expected in prior years; and it is expected to deliver significant scale outcomes for members – particularly those from the smaller transferring funds, but also those for members of the successor / receiving fund as the benefits of scale continue to manifest and come on-line.

FIGURE 5: **RECENT SFT / MERGER ANNOUNCEMENTS**



Notes to analysis:

The above analysis excludes SFTs <$500 million and includes only material Corporate Transitions

Successor / Receiving fund = fund that remains in existence post-merger

Transferring fund = fund that consolidates into the Successor fund

2017 2018 2019 2020 2021

We expect the current trend of smaller funds consolidating into larger funds to continue. Currently, many funds are faced with the challenges arising from a lack of scale – many of these funds are proactively investigating possible merger options in order to improve financial and non-financial outcomes for their members.

Regulators are also increasingly interested in, and at times the catalyst for, merger discussions, particularly where the fund has demonstrated governance/ compliance shortcomings or where investment performance or operational issues are identified. APRA is particularly focussed on proposed transactions where the resulting successor fund would have less than $30 billion funds under management. This has created increased challenge for funds in justifying and executing transactions below this threshold and further drives the trend of consolidation into mega-funds.

KPMG does expect there to be fewer mega fund merger announcements, following realisation from Boards and Management of the significant transition planning and integration activity required (and underway), in order to complete a merger transaction.

Consolidation activity is expected to continue to be most evident with small and medium funds partnering with large and mega funds over the coming years. "Bus stop" transactions are deemed far less likely to deliver sustainable medium- and long-term benefits and mega funds will look to execute simpler transactions, consolidating smaller parties into their existing structures with minimal concession, when compared with consolidation with another large fund, yet still seeking to deliver on the promises of increased scale for members.

SECTION 3:

REFLECTIONS ACROSS THE SUPERANNUATION INDUSTRY

Our analysis across the industry has been thematically categorised into insights from funds, service providers, and members.

In this context of growing transaction volumes driven by heightened regulatory impetus and the pursuit of scale and improved member expectations, KPMG has engaged with a cross section of superannuation industry participants, including fund executives, service provider executives and superannuation fund members, to provide insights into:

- Sentiment regarding fund consolidation
- The importance of transaction readiness
- Drivers of successful transaction execution
- Challenges associated with consolidation
- Members' perception of consolidation outcomes.

KPMG HAS SPOKEN WITH A CROSS SECTION OF THE SUPERANNUATION INDUSTRY TO BETTER UNDERSTAND EXPERIENCES OF AND CURRENT SENTIMENT TOWARDS CONSOLIDATION

SUPERANNUATION FUNDS

KEY THEME

What it takes to deliver a merger/SFT

CONTRIBUTORS

7 Funds between $0.9 billion - $182 billion assets under management

KEY REFLECTIONS

- Starting with the end in mind
- The importance of effective change management
- Balancing the transaction and the core business
- Developing realistic transaction timelines

SERVICE PROVIDERS

KEY THEME

Navigating a challenging consolidation landscape

CONTRIBUTORS

Administrators, Insurers, Investment Custodians, Legal & Professional Services firms

KEY REFLECTIONS

- Alignment with clearly defined strategic intent
- Understanding and navigating transaction complexity
- Planning through integration

MEMBERS

KEY THEME

Understanding transaction impacts for members

CONTRIBUTORS

Representative sample of ~500 participants with active superannuation and / or account based pension funds

KEY REFLECTIONS

- Transaction Awareness and impact of member communication
- Member cohort engagement
- Merger impact on member satisfaction

WHAT IT TAKES TO DELIVER A MERGER / SFT: THE FUNDS PERSPECTIVE

With numerous high profile anticipated mergers not proceeding and several more experiencing delay during assessment /due diligence phases, early planning, strong change management and transaction readiness are important considerations when considering and commencing merger activities.

Undertaking any merger activity introduces associated risk, cost and opportunity cost, however, impacts of these can be managed and mitigated through effective delivery planning. Reflecting on the successes and learnings from the first wave of consolidation activity provides opportunity to optimise for the future and to maximise benefit realisation for Members. Early planning and analysis is also critical to a fund's business plan, its proposal and business case, and ultimately the decision of a Board to proceed, in the best financial interests of its members.

