SUPER INSIGHTS 2022

From accumulation to retirement:
why it's time to shift the conversation

May 2022

KPMG.com/au/SuperInsights2022

Foreword

After a challenging period the superannuation sector and individual funds need to look forward.

2020 and 2021 saw superannuation funds implementing multiple, significant pieces of legislation — Member Outcomes, DDO, Your Future, Your Super - whilst operating under and responding to the unique and protracted implications of the COVID-19 pandemic. Many funds met this challenge whilst simultaneously involved in merger discussions and activities.

At the top end of the sector, based on 30 June 2021 data, the 13 funds with net assets above $50 billion held 75 percent of the total net assets (excluding SMSFs) and 78 percent of members.

Recoveries in markets as well as increases in contribution levels saw the industry fund sector overtaking the SMSF sector for the first time, holding 31.2 percent of net assets versus 29.4 percent for SMSFs.

In terms of key metrics over 2020/21 — the retail sector saw particularly significant increases (44 percent) in the average member contribution per active, pre-retirement member; experienced increases in operating costs (partly driven by the closure of ERFs) but at the same time experienced a 17 percent reduction in MySuper administration fees. The industry fund sector, however saw a marginal increase in operating costs but marginal decrease in MySuper administration fees. These and other metrics can be explored in the Dashboard, which includes a number of new views, and we look forward to further expanding the Dashboard in response to APRA's recent announcements around the expansion of its published data.

Looking forward

Whilst the Your Future, Your Super legislation – in particular stapling and the Annual Performance Test - will continue to put pressure on a segment of the sector and result in further consolidation, continuing funds need to look forward to meet their current and future member needs.

In the context of inflows which are no longer driven by default arrangements, retaining scale will be about the attraction and retention of members. With a significant portion (approximately 20 percent for the Super Insights population, excluding SMSFs) of total member benefits now in the retirement phase, the requirements of the Retirement Incomes Covenant formalise the need to develop strategies that will deliver better outcomes to members approaching and in retirement.

To succeed in retention and growth of this segment of the membership, funds will need to increase their access to data as an input to robust cohort identification and analysis, and understand the outcomes of retirement products and advice and guidance to members to develop fit for purpose strategies for their members.

Overlaying the need and formal requirement for retirement income strategies to deliver to the aging demographic, funds need to also cater for key developments and trends in member expectations of their superannuation funds, including in relation to ESG and funds' responses to climate change, expectations around digital and other forms of communications and services, and expectations around the personalisation of a member's interaction with their fund. All strategies to meet these demands need to be delivered in the context of increased regulatory scrutiny and the overarching requirement to act in members' best financial interests.

In this report we also highlight what we believe to be the key areas of focus by the sector in the context of meeting immediate and emerging requirements and challenges in relation to ESG, evolving financial crime and cyber threats, privacy risk, and digital capabilities among other topics. We will explore these in detail in an accompanying report to be released in June.

Funds that continue to look forward, and successfully refresh and develop their strategies to meet continually emerging themes will reap the rewards of delivering against the ultimate purpose of the superannuation sector – to deliver retirement outcomes to their members.

Linda Elkins
National Sector Leader,
Asset & Wealth Management

Methodology

APRA data explanatory notes

"This report contains data for APRA-regulated funds with more than four members. Pooled superannuation trusts (PSTs) have been excluded as their assets are captured in other superannuation funds. Exempt public sector superannuation schemes (EPSSS) have also been excluded.

Superannuation funds that wound up during their year of income in a given reference period are not included in that year or subsequent years. Superannuation funds that wound up after the reporting period but before the release of the publication, are included for that reporting period, and their wind-up date is noted in the report.

Superannuation funds that did not submit an annual return for a given reporting period are not included in that year."

Our analysis, as presented in this report and the accompanying KPMG Super Insights Dashboard, is a combination of leading analytics applied to 18 years of APRA and Australian Tax Office (ATO) published statistics, supported by insights gained from our team of asset and wealth management specialists.

At a macro level, we have defined the market along APRA guidelines of retail, corporate, public sector and industry funds - and included SMSFs to complete the landscape. KPMG has applied a sizing segmentation to group funds into those with greater than $25 billion AUM, between $10 billion and $25 billion AUM, and those funds with less than $10 billion AUM.

KPMG has relied on published statistics as the foundation of this report and, as such, acknowledges that the data contained within is wholly reliant on the accuracy of the underlying sources. KPMG has included all data contained within the APRA[1] and ATO[2] published statistics inclusive of null values. Where APRA and ATO have published updated data for prior years the data reflected in the Dashboard reflects the revised data and certain views may therefore have changed from the views published in prior versions of the Dashboard. The Super Insights Dashboard includes the 'Concise' view of the MySuper Heatmap[3] and three of the key metrics which form part of the Heatmap:

- administration fees (on a $50,000 MySuper representative balance)
- net cash flow ratio
- the adjusted total accounts growth rate.

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1 APRA Annual fund level superannuation statistics back series: June 2004 to June 2021 (issued December 2021) https://www.apra.gov.au/annual-fund-level-superannuation-statistics
APRA Annual superannuation bulletin – June 2021 (issued January 2022) https://www.apra.gov.au/annual-superannuation-bulletin
APRA Quarterly MySuper statistics – September 2019 – December 2021 and backseries September 2013 – June 2019 (issued March 2022) https://www.apra.gov.au/quarterly-superannuation-statistics
2 ATO SMSF quarterly statistical report June 2021 https://data.gov.au/data/dataset/self-managed-superannuation-funds
3 APRA MySuper Heatmap December 2021 https://www.apra.gov.au/mysuper-product-heatmap-0

It also includes the first edition of APRA's Choice Heatmap[4]. Other new views introduced this year are:

- each fund's average account balance
- the proportion of membership and AUM in pension phase
- the growth of members and AUM in pension phase
- the strategic asset allocation of MySuper products
- investment performance (net of investment fees and taxes) for 'growth funds', being investment options with a 61 percent to 80 percent allocation to growth assets, as collected by Chant West[5].

The 'MySuper Admin Fee ($50,000 balance)' view, which shows the administration fee charged to a MySuper member with a $50,000 balance, also now shows the fixed dollar and asset-based components of the administration fees.

As a change in methodology this year, the median metric shown for each view in prior years has been replaced by the weighted average metric where the individual fund results are weighted by the relevant measure (e.g. average members, average net assets etc.). In addition, we have changed the sizing segmentation which can be applied to filter the views to split funds below and above $10 billion, instead of below and above $1 billion.

We continue to note that there remain challenges associated with reporting across the superannuation industry and the data presented within APRA's published statistics. APRA's Superannuation Data Transformation project has commenced, including the collection of more granular and consistent data, as well as data from products beyond MySuper.

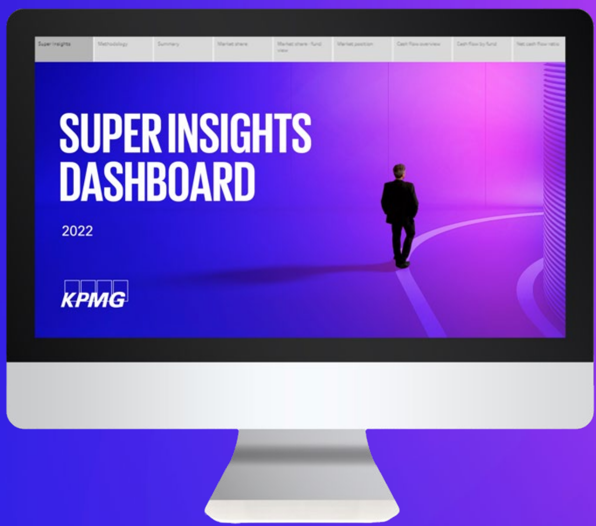
To protect the privacy of individual members, APRA has masked certain items in the data. Some items were not reported, indicating that either nothing was reported for the relevant period, or that the data cannot be calculated. In circumstances where either of these events happened, KPMG has removed the fund from the analysis.

4 APRA Choice Heatmap December 2021 https://www.apra.gov.au/choice-heatmap
5 Zenith CW Pty Ltd ABN 20 639 121 403 (Chant West), Authorised Representative of Zenith Investment Partners Pty Ltd ABN 27 103 132 672, AFSL 226872 under AFS Representative Number 1280401

KPMG Super Insights Dashboard

The KPMG Super Insights Dashboard contains interactive versions of the charts and graphs included in this report, as well as additional information. The Dashboard enables you to filter the data based on your own preferences. You can view industry and fund metrics for a particular year or segment of the industry, as well as view metrics for an individual fund in comparison to a peer group.

The Dashboard can be accessed via our website at KPMG.com/au/SuperInsights2022

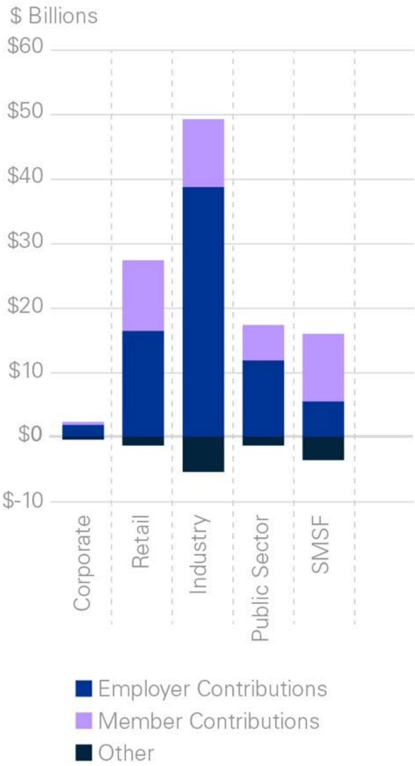


Additional analysis or information

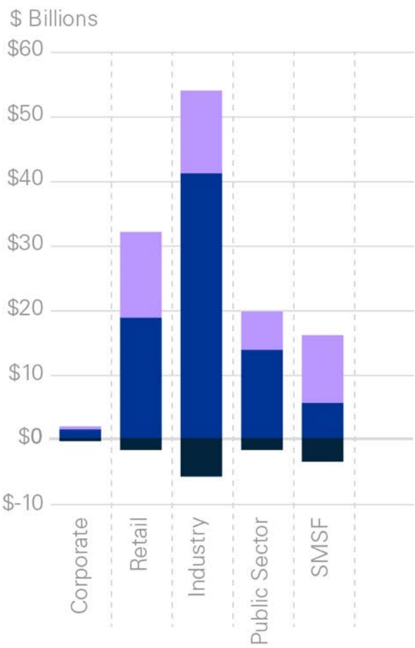
For any funds seeking additional information or further analysis of the data contained within the *KPMG Super Insights Dashboard*, KPMG's data analytics and insights team would be more than happy to discuss your requirements. This can include analysis of the performance of your fund against peer or competitor funds, modelling of impacts of potential fund mergers and projections of data. Feel free to get in touch with one of the KPMG contacts in this report.

Superannuation funds over 2020/2021

Total contributions to super 2019/2020



Total contributions to super 2020/21



Over 2020/21 investment markets and the sector rebounded from the initial impacts of the COVID-19 pandemic, however the Superannuation Early Release Payments continued to impact membership.

The sector captured by Super Insights increased from $2.4 trillion to $2.8 trillion, or from $1.7 trillion to $2.0 trillion excluding SMSFs.

The Superannuation Early Release Payments, which continued up to January 2021, and the first stage of the closure of Eligible Rollover Funds (ERFs), contributed to a 5 percent reduction in the number of member accounts – from 22.0 million to 20.8 million excluding SMSFs.

Mergers and acquisitions continued, reducing the number of APRA-regulated entities from 154 to 144 funds, displayed in the Dashboard as from 83 to 75 funds/providers as funds under the same trustee/provider have been combined.

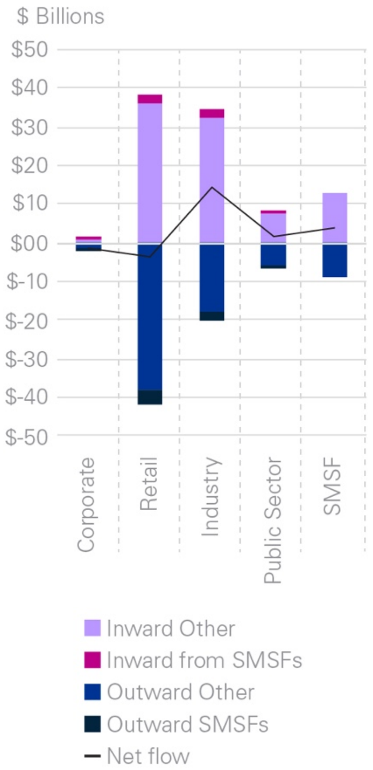
This section of the report looks at the experience and outcomes for funds in 2020/21 based on APRA's and the ATO's published data as well as investment performance information provided by Chant West.