Insights from fund executives across the sector highlight four (4) key themes & practices that underpin successful transactions.

1. CLEAR TRANSACTION OUTCOMES

MERGER / SFT ACTIVITIES CREATE POTENTIAL SIGNIFICANT OPPORTUNITY COST TO FUNDS, ESPECIALLY IF THE PROPOSED TRANSACTION DOES NOT PROCEED. STRIVING FOR STRONGER MEMBER OUTCOMES CREATES AN IMPETUS FOR FUNDS TO CAREFULLY CONSIDER TARGET MERGER PARTNERS, CLEARLY DEFINE STRATEGIC PRINCIPLES AND IDENTIFY POTENTIAL ISSUE. AND COMPLEXITIES EARLY.

Defined strategic ambition

The decision by a fund's Board to pursue inorganic growth by way of merger should be made in line with a strong and well-defined business case, developed either proactively by the fund or in response to an approach made by another party.

The rationale for the business case should be clearly aligned with the fund's long term strategic business plan (as required by prudential standards), with associated member outcomes objectives and key performance indicators. Endorsement of this strategy provides the foundation for a fund to enter the market and consider potential merger partners. It also ensures that the ultimate ambition for the fund is clearly defined, including target scale and membership outcomes, and how a transaction supports the roadmap to achieving these.

Identifying potential merger partners

Robust assessment is critical to a fund's identification of suitable potential merger partners. Comprehensive initial screening helps identify potential transaction risk arising from operational or strategic misalignment and structural/governance differences. This ensures that a potential transaction is in the best interests of members and consistent with the funds long term strategy.

Executives reflecting on past successful transactions shared openly the importance of having an approach to ensure the suitability of 'partner fit' and completing assessments prior to progressing merger discussions. The elements of assessment discussed by sector participants generally considered, but may not have been limited to:

- Brand and market position
- Member services and products
- Investment philosophies and service providers
- Fund capability and operations

> "High level discussion and engagement is a critically important phase during which key provisos, conditions and precedents are generally defined and settled."
> David Elia, CEO HostPlus

Starting with the end in mind

A spectrum of transactional outcomes are available to fund executives, ranging from full integration into a new or existing go-to-market identity, joint ventures, or even hybrid models such as consolidation of back-office functions etc. Selecting the right target outcome for each fund should be informed by clearly defined guiding principles and a detailed impact assessment of strategic and financial benefits for members of each fund.

Once potential merger partners are identified, fund executives were unanimous in their opinions regarding the importance of upfront discussions around key objectives, ensuring alignment and the early identification of potential roadblocks. Key considerations include:

- Well defined target end-state of the go-forward entity
- Guiding principles and strategic imperatives
- Post-transaction governance
- Heritage identity and brand positioning
- Roles and responsibilities in the new structure
- Risk appetite of each fund

Some executives reflected that well defined 'merger principles' will inform the overall complexity of the transaction and ultimately, the level of alignment between the two merging funds.

Successful mergers have all used these principles to inform and validate the proposed transaction timelines.

> "You can't underestimate how important it is to establish an early and strong relationship with the other party".
> Paul Northey, Chief Development Officer CareSuper

Early visibility of implementation complexities

Whilst well-articulated guiding principles for a merger are primarily driven by strategic imperatives, fund executives also indicated the importance of identifying, as soon as possible, potential areas of technical complexity in bringing funds together.

Given the number of issues that may impede transaction viability and / or cause implementation / finalisation delays, early visibility of key issues was noted as the key mitigant to addressing implementation complexity and risk.

Upfront consideration of visible red flags or roadblocks can provide an early assessment of merger/SFT viability and streamline due diligence and equivalency.

Executives reflected on the importance of targeting future state operating model simplicity when circumstance allowed, minimising complexity to allow for the transaction to be realised as efficiently as possible.

Post-merger monitoring

Once target objective and outcomes are well defined, executives spoke to the importance of establishing effective implementation governance and methods to monitor the performance of the merged fund with a view to ensuring effective oversight of benefit realisation.

Equally, where a transaction does not proceed a detailed review should be undertaken, typically as part of the member outcomes assessment process or a business performance review. There will be important learnings for fund executives and Boards, which can be used to inform the strategic way forward and to incorporate into any future transactions.