Cash flows

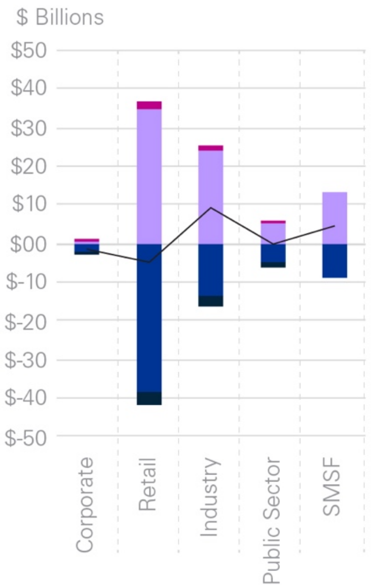
There was an increase in contribution levels between 2019/20 and 2020/21 with total member contributions increasing by 13 percent and employer contributions by 8 percent. However the experience across the sectors was mixed:

	Employer Contributions	Member Contributions
Corporate	-10%	-12%
Retail	15%	19%
Industry	6%	21%
Public Sector	13%	14%
SMSFs	1%	2%

Rollovers 2019/20



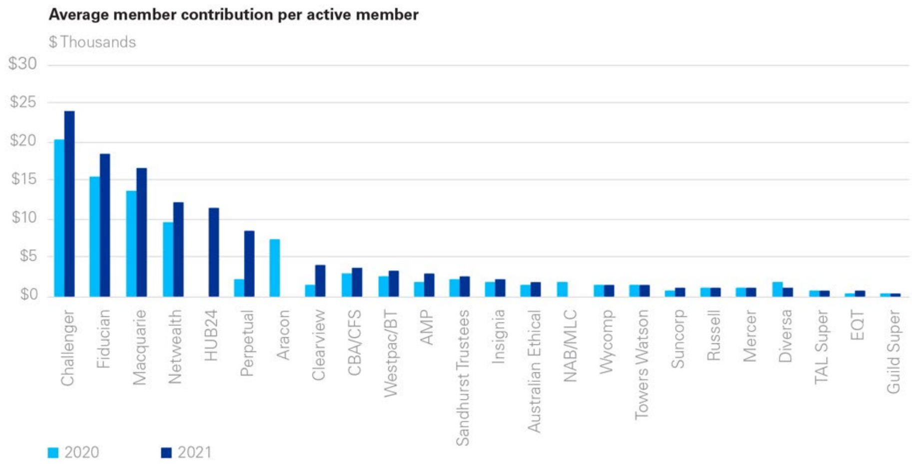
Rollovers 2020/21



The reductions in the contributions to the corporate sector largely reflect the reduction in the number of funds in this sector with IAG & NRMA Super and Toyota Super transferring into Sunsuper and Equipsuper (now displayed in the Dashboard as Togethr Trustees), respectively, during the year.

We note that the impact of stapling on default contribution flows, which came into effect in November 2021, is not yet reflected in these figures.

Looking at the average level of member contribution (salary sacrifice and personal contributions) per active member, the retail sector saw a 44 percent increase in the average member contribution, from $1,822 to $2,627, with most of the retail providers seeing a material increase.



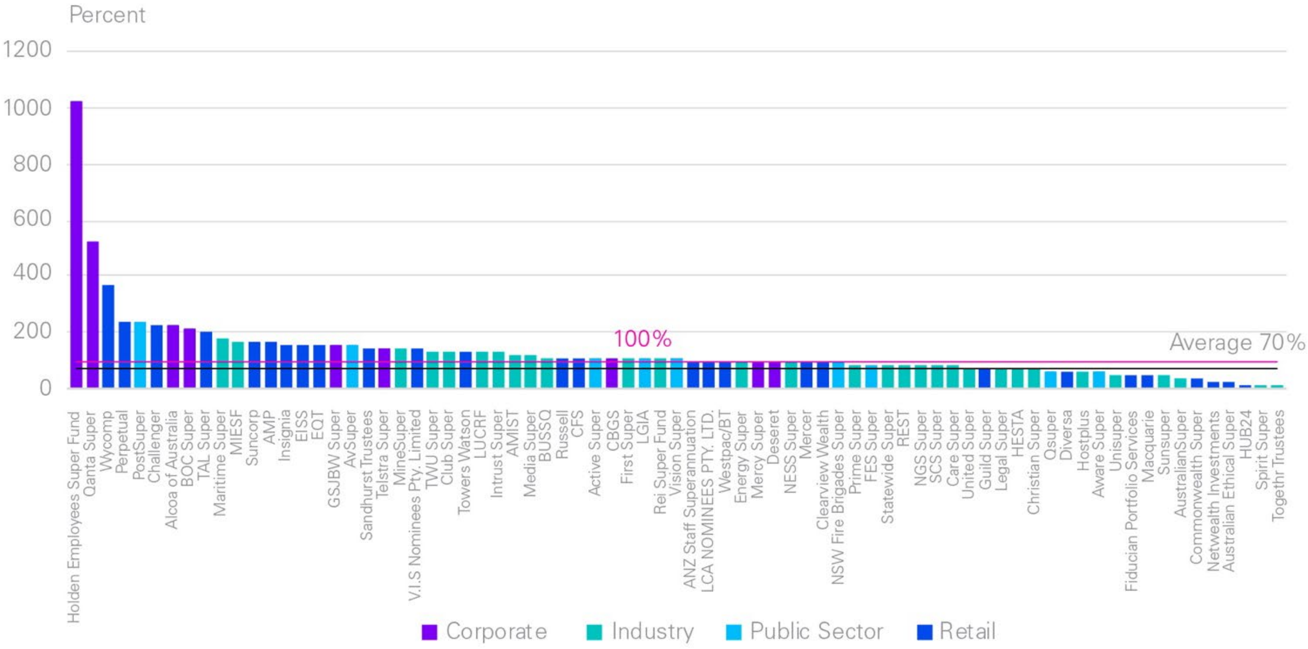
HUB24 was shown under EQT in 2020

The level of rollover activity generally declined between 2019/20 and 2020/21. In particular net rollovers into the industry sector declined from $15 billion to $9 billion. Net rollovers out of the retail sector increased slightly from $3 billion to $5 billion.

Overall, the average net cash flow ratio (net cash flows as a percentage of cashflow adjusted net assets) increased from 1.13 percent to 1.40 percent between 2019/20 and 2020/21.

The number of funds in net outflow decreased from 50 out of 83 funds/providers in 2019/20 to 38 out of 75 funds/providers in 2020/21.

Net outflow ratio – 2020/21

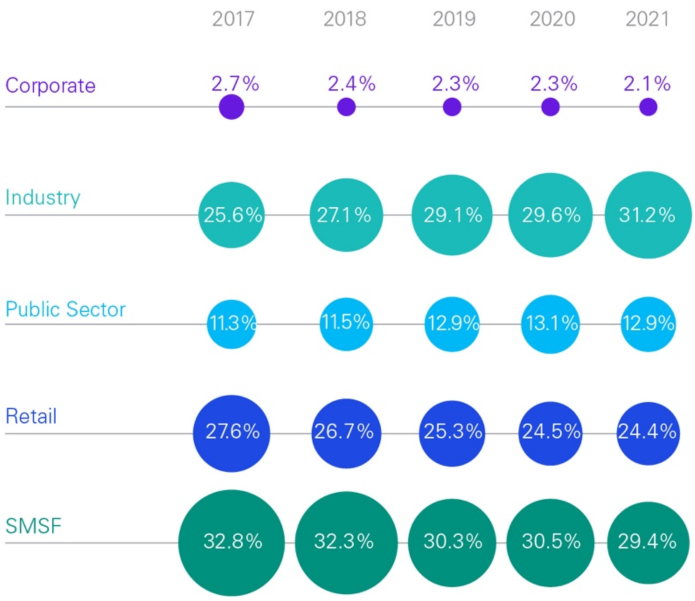


Sector market share

The combination of positive net cash flows and higher net returns, on average, across the industry fund sector, resulted in the industry fund sector overtaking the SMSF sector in total net assets for the first time:

	Net cash flows ($bn)	Sector return to 30 June 2021	Total net assets ($bn)
Corporate	-1.5	14.1%	58.4
Industry	53.4	16.1%	872.4
Public Sector	10.4	13.2%	359.3
Retail	-5.7	17.0%	680.2
SMSF	-15.4	13.0%	822.0

Market share across the industry

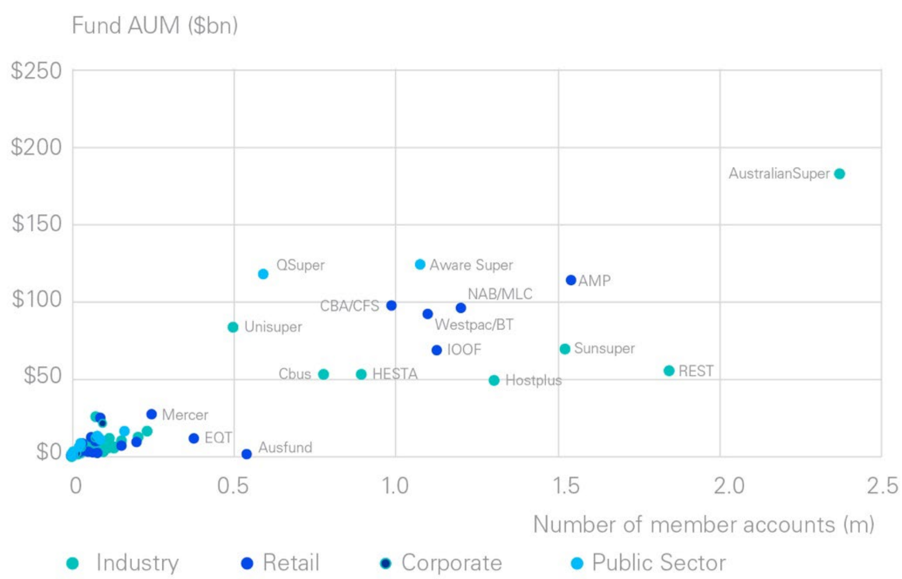


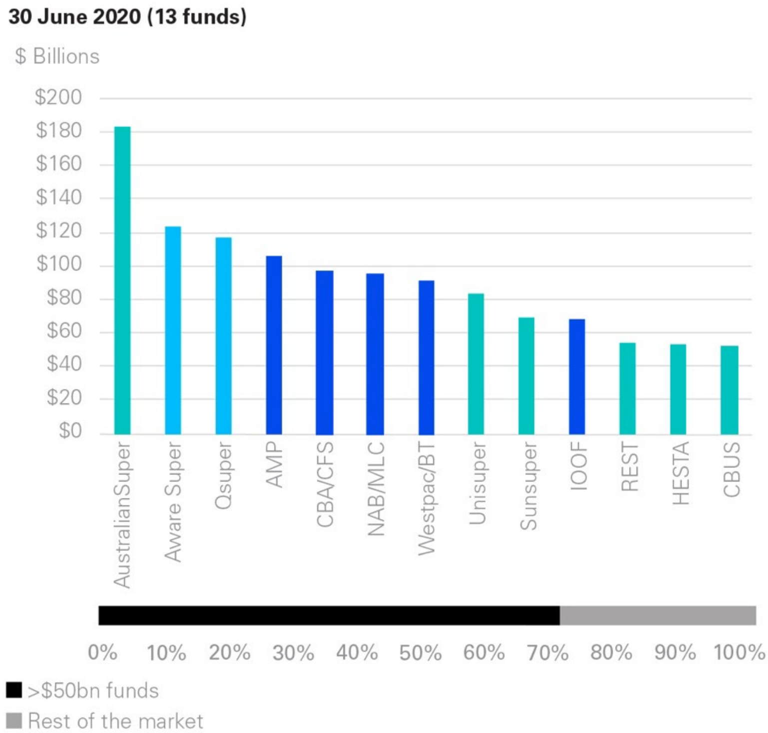
Market position

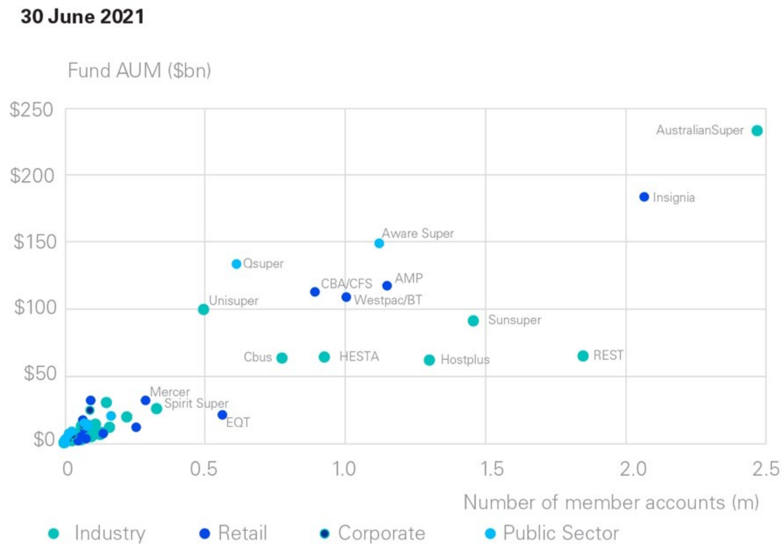
Hostplus joined the funds above $50 billion and IOOF's acquisition of the MLC business resulted in Insignia Financial being the 2nd largest fund by AUM and membership as at 30 June 2021.

As at 30 June 2021 the 13 funds with net assets above $50 billion held 75 percent of total net assets (excluding SMSFs) and 78 percent of members.

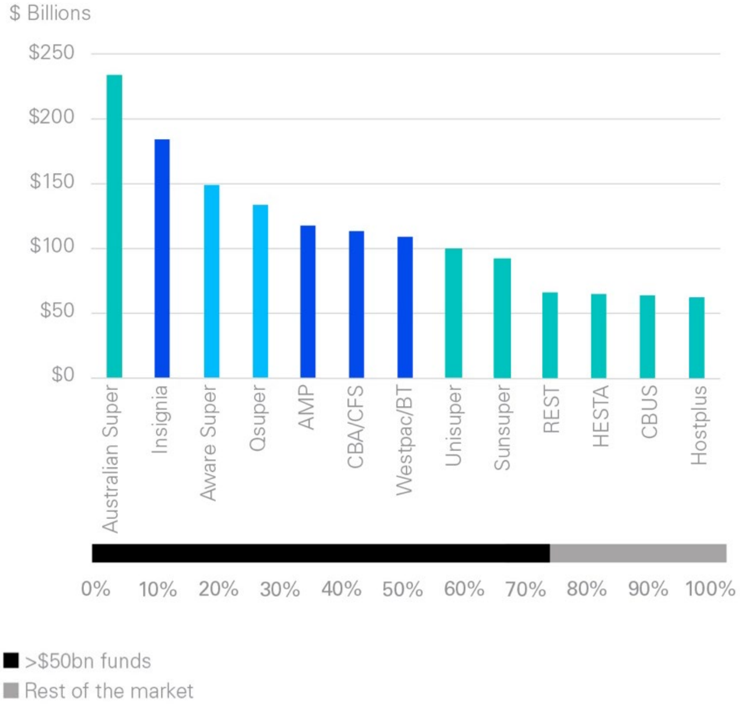
30 June 2020




30 June 2020 (13 funds)
$ Billions
$200
$180
$160
$140
$120
$100
$80
$60
$40
$20
$0
AustralianSuper
Aware Super
Qsuper
AMP
CBA/CFS
NAB/MLC
Westpac/BT
Unisuper
Sunsuper
IOOF
REST
HESTA
CBUS
0%
10%
20%
30%
40%
50%
60%
70%
80%
90%
100%
>$50bn funds
Rest of the market

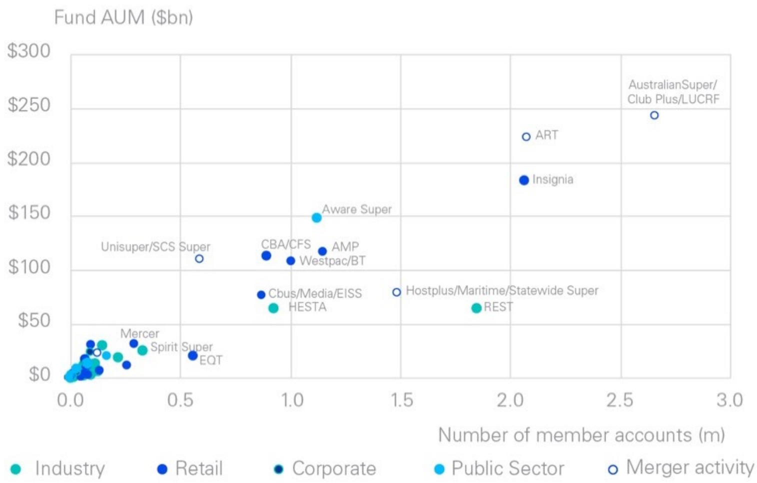

30 June 2021
Fund AUM ($bn)
$250
$200
$150
$100
$50
$0
AustralianSuper
Insignia
Aware Super
Qsuper
CBA/CFS
AMP
Westpac/BT
Unisuper
Sunsuper
Cbus
HESTA
Hostplus
REST
Mercer
Spirit Super
EQT
0
0.5
1.0
1.5
2.0
2.5
Number of member accounts (m)
Industry
Retail
Corporate
Public Sector

30 June 2021 (13 funds)



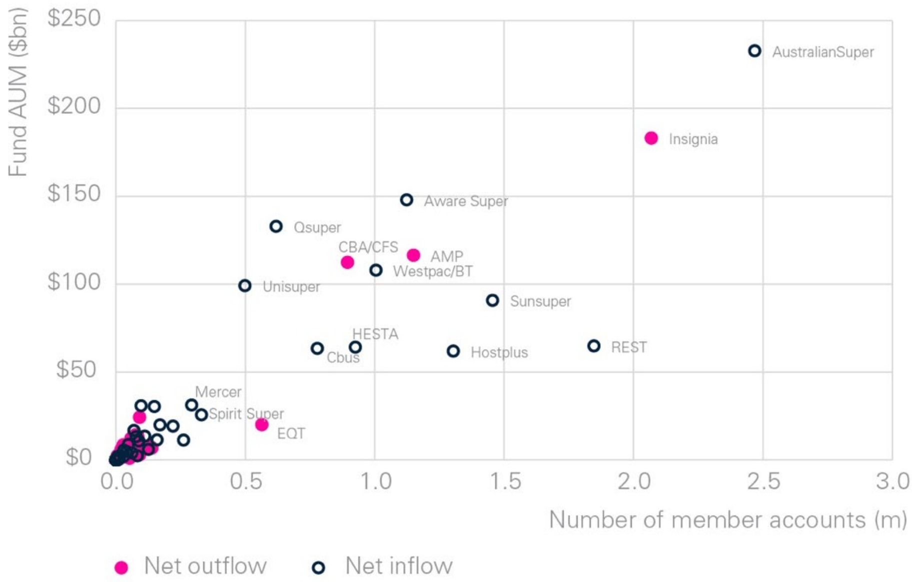
QSuper and Sunsuper's subsequent merger to form the Australian Retirement Trust, as well as other publicly known merger activity, had it completed, would have resulted in the following market position as at 30 June 2021.

As at 30 June 2021 – had merger activity completed



Differentiating funds between those in net outflow and in net inflow, it is evident that all of the above $50 billion industry funds are in net inflow whereas, of the large retail providers, only Westpac/BT was in net inflow over 2020/21.

Market position as at 30 June 2021 – funds in net inflow v net outflow

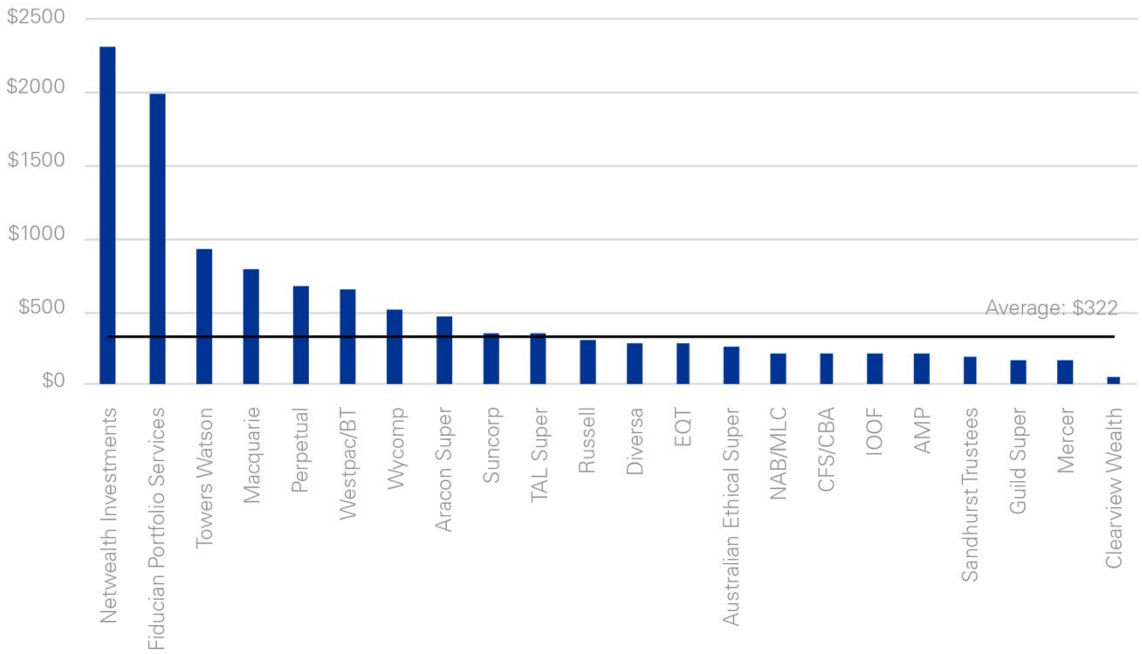


Fees and costs

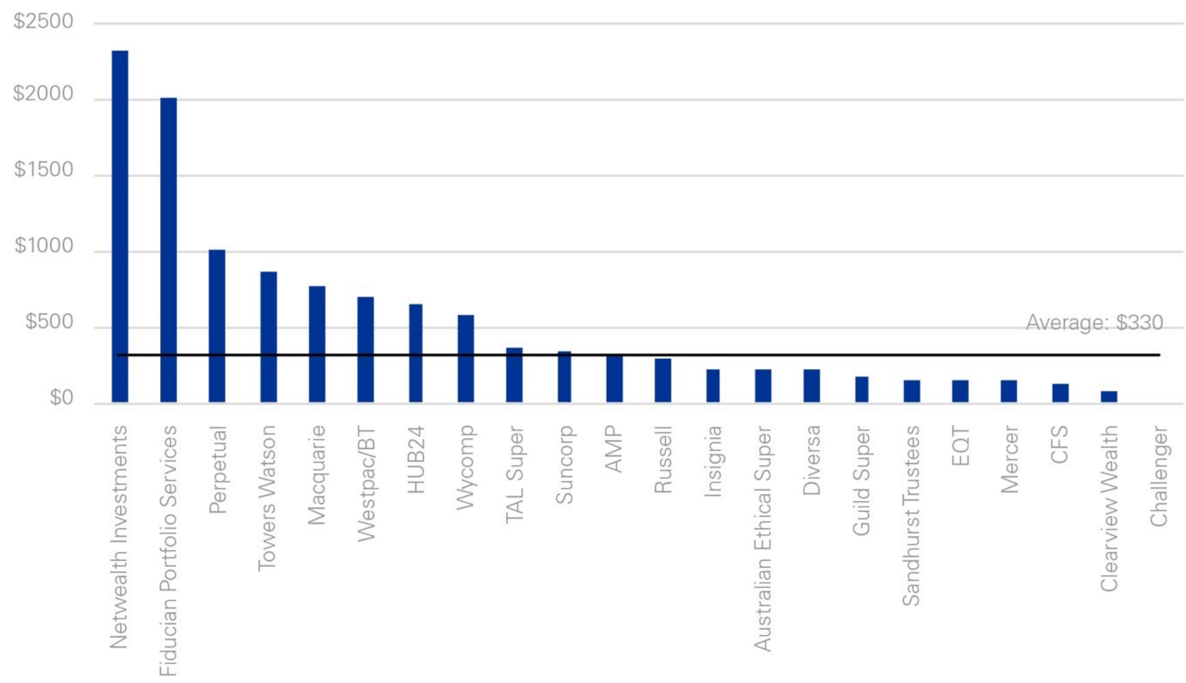
Between 2019/20 and 2020/21 the average operating cost per member increased from $220 to $239 for all funds (excluding SMSFs). However this was largely driven by the reduction in membership and closure of many of the (low cost) Eligible Rollover Funds. Excluding these funds from the metrics, the average operating costs per member increased from $235 to $240.