2. IMPORTANCE OF EFFECTIVE CHANGE MANAGEMENT

DURING CONSOLIDATION ACTIVITIES STAFF AND TRUSTEE BOARD MEMBERS MAY OFTEN EXPERIENCE SOME NATURAL APPREHENSION, INCLUDING A LACK OF CLARITY REGARDING THEIR ROLE IN THE GO FORWARD ENTITY. EXPERIENCE HAS SHOWN THERE IS REAL BENEFIT IN FUND'S PROVIDING MEMBERS WITH CLARITY ON WHAT IMPACT(S) AND BENEFITS THEY CAN EXPECT FOLLOWING THE TRANSACTION. TO MITIGATE THE PEOPLE IMPACTS AND PROVIDE COMFORT TO MEMBERS, EFFECTIVE COMMUNICATIONS, AS WELL AS STRONG PROGRAM AND CHANGE MANAGEMENT IS REQUIRED.

Nearly all fund executives surveyed reflected on the importance of effective change management in delivering transactions and maximising member benefit realisation.

This was particularly evident in discussions with smaller funds, where transaction delivery requirements on internal resources/ staff can be material. Key change and program management capabilities identified by fund leadership teams included:

- **People Management** – A fund's employees are critical to executing a transaction and many executives have recognised this, investing in staff support initiatives during transactions, particularly where roles are at risk. This was seen to be key to ensuring ongoing employee wellbeing and productivity.
- **Culture** – Establishing an effective culture, both individually and shared between the funds, improves ways of working, drives alignment between teams and helps foster a shared ambition and vision for the target transactional outcomes.
- **Stakeholder Communications** – Key stakeholders, including fund staff, business partners, employers, regulators and ultimately members, will all look for insight and updates – with the associated effort requiring investment by the fund in communications and engagement activities.
- **Board Engagement** – Board members should be provided with clear communication throughout the transaction, summarising strategic options available to the fund, key decisions to be made, and potential member outcome impacts.
- **Project Management** – Transactions can be long and exhausting processes, requiring strong leadership from a dedicated PMO and change resources.

"Keeping people [staff] informed as much as possible and take them on the journey every step of the way is critical so that they buy into the [transaction] … and that ultimately the members of the fund will be better off if we make this happen"

Nick Vamvakas, Group Executive Strategy & Growth CBUS

Surveyed executives also spoke of the success in integrating merger project teams and BAU teams at some point during the merger, normalising their activities and the new fund's future state of the business with a view to improving collaboration and reinforcing the importance of the transaction to the fund in order to optimise outcomes for members.

"An SFT is a transfer of assets, whereas a merger sees funds embracing cultures holistically, seeking to become bigger and better than either fund was previously"

Katherine Kaspar, CEO MIESF

3. BALANCING THE TRANSACTION AND THE CORE BUSINESS

DELIVERING A COMPLEX TRANSACTION WHILST MAINTAINING SERVICE LEVELS AND DELIVERING A FUNDS EXISTING BUSINESS AS USUAL AGENDA OF PROGRAMS/ PROJECTS/INITIATIVES REQUIRES A SUBSTANTIVE INVESTMENT OF TIME, FINANCIAL RESOURCE, AND STAFF'S EMOTIONAL ENERGY FROM BOTH FUNDS. TO DELIVER THIS, FUNDS NEED TO BALANCE STRATEGIES, PRIORITISATION, AND LEVERAGE LEARNINGS FROM PAST TRANSACTIONS.

Fund executives we spoke to reflected that delivering a transaction in many instances requires a fund to maintain two distinct business strategies for a period; one focussed on running continued fund operations and the second focussed on executing the transaction.

Managing concurrent strategies can create significant pressure on staff and leadership. Executives reflected on this challenge and spoke openly about the high demand, low-cost environments, and competitive nature of the broader market in which they operated and against which a merger transaction's success would be assessed.

Some important mechanisms identified by fund executives to manage these pressures include:

- Understanding and managing the opportunity costs of pursuing inorganic growth such as but not limited to the inability to invest in systems upgrades, staff development and/or process improvements.
- Remaining nimble and agile in identifying and prioritising business activities.
- Maintaining rigour in core fund management functions.
- Helping staff manage transaction and material change fatigue.

Rigour in delivering Inorganic growth

Some funds have already developed or identified the need for internal expertise in transactional execution.