For retail funds, excluding ERFs, the average operating costs per member increased from $322 to $330.

Operating cost per member – retail funds 2019/20 (excl. ERFs)

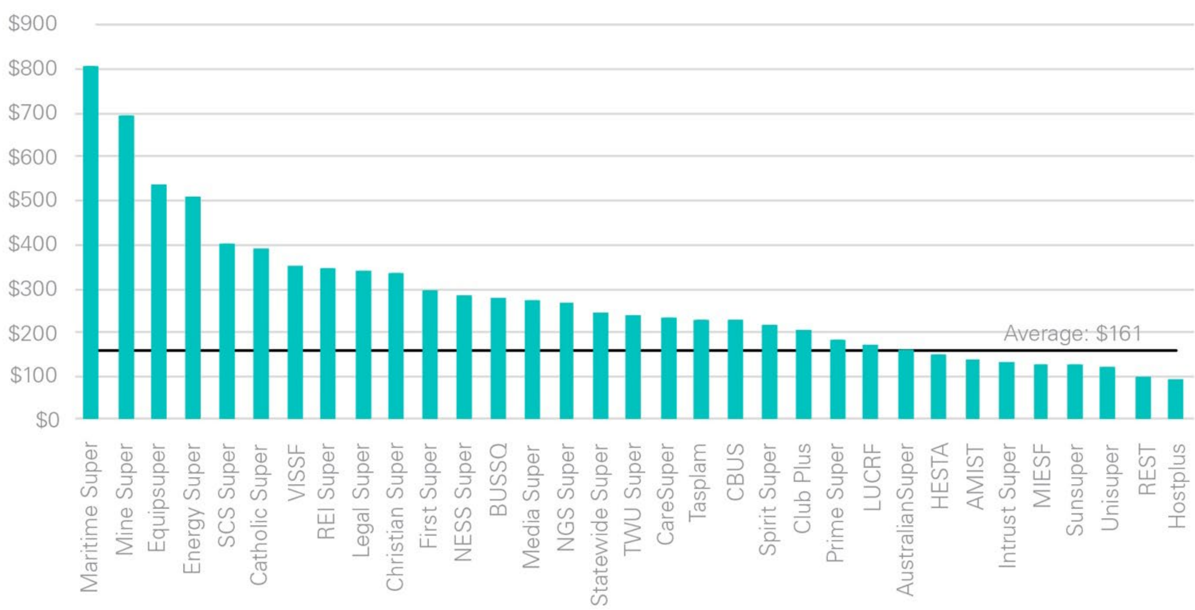


Operating cost per member – retail funds 2020/21 (excl. ERFs)

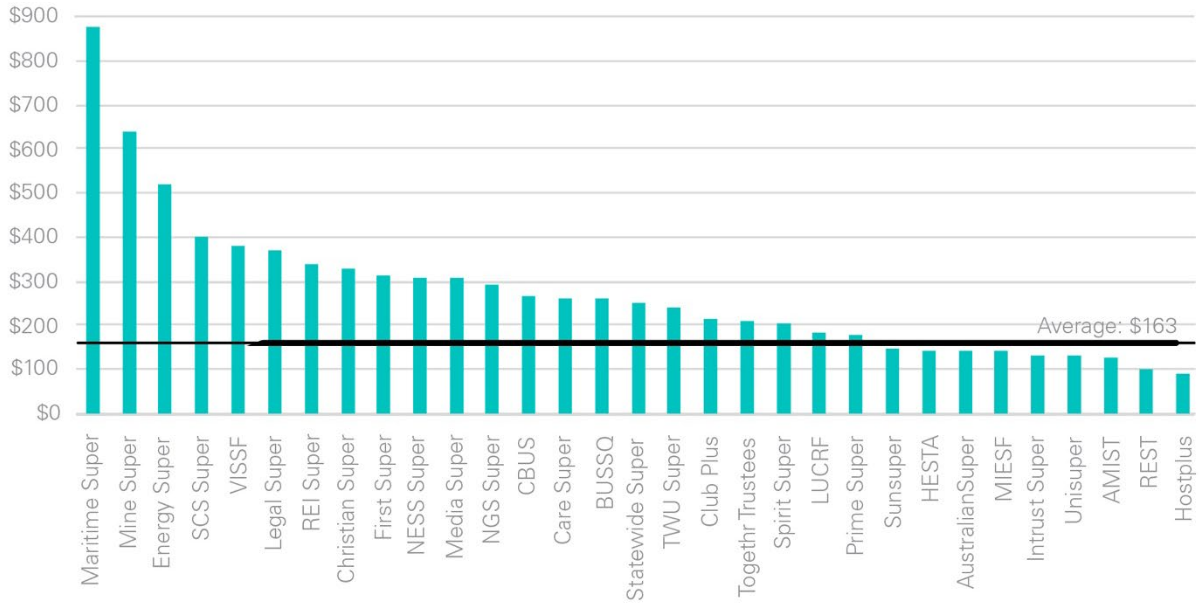


For industry funds, the average operating costs per member marginally increased from $161 in 2019/20 to $163 in 2020/21.

Operating cost per member – industry funds 2019/20



Operating cost per member – industry funds 2020/21

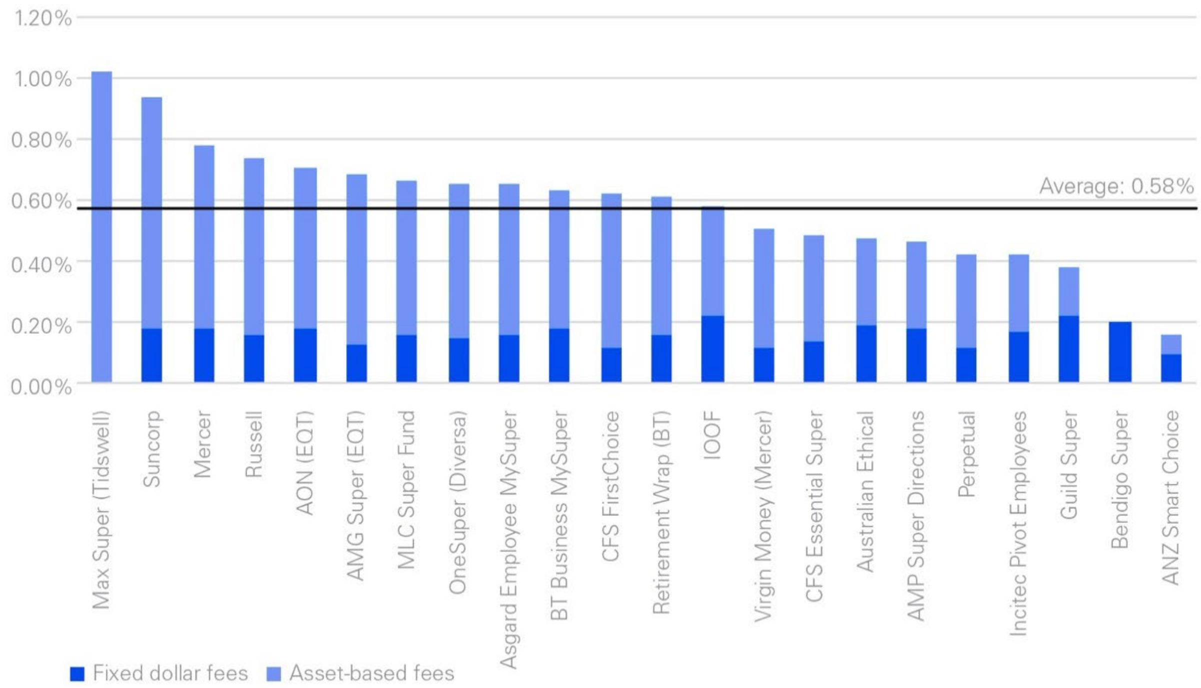


Whilst the average operating cost per member increased across the Super Insights population (excluding SMSFs), the average MySuper administration fee – charged to a MySuper member with a $50,000 balance – marginally decreased, from 0.36 percent to 0.32 percent of the account balance based on the MySuper administration fees reported to APRA as at 30 June 2020 and 2021.

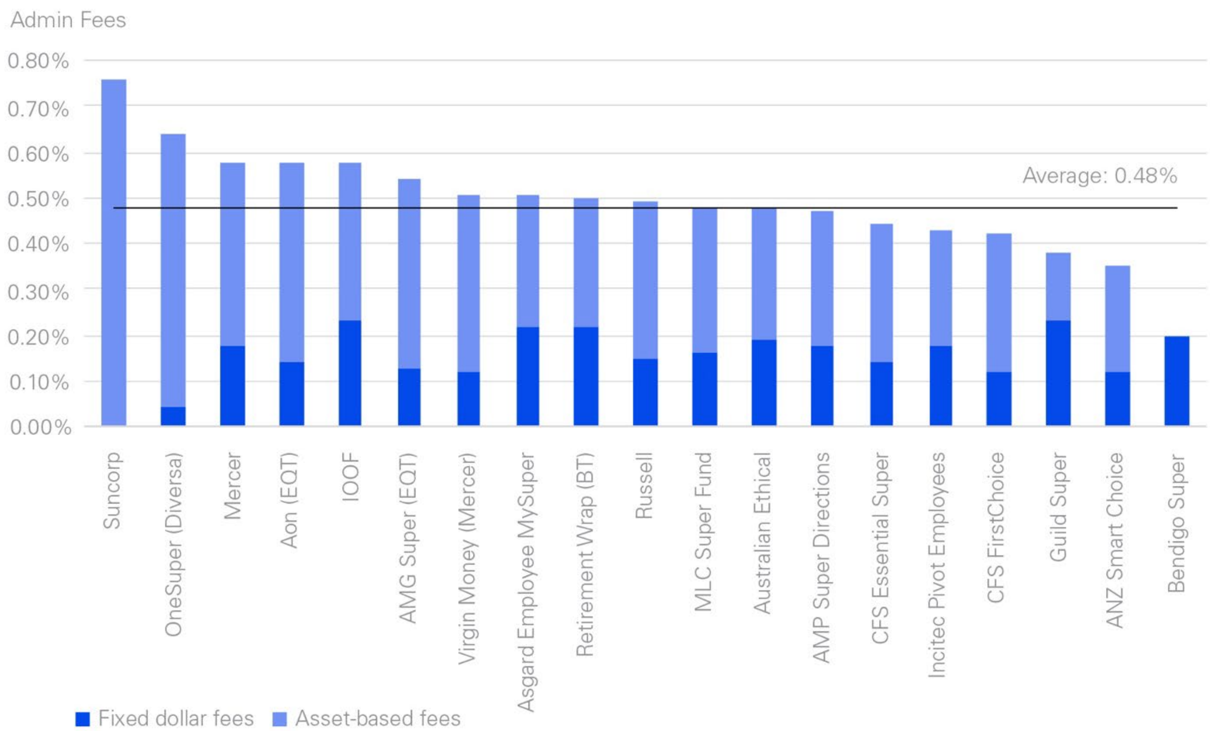
The retail sector saw the most significant change, with reductions in fees across most funds and the average MySuper administration fee reducing by 17 percent, from 0.58 percent per annum to 0.48 percent per annum. The average MySuper administration fee in the industry fund sector reduced, only marginally, from 0.28 percent per annum to 0.27 percent per annum.

The 'MySuper Admin Fee' view now shows the split of administration fees charged between those charged as a fixed dollar fee and those charged as a percentage of assets. The retail products tend to have a higher portion of fees calculated as a percentage of assets than for the industry funds' MySuper products, although the bulk of the industry funds' MySuper products now charge a percentage of assets fee.