In several cases funds have created roles responsible for delivery of inorganic growth initiatives and ensuring fund readiness for merger activities.

Transactional execution is not yet widely considered a core skillset across the industry. However, as some funds started to mature their transaction capabilities as far back as 2015/2016, executives are seeking to leverage prior experience as much as possible in pursuit of continuous improvement and there is evidence of rapid capability build occurring in a number of mega funds.

"Every merger delivers additional insights, learnings and experiences that we actively review and consider post-merger. We have a view to continuously develop and hone our merger proficiencies and capabilities".

David Elia, CEO Hostplus

Backfilling operational roles as needed, allows internal staff to focus on transaction deliverables, delivering greater efficiency in bringing the two funds together given their deeper understanding of the funds and reducing reliance on external delivery teams. Funds that have not reached transaction maturity will still seek to compliment these capabilities, through external support from advisors and service providers such as administrators, insurers and custodians.

4. DEVELOPING REALISTIC TRANSACTION ROADMAPS

AS TRANSACTION CHALLENGES AND COMPLEXITIES EMERGE, MILESTONE DATES ARE QUICKLY PUT UNDER PRESSURE. TO ENSURE EFFECTIVE TRANSACTION DELIVERY, FUNDS NEED TO BE ABLE TO RESPOND WITH AGILITY TO EMERGING ISSUES, ADJUST THEIR DELIVERY TEMPO AND ENSURE THEY HAVE ALLOCATED ADEQUATE CONTINGENCY.

Initial transaction delivery targets, borne from early high-level Board discussions, are often ambitious, particularly when developed ahead of detailed assessment of complexities. Validating assumptions, the readiness of both funds for a merger and then testing early expectations against a detailed bottom-up assessment has been an operational priority for fund CEOs, COOs and CFOs.

Typical transaction delivery timelines for an SFT are currently reported as being between 9 and 24 months. Fund executives highlighted the importance of underpinning a transition roadmap with clearly defined joint governance structures/arrangements, an agreed operating model and an approach the monitors collective delivery risk.

Common and unanticipated challenges can arise due to:

- Administrative complexities (particularly where there is a transition between self-administrated and third-party administered funds)
- System challenges and data limitations
- Clarity of a merged fund's board and management team arrangements
- Aligning fee discrepancies between member cohorts
- The treatment of reserves
- Alternate practices that may impact unit pricing.

Fund executives indicated that core to resolving these challenges was ensuring that both funds can identify and respond to challenges practically whilst demonstrating a level of flexibility in their approach that is supported by well-defined decision making processes and governance.

Challenges may also arise when differences in operating rhythm between funds exists. Smaller funds do not typically have the capacity to resource transactions in the same manner as larger funds. As a result, transaction tempo may need to be tempered to a level that is manageable by both funds or one fund may opt to resource more of the activity associated with transition finalisation.

Setting expectations regarding cost and contingency (for unknown matters) was observed as a key learning to effective delivery. Executives also reflected this was even more pertinent during the COVID-19 pandemic over the past 18 months requiring funds to adopt new ways of working in a remote setting amid transaction activity.

PREPARING A FUND FOR A MERGER:

- Assess the merits of a merger through the lens of the fund's strategic and business plans and whether Members Bests Interests objectives will be met.
- Establish the key principles and target outcomes which will inform the trustee's decision making – what is important to your fund to achieve through a merger. Critical to this is the anticipated outcomes for members.
- Develop a merger Business Case framework that allows you early visibility regarding potential financial and strategic benefits arising from a merger transaction.
- Develop partner selection frameworks and assessment criteria to identify any potential roadblocks as early as possible.
- Implement clearly defined governance frameworks to support efficient and appropriate decision making.
- Review existing internal capabilities, key resources and identify potential capability gaps.
- Invest in data readiness, targeting strong data integrity for a smooth migration transaction.
- Consider the end-to-end transaction, identifying any dependencies or support requirements.

NAVIGATING A CHALLENGING CONSOLIDATION LANDSCAPE: THE SERVICE PROVIDER PERSPECTIVE

As service expectations from trustees increase, service providers – such as administrators, insurers, custodians and investment managers - need to deliver increasingly technical 'business as usual' services. Growingly, a core component of these services is supporting their partner funds with pursuing inorganic growth opportunities that improve member outcomes. These service providers are complemented by transaction specific advisors, including Legal and Tax advisory that help execute specific transactions and ensure fund readiness.

As transaction volumes increase, service providers are maturing deal experience and expertise, positioning themselves as key enablers and facilitators of consolidation activity for their partner funds. Deep technical knowledge in operational execution is enabling service providers to help funds de-risk transaction delivery, identify potential implementation issues and provide best practice integration support.

Insights from a cross-section of service executives confirms three (3) core components of successful superannuation fund transaction execution across a transaction lifecycle.

1. CLEARLY DEFINED AND ALIGNED STRATEGIC INTENT

GIVEN THE IMPORTANCE OF ALIGNING STRATEGIC OBJECTIVES OF TWO MERGING ENTITIES, ENGAGING KEY SERVICE PROVIDERS EARLY IN THE TRANSACTION PROCESS IS KEY TO EFFECTIVE TRANSACTION PLANNING AND THE DELIVERY OF CRITICAL SERVICES THESE PARTNERS PROVIDE. EARLY ENGAGEMENT ALSO ENABLES IMPROVED SEQUENCING OF SUPPORT ACTIVITIES.

To ensure the successful and timely implementation of a superannuation fund merger, service provider executives emphasised the importance of intra-fund strategic alignment, focus on member best (financial) interests and a view on how best to create end-to-end operational alignment in the future state.

Trustees must be able to demonstrate why the decision to merge (or not) is in the best financial interests of their members. Upfront clarity from each fund on its strategy, not only validates suitability of the partnering funds but also, de-risks transaction delivery through providing a common understanding of:

- Anticipated member outcomes
- High level operating model design
- Go-forward product offering
- Digital infrastructure expectations & roadmaps
- Administration arrangements and transitions
- Potential tax implications
- Proposed structuring options and implications
- Governance, risk and compliance
- Investment performance outlook
- Insurance arrangements
- Day 1 Expectations
- Longer term post-merger objectives

"It's critical that funds are clear on the structure they want to use to implement their merger and why the proposed structure optimises outcomes for the go-forward entity and members."

Sarah Yu, Partner

King & Wood Mallesons

With the regulators increased interest in potential merger outcomes for funds which have demonstrated governance / compliance shortcomings or where investment performance or operational issues are identified, alignment on these issues is particularly important. Whilst they create opportunity or need for a merger it can also result in friction and in some instances add further transaction complexity or even derail transactions.

Trustees must be in a 'merger ready' position, be jointly aligned in terms of the go-forward strategic intent of a merged fund, have clarity on members' best financial interests and a well-developed approach to engaging with key regulators throughout the transaction.

Early alignment and consensus between funds and with their service providers on the go forward strategy for the merged entity:

- Enables effective integration planning
- Supports service providers working strategically with funds by providing inputs to insurance / administration design rather than responding tactically to integration needs
- Helps identify potential roadblocks to a transaction
- Supports funds to be 'merger ready'
- Allows service providers to plan, prioritise and allocate resources to enable transaction timelines
- Reduces the risk and cost to delivering short term and longer-term outcomes

Whilst immediate alignment between the funds is often the preferred operational solution, service providers acknowledge this is not always possible. This is particularly the case when target operating model discussions are not finalised, legacy issues remain or where there is insufficient time to operationalise a harmonised approach at Day 1.

Partnering on strategic ambition

Two consistent themes emerged from interviews with service providers around how their involvement in transactions can be optimised to help drive strategic design and alignment:

01 **Transparent strategic conversations** allow service partners to augment their service delivery to well defined fund ambitions. This may include designed merger simulation exercises, identification of key transaction risk areas, the use of methods/ technologies to accelerate transitions or refined member facing solutions.

02 **Early engagement** in the transaction, including involvement (where possible) in strategic planning and transaction due diligence, enables identification of possible complexity and allows for improved sequencing of support activities.