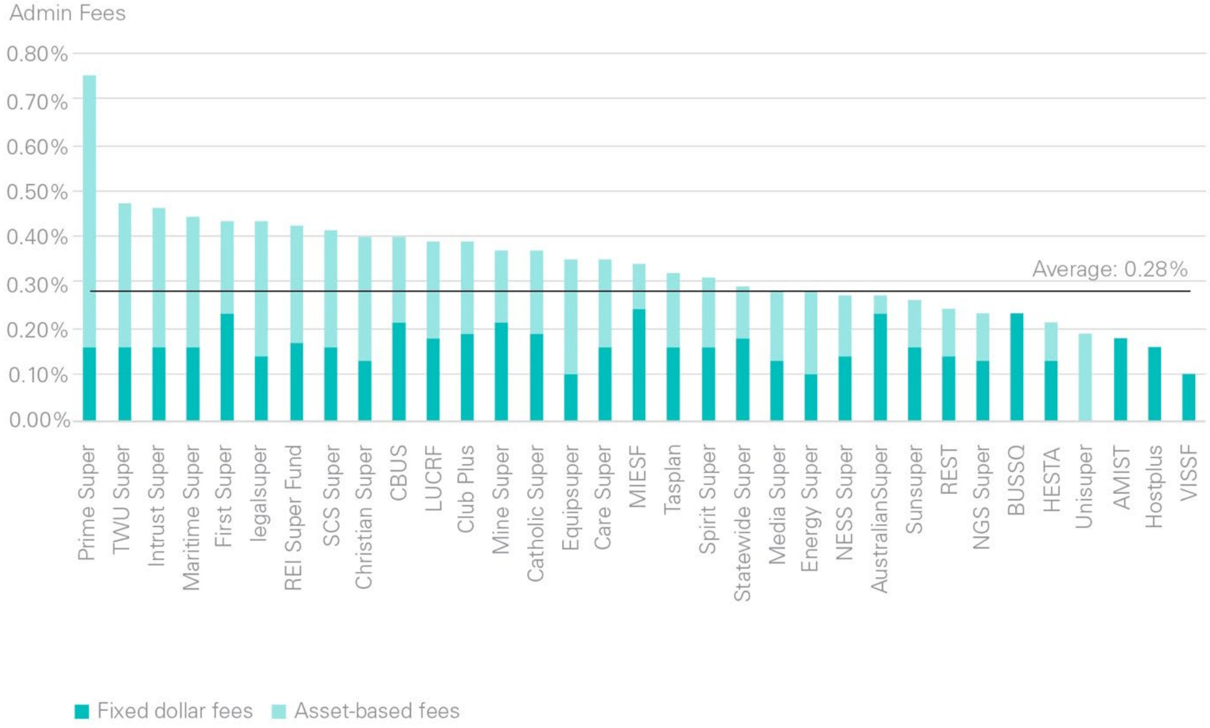
MySuper Administration Fee ($50k balance) – retail funds 30 June 2020



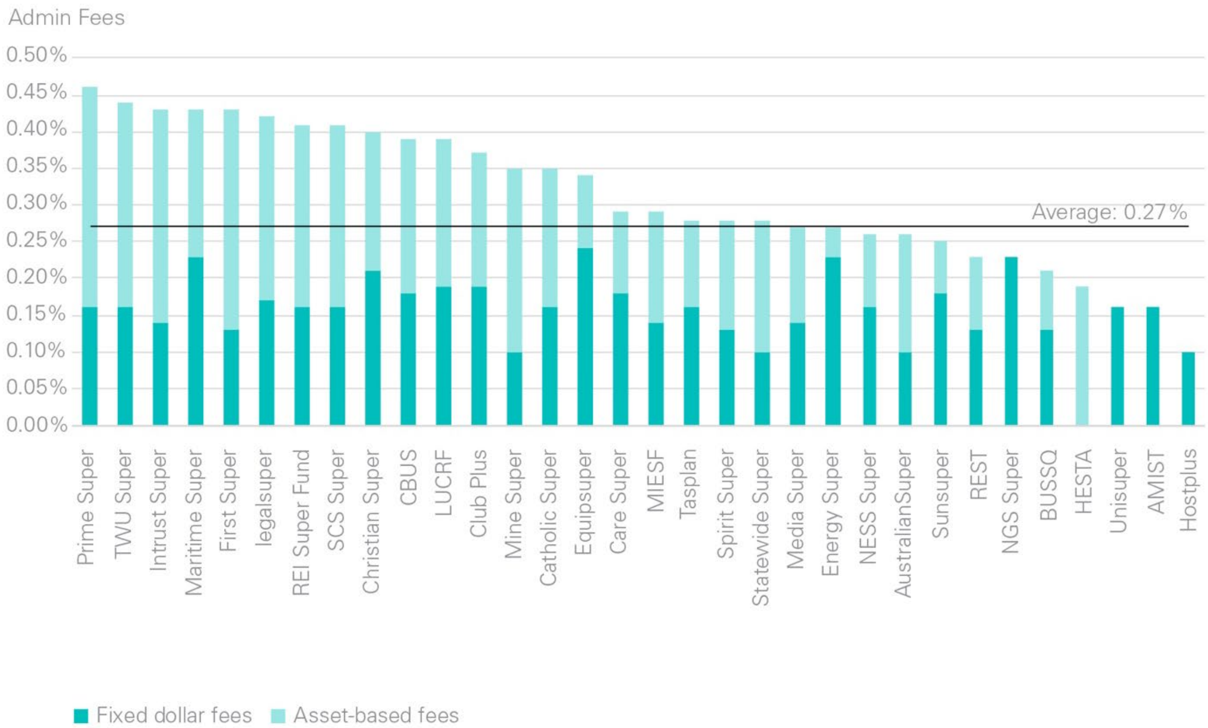
MySuper Administration Fee ($50k balance) – retail funds 20 June 2021



MySuper Administration Fee ($50k balance) – industry funds 20 June 2020



MySuper Administration Fee ($50k balance) – industry funds 20 June 2021



Size matters?

The Super Insights Dashboard allows filtering of funds/providers by AUM, grouping funds/providers by less than $10 billion AUM (42 funds/providers), $10 billion to $25 billion AUM (16 funds/providers) and above $25 billion AUM (17 funds/providers). Applying these filters to key metrics results in:

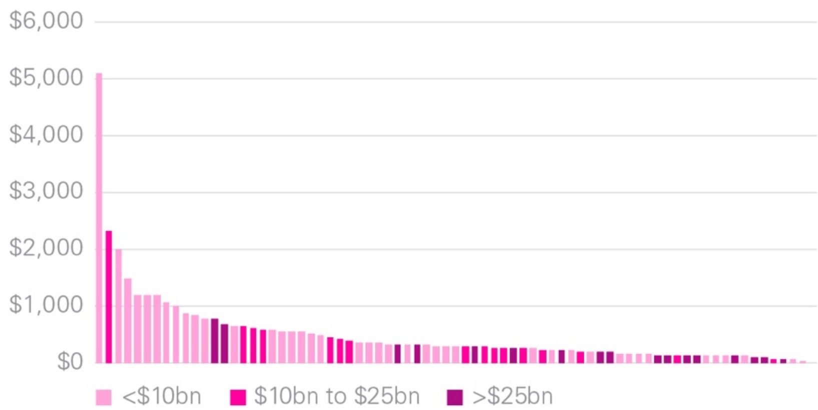
Weighted average metric by size cohort

	<$10 billion AUM	$10 billion to $25 billion AUM	>$25 billion AUM
Operating costs per member	$312	$326	$221
Net cash flow ratio	-2.1%	3.8%	1.4%
Member contribution per active member	$1,408	$2,148	$1,922

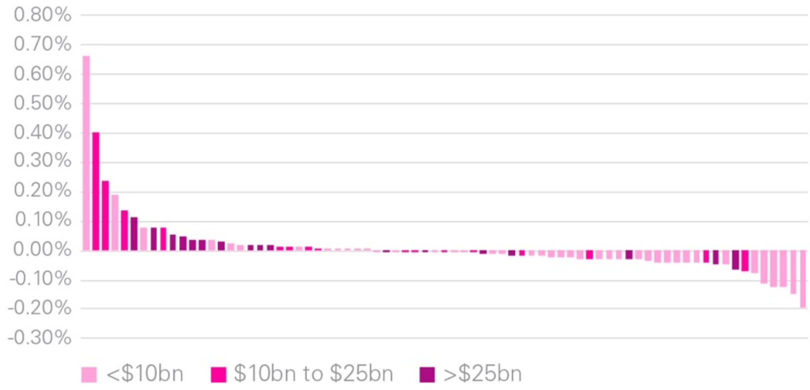
Comparing these average results across chorts indicates that, whilst size appears to result in some efficiencies in costs, it is not necessarily a driver of net cash flows or average member contributions, with the average result being strongest in the $10 billion to $25 billion AUM cohort

However looking at these metrics across the individual funds/providers indicates that size is not the sole driver of results.

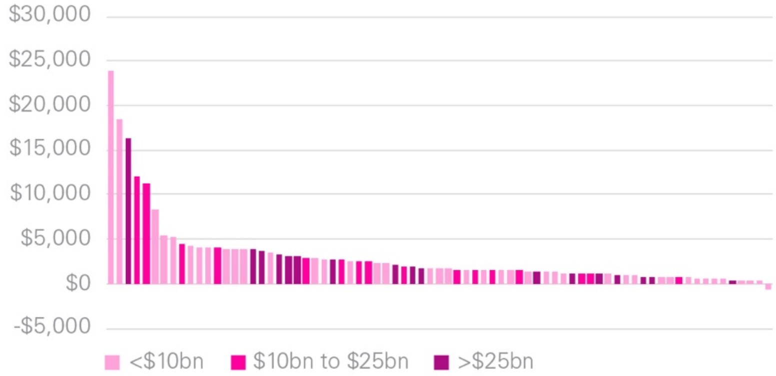
Operating cost per member – by AUM 2020/21



Net cash flow ratio – by AUM 2020/21



Member contribution per active member – by AUM 2020/21

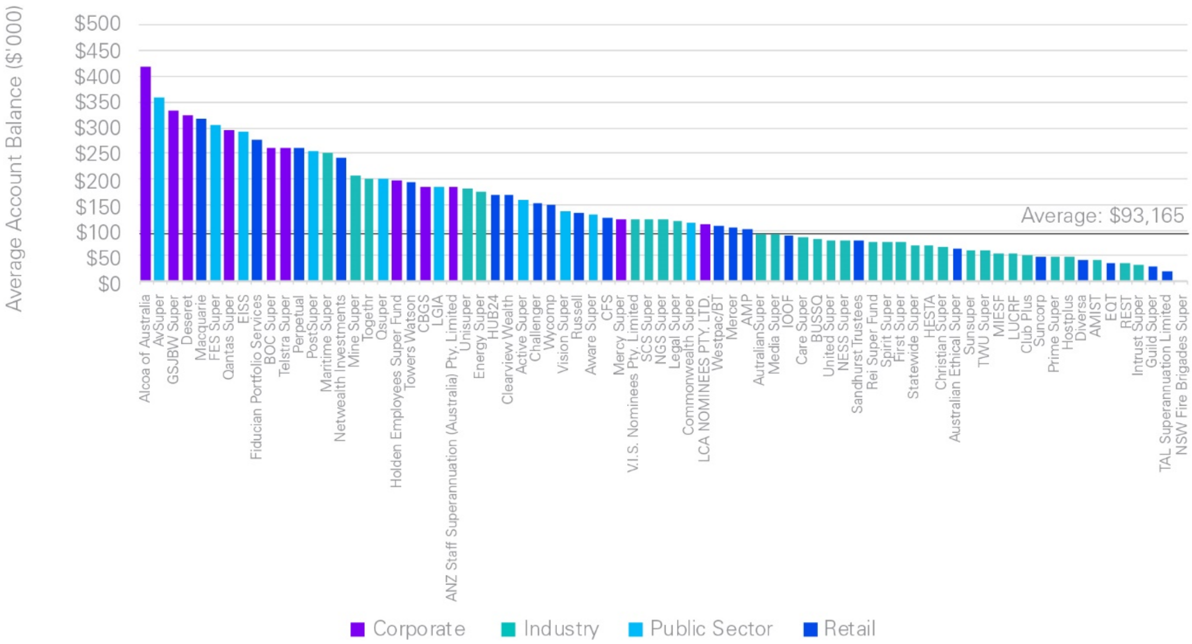


New views

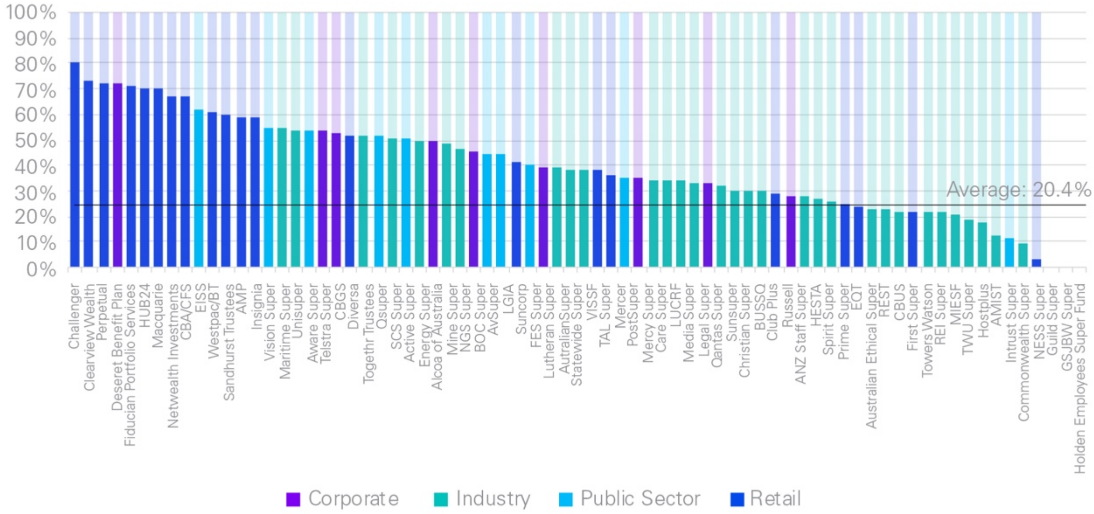
Two of the new views introduced to the Dashboard this year show the average account balance by fund and the proportion of AUM in pension phase. As expected the corporate and public sector funds have the larger average account balances, whilst the providers offering wrap products have the higher proportions in pension phase.