> **"Engage early, so we can help avoid the pitfalls, risks, and costs and provide visibility on complexities drawing insights from executing over 200 transactions"**
>
> Dee McGrath, CEO Retirement & Superannuation solutions Link

2. UNDERSTANDING AND NAVIGATING TRANSACTION COMPLEXITY

MERGERS AND SFTS ARE NATURALLY COMPLEX. FAILURE TO IDENTIFY TECHNICAL ISSUES CAN RESULT IN MATERIAL TRANSACTION DELAYS. EXAMPLES NOTED BY SERVICE PROVIDERS INCLUDED INSURANCE CONSIDERATIONS FOR SEVERAL GRANDFATHERED POLICIES, SMALL MEMBER COHORTS REQUIRING SUPPORT PROVIDED BY A LEGACY SYSTEM, ETC. TO MITIGATE POTENTIAL TRANSACTION COMPLEXITY, FUNDS SHOULD ACTIVELY SEEK TO LEVERAGE SERVICE PROVIDER EXPERTISE, INPUTS, RESOURCES AND TOOLS.

A shared sentiment across the service provider group was the increasing complexity in delivering merger outcomes. The legal and regulatory environment drives much of this complexity, with changes in this domain impacting transaction processes and timelines, to the extent prior mergers and SFTs no longer provide an accurate indication of what is required in the current environment.

Leading service providers are establishing contemporary transaction credentials by working across numerous transactions of varying size and complexity. This provides funds the opportunity to leverage lessons learned and experience in identifying and managing known areas of consolidation complexity.

Some prominent areas of complexity where service providers have provided support and design leadership include:

Administration

- Target operating model design support
- Treatment of Defined Benefit members/products
- Defining technology integration roadmaps
- Integration risk assessments

Insurance

- Harmonisation of Insurance solution design
- Member cross-subsidisation
- Policy grandfathering
- Historic claim management

Investment Management

- Unlisted and directly held assets
- Other complex assets (limited partnerships, private equities)
- Transition of pooled vehicles to mandates

Taxation

- ATO engagement
- Limitations in availability of loss and rollover relief
- Availability of tax deductions on merger costs incurred by the transferring fund
- Complexity in asset holding structures
- Harmonise tax and risk governance
- Protection of valuable tax attributes in go-forward structure

Legal / Regulatory

- Engagement with, and submissions to, relevant Regulators
- Member equivalency/rights assessments
- Best financial interests' assessment and compliance
- Member privacy and confidentiality considerations
- Competition law considerations

Service provider executives reflected on the repeatable nature of certain elements of consolidation transactions (generally integration) activities and noted the value of robust frameworks and tools that support and allow the identification and resolution of transaction complexity to occur in a well-managed manner.

That said, no two transactions are identical. Service providers also highlighted instances where some trustees have found themselves having to meet higher thresholds and more stringent legal tests than strictly necessary, at times at the insistence of the regulators. This is particularly noted for internal mergers within retail superannuation businesses.

Higher threshold tests for a merger to be deemed feasible, may extend beyond what is legally required to protect the interests of members. Additional considerations can necessitate the retention of legacy arrangements which can significantly impact the operating costs of the go-forward fund.

"From our experience advising on mergers across different sectors, we can navigate through the different legal hurdles and regulatory expectations in a way that can reduce complexity, minimise the retention of legacy arrangements and optimise the operating model of the go-forward fund."

Zein Al Hassan KPMG, Partner – Deals, Tax & Legal

Additionally, regulatory engagement was noted as a critical consideration for funds undergoing a transaction. Planning all regulatory engagement points across relevant regulators (ASIC, APRA, ACCC, ATO) is key to de-risking delivery.

In relation to taxation, engaging in real time with the ATO and their superannuation and superannuation fund merger specialists is important to ensure that the tax consequences of significant transactions are well understood. The timing of this engagement is critical as, for example, decisions around asset rollover and target operating model need to be made well in advance of the lodgement of the closing fund's tax return.

In planning for a consolidation transaction, funds should consider partnering with trusted service providers to ensure contemporary market experience is considered, costly lessons learned are avoided and robust leading practice tools are used to inform complex decision making.

3. PLANNING THROUGH INTEGRATION

NOT ALL INTEGRATION ACTIVITIES WILL BE DELIVERED ON 'DAY 1' AND MANY ARE OFTEN ADDRESSED BY THE GO-FORWARD ENTITY. GIVEN A DEDICATED TRANSACTION TEAM IS OFTEN DEVOLVED POST-MERGER DATE, ESTABLISHING SPECIFIC TIMELINES, ACCOUNTABILITIES, AND RESOURCING ARRANGEMENTS TO DELIVER THE REMAINING INTEGRATION ACTIVITIES IS A MUST FOR ENSURING BENEFIT REALISATION AND READY THE FUND FOR FUTURE CONSOLIDATION ACTIVITIES.