As at 30 June 2021 the average account balance across all sectors (excluding SMSFs) was $93,165, whilst 20.4 percent of assets and 6 percent of accounts were in pension phase.

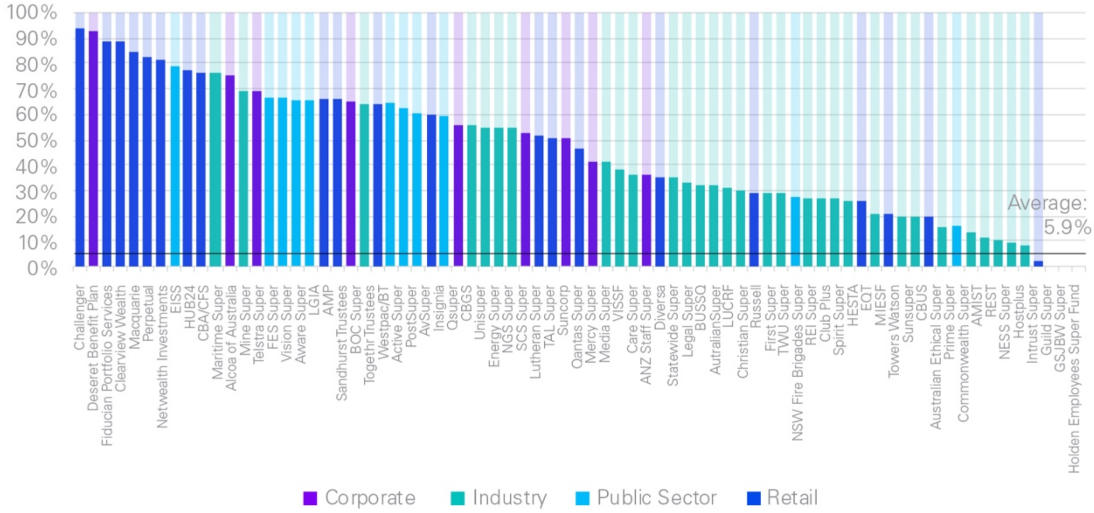
Average account balance – 30 June 2021



Proportion of AUM in pension phase – 30 June 2021



Proportion of membership in pension phase – 30 June 2021

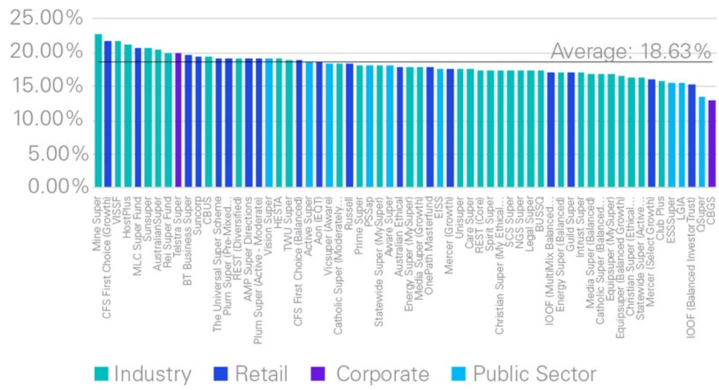


Finally, to round out the information provided by the Dashboard and recognising that APRA publishes limited investment performance information that is suitable for comparisons, we have incorporated a new view providing 1, 5 and 10 year net of investment fees and tax information for 'Growth Funds'. These are investment options offered by funds/providers that have a 61 percent to 80 percent strategic allocation to growth assets.

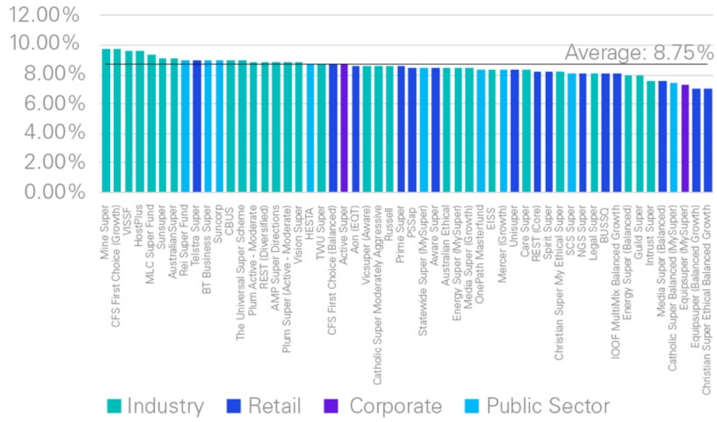
This view uses data collected and provided by Chant West.

Based on this information, whilst investment options offered by the industry fund sector show stronger performance over the 10 years to 30 June 2021, there is a more even spread across the sectors in the top performing options over the 1 year to 30 June 2021.

Performance of Growth Funds – 1 year to 30 June 2021



Performance of Growth Funds – 10 years to 30 June 2021



Super of the future: Beyond the Retirement Income Covenant

Harnessing the opportunities created by regulatory and sectoral change will enable funds to deliver better outcomes for members well into retirement.

Whilst the key sectoral drivers of change remain the same ones KPMG has covered in previous versions of Super Insights, the focus and intensity of these drivers has changed. The escalating pace of change is creating opportunities which progressive funds can harness to deliver better outcomes for members.

Key Drivers of change in the Superannuation Sector

- Persistent regulatory change and scrutiny
- Consolidation activity accelerates
- Demographic shifts
- Shifting consumer expectations
- Digital and value chain disruption

Persistent regulatory change and scrutiny

Over the preceding decades, the sector has faced into significant regulatory change but never more so than in the last 2-3 years, which has seen 180 plus recommendations, first made in the Murray Review and Haynes Reports, enacted into law.

Even the nature of the legislative change has shifted. Where regulatory changes to super have generally been technical and administrative in nature in the preceding years, the recent program of change has been significant and aimed at enhancing the robustness, transparency and maturity of the sector. Driven largely by consumer and regulatory expectations, the recent changes impacting super funds have set new standards in terms of the following:

Decision making frameworks: The process and evidence funds need to go through to make decisions (including evidence to support decisions) in the best financial interests of members.

Accountability: Setting clear expectations and obligations on trustees and fund executives who are required to set, monitor and report on their business plans, how they design and distribute products and the outcomes for members.

Transparency: Not only in terms of how the fund is managed and operated (for example annual member meetings, publishing summaries of member outcomes assessments) but also in terms of how members' monies are invested with Portfolio Holding Disclosure going live in 2022.

Product design and distribution: Setting obligations on the product manufacturer and issuer to ensure products are designed fit for purpose for their target market and distributed through appropriate channels and distributors.

Directing Superannuation Guarantee contributions: Moving away from default contribution flows and providing employees with tools to compare super funds.

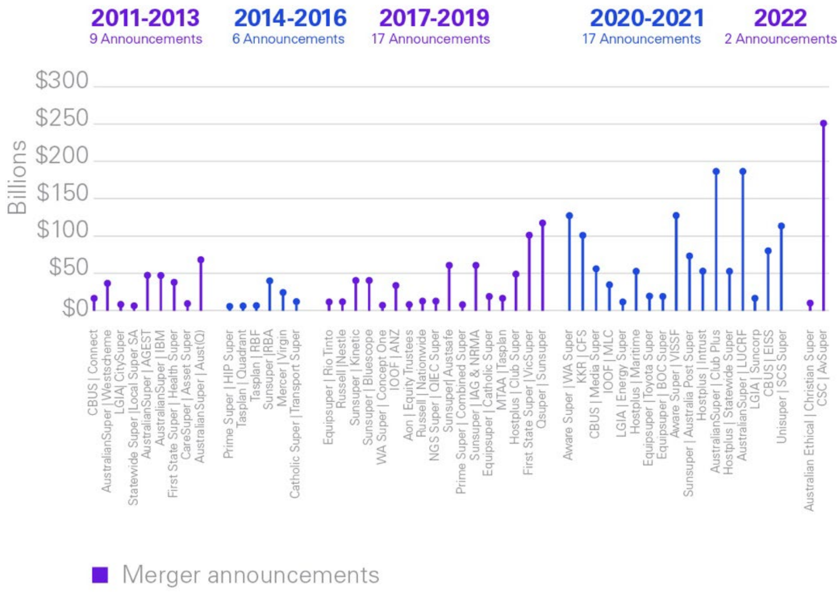
Retirement Income Covenant: Setting a framework which asks the trustee to document, review and implement a retirement income strategy.

Consolidation activity accelerates

Without a doubt, consolidation continues to be one of the key drivers of change in the sector.

- In the 6 years between 2011 and 2016 there were 15 ‘material’ (above $500 million) Successor Fund Transfers (SFTs) announced.
- In the 3 years between 2017 and 2019 there were 17 announcements.
- 17 announcements were made in 2020 and 2021.
- 2 SFTs have been announced so far in 2022, with many more under discussion.

Ten years of mergers & transformation in Australia's superannuation industry

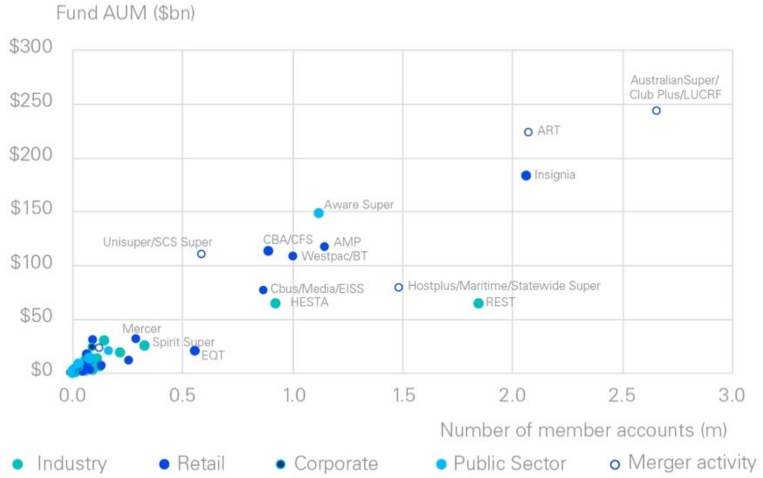


"APRA's paper showed hard evidence that lack of scale was hindering performance and undermining future outcomes for members".

Margaret Cole [6]

Consolidation is resulting in the creation of mega funds as shown below.