Whilst each transaction considers a unique target state / consolidated operating model, executives noted that the path to achieving this new state never be the same for any two transactions.

As a result, the Day 1 ambitions will also be specific to each transaction. While less complex SFTs will typically see most service offerings and members consolidated at Day 1, more complex merger transactions can see elements of service provision 'parked' for up to 12 months.

To the extent they are not addressed at Day 1, Funds will typically work with service providers to implement other integration areas, often including:

- Rationalised administration arrangements
- Rationalised product offer(s)
- Rationalised investment portfolios / arrangements
- Consistent or rationalised insurance arrangements
- Integration of non-core technology platforms
- Integration of staff / resourcing

Defining the post-transaction roadmap

Where integration activities are designated to be completed after Day 1, service provider executives spoke of the importance of having well defined integration roadmaps as early as possible.

> "We need to stay well connected [with fund partners] to understand their state of play and to inform our planning at a senior leadership level".
>
> Chris Stevens, COO Mercer

A lack of clarity on integration timelines, can result in ongoing delays to integration, further impacting service provider bandwidth and potentially putting at risk the realisation of member benefits.

OPTIMISING TRANSACTION SUPPORT

- Align all stakeholders on strategic imperatives
- Engage partners early in the transaction to identify possible areas of complexity and to enable improved sequencing of support activities
- Establish efficient and well-defined governance structures and decision-making frameworks
- Pro-actively engage strategic partners in product and fund design exercises
- Collaborate to identify areas of potential transactional complexity during due diligence
- Establish Day 1 operating model aspiration
- Define upfront the implementation roadmap for end state target operating model

UNDERSTANDING TRANSACTION IMPACTS FOR MEMBERS: THE MEMBERS' PERSPECTIVE

Many funds have faced common challenges in driving engagement across their membership. Building strong engagement is particularly important ahead of and during transactions. Ensuring members understand what is happening, why it is happening, the impacts of a transaction on their retirement savings and any changes to their services is important to optimising member retention and advocacy.

Every fund undertaking a transaction is invariably focused on the best financial interest of members, improving member outcomes and using member betterment as a key driver in transaction related decision-making. However, translating these benefits in real terms to members can be difficult.

KPMG has undertaken a proprietary survey with a representative sample of superannuation fund members to understand members' current awareness and sentiment towards transactions, experiences of consolidation to date, and their perception of consolidation impacts.

KPMG SURVEYED A NUMBER OF AUSTRALIANS WITH RETIREMENT SAVINGS TO UNDERSTAND THE LEVEL OF AWARENESS, PERCEPTION AND EXPERIENCE OF SECTOR CONSOLIDATION

SURVEY SAMPLE

500+

Responses received

METHODOLOGY

National

Census aligned participant group surveyed through online questionnaire

ANALYSIS GROUP

51%

of responders a "Member of a Merged Fund"

AWARENESS

1 in 5

Members are transaction aware

1. AWARENESS REMAINS LOW, BUT IT IS POSITIVELY IMPACTED BY FREQUENT COMMUNICATION

AWARENESS OF MERGER ACTIVITY REMAINS LOW, WITH ONLY 1 IN 5 MEMBERS OF 'MERGED FUNDS' AWARE THAT A TRANSACTION HAS TAKEN PLACE. THIS GROUP TYPICALLY REPRESENTS THE MOST ENGAGED AND ACTIVE SUPERANNUATION FUND MEMBERS

Whilst over half of those members surveyed were identified as a member of a 'merged fund' (characterised as a fund that has undertaken a merger or SFT transaction), only one in five of those members were aware of the transaction. The majority of those transaction aware members were satisfied with the level of communication received throughout the transaction.

'Transaction aware members' – those who are aware that a transaction had been completed, are significantly more likely to engage with their fund on a regular basis.

50 percent of transaction aware members reported at least monthly contact with their fund (either communications received from the fund, or contact made by the individual). By contrast only 21 percent of members who were unaware of the transaction or members of a non-merged fund had similar frequency of communication with their fund. In these groups, communication on a quarterly basis (or even less frequently) is most likely, with at 25 percent engaging with their fund less than once every 6 months.

There is a strong and proven link between regular, effective engagement with members and transaction awareness. Funds need to continue to build engagement across the entirety of their membership to build awareness of transactions and the potential impacts to their members.

2. TRANSACTION AWARE MEMBERS ARE ALSO TYPICALLY THE MOST POSITIVE TOWARDS MERGER ACTIVITY

THE MAJORITY (57 PERCENT) OF 'MERGED FUND' MEMBERS HELD A NEUTRAL ATTITUDE TOWARDS FURTHER PROPOSED TRANSACTIONS. HOWEVER, FOR THE SUB-SEGMENT OF 'TRANSACTION AWARE MEMBERS' THE SENTIMENT TOWARDS FUTURE TRANSACTIONS WAS MOSTLY POSITIVE (58 PERCENT).

1 in 5

Members of funds that have completed transactions are aware that a transaction has been completed.

58%

Of aware merged fund members hold a positive attitude towards consolidation activity.

Members who are unaware of past transaction activity hold a strongly neutral outlook towards proposed merger activity (63 percent) with (9 percent) viewing future transactions in a negative light. The sentiment of this cohort potentially reflects the overall lack of engagement with their superannuation.

By contrast, 'transaction aware members' of merged funds generally (58 percent) hold positive attitudes towards consolidation, with only 8 percent holding a negative attitude towards a potential future transaction.

These responses demonstrate positive lived experiences for engaged and transaction aware fund members. However, for majority of the Australian population, where awareness is low, overall sentiment remains neutral. This creates an impost for funds to increase awareness across member cohorts of the real member benefits that transactions can realise, which in turn could uplift sentiment towards future consolidation activities.

3. MERGED FUNDS LIKELY TO SEE SMALL INCREASES IN MEMBER SATISFACTION

The profile of a member who is transaction aware presents a highly engaged individual, in frequent communication with their fund and with good awareness of the product categories and offerings available to them. As a result, they are also the cohort most likely to consider alternative solutions available in the market (52 percent would consider rolling over to another fund), however they are also the cohort with the highest overall satisfaction with their current fund. As a group, it is therefore likely that they would be the most perceptive to changes in experience and product offerings following a transaction. Those surveyed reported a small positive improvement in their satisfaction with investment returns and products offerings following the completion of a merger (increasing 4 and 6 percentage points respectively).

Market feedback and direct member quotes reinforce perception of improved fees, and product ranges. When asked "What changes did you experience to your fund [following the transaction]?" responses included:

"Lower fees"

"Better App on smartphone"

"More information online"

"A marked improvement in value"

"Better yields"

"Better product range"

However, overall perception of real member benefits or experience improvements remains limited across the entirety of fund members. This demonstrates a clear gap between the realisation of member benefits as part of a transaction business case and members' perception of these product/service improvements. Net Promotor Score (NPS) monitoring could be an effective avenue funds may utilise to measure member perceptions of transaction outcomes.

Funds will need to continue driving engagement across their member cohorts to bring transaction benefits front of mind for their members.

BUILDING MEMBER ENGAGEMENT AND POSITIVE SENTIMENT THROUGH A MERGER:

- Build strong communication channels and providing regular contact with members
- Increase communication activity ahead of and during a merger/SFT
- Ensure that communications translate post-merger benefits and experience improvements for fund members
- Undertake ongoing monitoring of NPS results to understand member perceptions pre- and post-transaction.

+6%

Increase in satisfaction for 'transaction aware merged fund members' with their superannuation fund's product offering post-transaction.

METHODOLOGY

KPMG conducted a statistically robust online survey with participants from the National population. The survey aimed to achieve a representative sample by obtaining a broad cross-section of demographic traits. Participation was optional and participants were not made aware of the survey topic at the outset, nor who the survey sponsor was. The survey targeted 500 responses, with 507 received in total, and following quality control checks, 423 used in the analysis and reporting, Quotas and weighting processes were used to ensure the age, gender and location proportions were in line with Census reported proportions. For analysis purposes, two distinct groups were identified, being members who were members of a merged (n=241) and non-merged funds (n=231). Members were classified based on their fund and not on claimed knowledge of being part of a merged fund.

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