As at 30 June 2021 – had merger activity completed

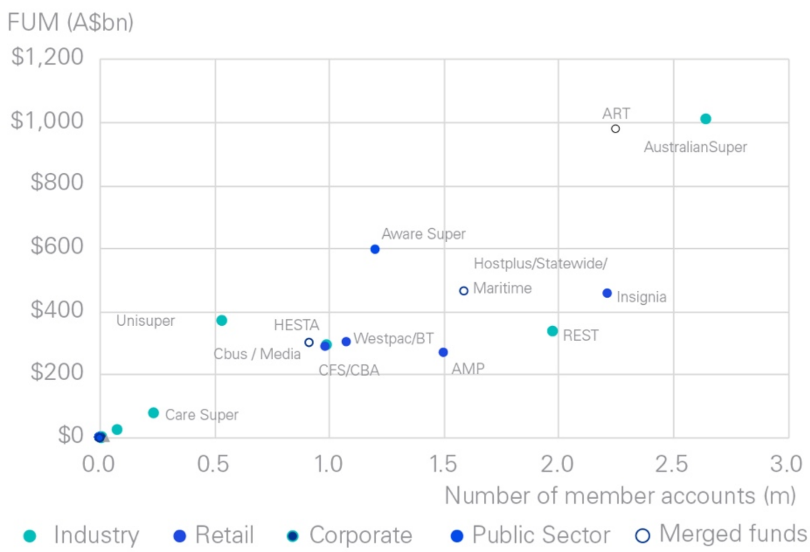


Excluding any further potential mergers, AustralianSuper and Australian Retirement Trust (ART) are expected to continue to dominate the industry, each growing from ~$200 billion in 2021 to approximately $1 trillion in AUM by 2040. Aware Super may grow from sub $200 billion to $600 billion in AUM; Insignia (the former IOOF / MLC) may grow from sub $200 billion in 2021 to $500 billion in AUM by 2040.

The projected market position at 30 June 2040 reflects projections of each fund/ provider based on recent contribution and benefit flows to each fund and does not allow for any future fund consolidations. Under these projections, a small number of large 'mega funds' will continue to pull away from the rest of the population. However, in practice, multiple drivers – future consolidations, individual funds' levels of success in attraction and retention of members, particularly in the retirement space – will impact how the market shifts.

In particular, the projections for the retail providers reflect the impacts on member cash flows of the Royal Commission and the recent restructures which have and are occurring in this sector. Their growth trajectory will reflect how successfully these providers emerge from the current distractions.

As at 2040 – projected market position



Source: KPMG

[6] 2022 APRA Member Margaret Cole - Speech to the Investment Magazine Chair Forum | APRA

In late March 2022, speaking at the *Investment Magazine's Chair Forum*, APRA encouraged funds to continue to consider merger options *and* disclosed its views on the sustainability of a number of funds in the sector: out of 78 funds, 38 funds (both MySuper and Choice Funds), are sub-scale with declining sustainability metrics.

APRA assesses three sustainability metrics: total account growth rate, net cashflow ratio and net rollover ratio over rolling 3-year periods.

APRA's analysis of the sustainability metrics over the 3 years to 30 June 2021 highlighted 38 super funds which are declining across all three sustainability metrics, made up of:

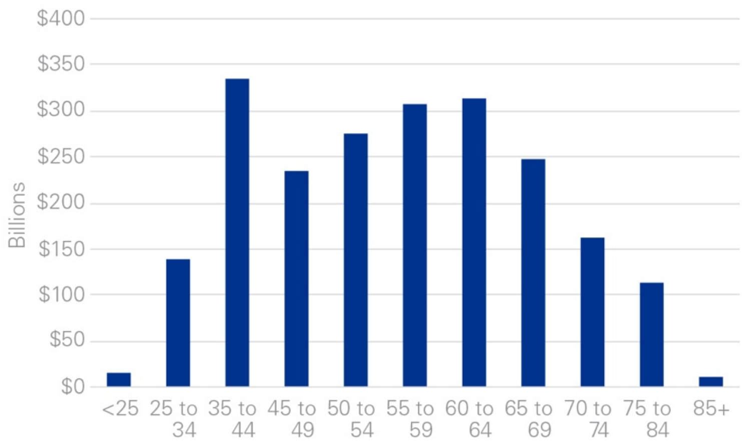
- 24 of the 47 small funds (<$10 billion AUM)
- 11 out of the 18 medium funds ($10 billion to $50 billion)
- 3 out of 13 large funds (>$50 billion).

Given the level of regulator scrutiny (noting that APRA has also confirmed it is seeking greater powers to force mergers), we expect the consolidation trend to continue for a number of years yet.

Demographic shifts: Australia's aging population will drive product and solution development

"Over the next 10 years, an estimated 3.6 million Australians will move from the accumulation phase to the retirement phase of superannuation, with somewhere in the region of $750 billion in aggregate retirement savings" **Helen Rowell, APRA, November 2021[7]**

Total FUM by age 30 June 2021



Source APRA fund-level superannuation statistics 2021, KPMG analysis

Based on KPMG projections, which apply the ABS population projections to the current APRA and ATO data, total pension assets – across the Super Insights population including SMSFs, as well as exempt public sectors funds - will grow to approximately $1.4 trillion in 2030 and $2.5 trillion in 2040.

Although new workforce entrants will mean that the industry as a whole is not expected to move into a net outflow position, total pension payments are expected to be approximately $137 billion in 2040, compared to approximately $46 billion in 2021.

[7] APRA Deputy Chair Helen Rowell – Speech to the Australian Financial Review Super and Wealth Summit, 22 November 2021

Following the passage of the Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021 early this year, the Retirement Income Covenant (Covenant) legislation takes effect from 1 July 2022. The legislation requires trustees to "formulate, review regularly and give effect to a retirement income strategy" and make a summary of it publicly available.

APRA and ASIC's guidance issued in March 2022[8] set out an indicative pathway under which, prior to 30 June 2022, funds need to:

1. prepare retirement income strategies
2. assess outcomes of existing products and assistance offered to members (in business performance review and annual outcomes assessment)
3. update business plan to reflect retirement income strategy.
4. take reasonable steps to gather the information necessary to inform the strategy

In developing the Retirement Income Strategy (RIS) the trustee must:

- understand and segment members by retirement income needs (I.e. cohorts)
- address how the trustee will achieve and balance the following oftentimes competing objectives for each cohort:
  - maximising the retiree's expected income
  - ensuring flexible access to capital
  - managing risks to the sustainability and stability of retirement income, including longevity, investment, inflation and any other risks
- consider different sources of retirement income, net of tax, including income paid from the fund, the age pension and any other sources the trustee determines
- determine how the "period of retirement" will be defined with reference to the membership
- consider how existing and potential product offering(s) benefit the different member cohorts and achieve and balance the above objectives
- consider what additional support such as guidance and advice may be required to assist members.

8 Implementation of the retirement income covenant | APRA

To create an effective RIS requires a change of approach from the traditional product strategy. In addition to considering all the matters generally considered in designing and analysing products (for target markets/cohorts), the RIS requires that analysis be undertaken to determine the better product relevant for each cohort(s) using ex-post rather than ex-ante analysis – that is assess analysis showing the outcome of the product (in terms of the above objectives) versus other potential product designs (see Long Term Strategic Considerations for more details).

Further, APRA and ASIC's guidance asks that funds address the following key considerations in addressing the above objectives:

Oversight and strategy implementation: Develop a RIS consistent with the super fund's business plan and cohort needs, which addresses the objectives of the Covenant.

Strong product governance and distribution practices: A strong product governance framework is needed to ensure the trustee's product offerings are designed to meet the needs of members, consistent with the fund's business plan and existing Design & Distribution Obligations (DDO) Target Market Determinations (TMDs) with its reasonable steps amended as needed.

Robust analysis of member cohorts/sub-classes: Consider what additional information is required to determine cohorts and /or sub-classes.

Quality data: Highlighting the types of data to source in order to help develop, analyse, monitor and review the product(s), cohorts, outcomes and development of the RIS.

Fit for purpose assistance for members: Funds will need to contemplate how they will bring their solution to market together with tailored education, guidance and advice (as appropriate), consistent with their TMDs and DDO practices.

Long term target strategic considerations: Beyond compliance

As with any substantial reform – particularly one focussed on the member – it is critical that the fund's short-term plans are aligned with and inform the long-term target state.

One positive expression of the longer-term strategic question to solve is:

> The retirement services, education and strategies/products available for each of our members will be better or at least as good as they could get at another fund.

At an operational and project level, many funds have agreed with the logic expressed below.

Best understanding of members

Member circumstances
- Age
- Assets
- Martial status
- Health

Member preference
- Income level
- Risk aversion
- Access to lump sums
- Bequests
- Retirement age/work plans

+

Best understanding of outcomes

Available strategies & products
- Benefit defined & discretions
- Underlying investments
- Guarantees
- Fees

Future economics / markets
- Investment market / returns
- Variability
- Correlations
- Risk management costs

Longevity
- Likely levels & potential variability

=

Best retirement income solution

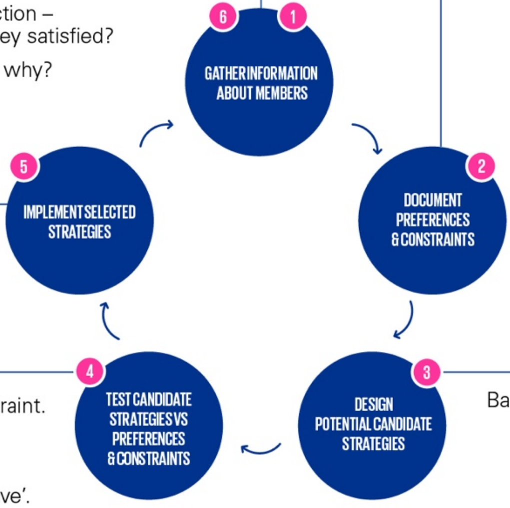
Strategy / product that best matches outcomes to member preferences / circumstances

This crystallises the key analysis required to develop strategy and offerings; understanding member circumstances and preferences, and analysing the outcomes that candidate strategies deliver against those preferences.

Funds have already spent significant time and resources to understand their members – more is required in this area. Particular focus is also needed on the ability to analyse outcomes from candidate strategies for which many funds will need to develop their modelling of future outcomes.

Funds need to consider key contextual factors relating to the time and effort members will spend on decision making, how they will interpret information they receive and what existing bias/frames exist. Not all will go through a long face-to-face advice process.

The below sets out a potential development cycle process.



GATHER

+ General - focus groups, surveys, internal and external data sources.
+ Analysis of member strategy selection – reason why they chose, and are they satisfied?
+ Analysis on members who leave – why?

DOCUMENT

+ Member Preferences and constraints / considerations:
+ Pathway – path member access info and advice.
+ Understand – ability of the member to understand strategy.
+ Confidence/trust/ behavioural constraints – member beliefs and values.
+ Operational complexity and cost.

DESIGN

+ Based on documented preference vs constraints.
+ Filter existing and new potential products, and create a shortlist of strategies.

TEST

+ High priority – preference vs constraint.
+ Ability fine-tune – flexibility for member choice.
+ Lower priority – what is 'nice to have'.
+ Risks – identify risks in the strategy. Assess and document why acceptable.

IMPLEMENT

+ Decide and implement selected strategy.

Shifting consumer expectations: Present opportunities for funds to drive growth, retain and build trust

Further to the demographic shift signalling a need for greater focus by funds on the retirement phase, both the lived experiences of the pandemic and natural disasters faced largely on the eastern seaboard of Australia have also had a marked impact on Australians and their expectations of funds.

- ESG: 33 percent of Australians already make ESG investment choices and 45 percent are seeking to do the same[9]
- However, Australians face barriers in terms of a lack of awareness of product solutions and tools to help them invest consistently with their ESG objectives, and approximately 25[10] percent of Australians want financial advice assistance. 71 percent of this next wave are concerned about climate change and high net worth investors are looking for investments which demonstrate better governance. Regardless of the investment focus, this next wave is seeking greater information and help from their fund and financial advice and tools to help them select investments that match these investment objectives.
- Past digital barriers have been broken.
- Members expect to be able to access information and help as and when they want it and ideally for the information and help to be personalised ("know me").

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[9] Investment Trends research – ESG Adviser and Investor Report 2022
[10] Ibid

Digital and value chain disruption

The pressures caused by regulatory change (mergers creating larger funds, stapling, benchmarking) are causing ripples of disruption that go beyond addressing the immediate regulatory ask.

These disruptions extend to the core activities of the fund, including;

- its investment strategy and approach
- client interfaces and digital maturity
- the efficiency of its operations.

Digital maturity will lift

Digital transformation agendas are accelerating as funds recognise the need to better understand their members in order to meet the trustee's obligations and to deliver a superior member interface generally and particularly in addressing advice challenges.

The recent cluster of regulatory reform, particularly the RIC has required funds to tap into their digital resources to better understand their member base. As a result, funds are generating a wealth of member data and seeking better ways to manage their existing data and digital resources. Our research shows that 59 percent[11] of funds have a clear digital business vision and strategy.

Combined digital interfaces with deeper member data can be used to deliver targeted, digitally accessible member education and guidance. However, the level of digital maturity varies between funds; 49 percent[12] do not use customer data to deliver personalised experiences and 50 percent[13] do not have a view of all customer interactions.

Efficient delivery of advice will require development and deployment of digital solutions. As we have explored previously, the growing advice gap is being felt particularly among super funds and their members. Adviser numbers are declining while account balances and demand for advice is growing.

[11] Harvey Nash/KPMG CIO Survey 2018 (KPMG International and Harvey Nash, 2018)
[12] Harvey Nash/KPMG CIO Survey 2018 (KPMG International and Harvey Nash, 2018)
[13] Harvey Nash/KPMG CIO Survey 2018 (KPMG International and Harvey Nash, 2018)

Members' need for advice will increase as their balances grow and the products available through their fund become increasingly complex (consider the impact of retirement solutions and ESG investment options as just two drivers of increasingly complex choices available to members). With this growing complexity, members will increasingly look to their super funds for advice – the cost of a holistic adviser/planner is prohibitive for most and the lower cost bank channels that might have previously satisfied the mass affluent segments have departed the market.

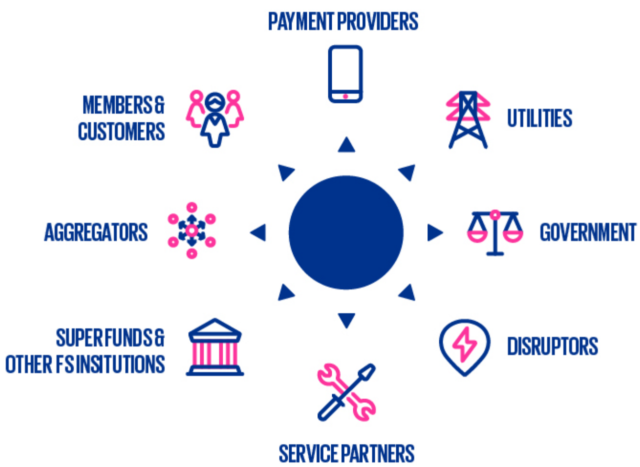
Super funds, on the other hand, should be looking for advice solutions to retain members who might look for a more comprehensive solution elsewhere. Digital advice solutions provide a scalable way to satisfy the unmet advice needs of a large number of members and where deployed along a well designed lifetime customer journey, may assist members in decision making during their accumulation phase and into retirement.

The value chain will be disrupted

Mounting cost and fee pressures, both from benchmarking and pressure to compete against ever larger peers, combined with the opportunity to take advantage of significant scale will drive funds to look for efficiency gains along the value chain.

- Fewer and larger mandates will be negotiated to force down external investment management costs, while larger funds will continue to internalise their investment capabilities
- Larger funds will need to invest more in offshore markets and can take advantage of their significant scale in selecting new investments
- Digital investment and operational efficiency projects can be deployed to reduce costs

In addition, the larger, more complex super funds of the future will likely partner with third party organisations in a move towards an open eco-system of services. The new normal of customer journeys will involve data sharing and partnering with organisations outside the traditional financial services industry: a move *from* limited data access, sharing and centralised business model, *towards* multi-directional data access and sharing across super funds, banks and financial service institutions.



What does all this mean?

The sectoral trends, together with the raft of regulatory change, are driving significant and broad changes to the sector, including structural changes.

With structural consolidation and change of ownership (decoupling) of wealth businesses from the banks, we will continue to see a convergence of market. As offers become homogenous, those funds which focus on driving better member outcomes, simplifying offerings and operations (post mergers) to synergise scale benefits, and who drive digitisation of operations, leverage data and provide value added solutions which enable members to 'live in the app' are more likely to succeed at retention and win new members.

As Australians continue to age, and now with the enactment of a Retirement Income Covenant, we expect to see the development of a broader base retirement offering and continual product and solution innovation as funds strive to differentiate their offerings to retain and grow their member base.

Further, those funds which seek to offer authentic and transparent offerings to enable members to make informed decisions which align with their values, in addition to meeting their needs and objectives, will be better placed than others.

None of these future states can be achieved with minimal effort and impact on the fund's operating model and business. The ability to retain and attract capable, experienced and sufficient resourcing will continue to be a positive contributor to a fund's success.

Transformation, in a balanced and strategically responsible manner is therefore imperative. Business cases will need to address a number of considerations not least of which is best financial interest duty.

The value of patience

Ian Fryer
General Manager
ChantWest

Two years on from COVID market crisis, the value of patience is clear

The COVID crisis struck quickly and, perhaps because it was a public health crisis as well as a financial one, it sparked a strong nervous reaction from super fund members. Funds' call centres were inundated, and despite their best endeavours, funds received record numbers of investment switch requests. From our discussions, it seems between 2 percent to 4 percent of members switched in each fund – higher than in the GFC. This likely translates to over 500,000 members switching out of their funds' default growth option (61 percent to 80 percent invested in growth assets). The majority of those switched all the way to cash rather than to an intermediate conservative option.

Most of the switching activity occurred between late February and mid-April 2020. As it turned out, the COVID-induced downturn was relatively short-lived and markets started staging a recovery from the end of March. These early signs weren't enough for the switchers, however, and only about 25 percent had switched back out of cash by the end of June 2020. Central bank stimulus around the world, the rollout of support measures (eg. JobKeeper), vaccine developments and the US election all boosted confidence so that by the end of December 2020, about 50 percent of members in most funds had moved back out of cash. But about half were still in cash, and funds tell us that 20 percent to 25 percent were still in cash a year later at the end of 2021, earning close to a zero return. Clearly, these people either lacked the confidence, or motivation, to move back out of cash.

Let's now look at the financial implications of these switching decisions. Table 1 shows that hypothetical Member A, who sat tight in the median growth option throughout the two years to the end of December 2021, received a cumulative return of 17.6 percent. Contrast that with Member B, who switched to cash at the end of February 2020 (i.e. early in the crisis) and has remained there ever since. Their cumulative return for the two years is -0.7 percent. But even worse was Member C who hit the panic button a little later at the end of March 2020. If they were still in cash at the end of 2021 (as is quite likely) their cumulative return would have been -9.7 percent.

Table 1: Switching vs Non-switching Comparisons – Cumulative Returns for 2 Years to 31 Dec 21

	Member A Growth only – no switching	**Member B** Switched to Cash 28 Feb 2020 and remained	**Member C** Switched to Cash 31 March 2020 and remained
Cumulative return (%)	17.6	-0.7	-9.7

Source: Chant West

Even after just two years, we can see that the implications of those switching actions for Members B and C are quite dramatic. Having begun 2020 with the same $300,000 in their accounts as Member A, they finish 2021 behind by $55,000 and $82,000 respectively. And looking ahead to retirement, they end up with considerably smaller nest eggs which, if they take no remedial action such as additional contributions or delaying retirement, will see them with a diminished standard of living.

The timing is too difficult

But how about those members who switched to cash and subsequently switched back throughout 2020 and 201? How did they fare? The answer is it all depends on the timing.

Table 3 looks at the experience of four more hypothetical members who switched to cash and back to growth, but at different times. Three of the four fared worse than our 'sit tight' Member A, although all four did better than Members B and C, who are still in cash. The best result was achieved by Member D, who was an early mover, switching to cash at the end of February 2020 and then back to growth at the end of June. By doing so they missed the worst month's return for growth, which was –9 percent in March, and picked up most of the recovery which occurred in the second half of the year.

Table 2: Switching Comparisons – Balances at 31 December 2021 and 10 Year Projections Based on Assumed Returns

	Member D Into Cash 28 Feb 2020Into Growth 30 Jun 2020	**Member E** Into Cash 28 Feb 2020 Into Growth 31 Dec 2020	**Member F** Into Cash 31 Mar 2020 Into Growth 30 Jun 2020	**Member G** Into Cash 31 Mar 2020 Into Growth 31 Dec 2020
Cumulative return (%)	21.8	12.3	10.8	2.1
Account balance 31 December 2021 ($)	363,000	335,000	330,000	305,000
Projected balance 31 December 2031 (3.5% pa return) ($)	497,000	459,000	452,000	417,000

Source: Chant West

There's a very important point to be made here. Member D got lucky, because to achieve what they did required them to get two very difficult decisions right – when to switch out and when to switch back. There were no obvious triggers for either move (particularly to re-risk up), and the chances of getting the timing right are very slim even for experienced investors. In reality very few people got both those decisions correct like our Member D.

It's worth noting that members D, E, F and G are all now back in the growth option where they started and have been for at least a year, so they have all enjoyed the strong double-digit performance delivered by the median growth fund in the 2021 calendar year. When we compare their December 2021 balances, we can see the result of their brief time 'out of the market'. With the exception of Member D, who got lucky, the other three are all trailing our 'sit tight' Member A. Member E is $16,000 behind, Member F is $21,000 behind and Member G, who was slow switching out to cash and slow switching back to growth, is a whopping $46,000 behind. All that over just two years.

Making big decisions without advice is dangerous

Apart from the folly of switching on impulse, another thing this episode has taught us is the value of advice. The funds we have spoken to tell us that members who sought any advice from their fund were less likely to switch than those who didn't. Had they done so, they might well have saved themselves from the self-inflicted financial damage. They would most likely have been told that the option they were in suited their investment timeframe, that it was well diversified into assets other than shares and that this would cushion the blow of the share market collapse, which proved to be correct.

Even if they had switched out, advice would have been helpful to guide them back into their appropriate option. Without advice it's easy to procrastinate, as we've seen from the large number of members still in cash two years after the crisis.

The fear of losing money, even if only on paper, is a powerful emotion and difficult to overcome without the calming influence that expert advice – either from within the fund or from an external adviser – can exert. For the hundreds of thousands of members who did switch, the anxiety proved to be too much. They have now discovered that risk aversion comes at a cost. It may feel safer to respond to a short-term market downturn by switching to the safety of cash but, unless your investment time horizon is very short (in which case you should probably not be invested in a growth option anyway), that action will almost certainly leave you worse off in the end.

Synopsis

From our discussions with funds, KPMG believes the following areas will be among the key focal points in 2022.

Key focal points in 2022

Superannuation funds and the risk of ESG

With an already busy agenda navigating significant regulatory reform, changing member preferences and a sector still in transformation, the industry has moved beyond simply viewing ESG as a risk and compliance tool and instead considers it in terms of value creation for all stakeholders. We explore how implementing ESG and sustainable investing is a journey that encompasses considerations for a whole of business strategy, member retention and social licence, amongst other things.

Tax governance and risk management considerations

Tax governance and risk management considerations for superannuation funds continue to evolve and require adaptation. Ranging from the ATO's 'Justified Trust' initiative, governance and controls over third-party tax data, tax matters relating to fund mergers and the Retirement Income Covenant to considering the future of the tax function, we show what superannuation funds need to consider to stay on top of their 'tax game'.

Evolving financial crime and cyber threats

As crime threats have evolved, there is a need to invest in technology, data, team capability and quality assurance to ensure financial crime programs and operations are fit for purpose and operating effectively. In this article we discuss recent developments in mandatory breach, anti-money laundering, fraud, bribery and corruption, whistleblowing and sanctions and show how effective board and senior management oversight are essential to sound and effective financial crime risk management.

Adaptative investment operations

As the superannuation system grows, matures and consolidates, superannuation funds are required to consider the efficiency and effectiveness of their investment operations and governance arrangements to ensure that they are proactive and adaptive in responding to internal and externa market factors. We discuss a range of considerations for superannuation funds to ensure that their investment operations stay abreast of industry changes and can benefit from the continued growth in the superannuation system.

Key focal points in 2022

Risk and Regulation: APRA's and ASIC's joint focus

Whilst demonstration of strong governance and transparency remains high on the priority list for both regulators, the focus has shifted from implementing (the recommendations from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry) to 'embedment' and 'uplift'. We discuss APRA's focus on improvements to the implementation of SPS 515 Strategic Planning and Member Outcomes, Members Best Financial Interests (MBFID), product underperformance and the Retirement Income Covenant (RIC). Noting that ASIC sees DDO as the crown in their regulatory toolbox, in this edition, we focus on ASIC's emphasis on Insurance in Super, the Internal Dispute Resolution (IDR) Framework, disclosure and communication as well as the Financial Accountability Regime (FAR) and the New Breach Reporting Laws.

Privacy risk and merging technologies

Whilst emerging technologies such as Machine Learning (ML) and Artificial Intelligence (AI) have enabled savvy superannuation funds to better gather and harness their members' preferences, behaviours and insights, it has also increased data privacy risk. We argue that early assessment and mitigation of privacy risk is key and that funds should adopt a Privacy by Design (PbD) approach and conduct Privacy Impact Assessments (PIAs) at the design stage of the technology solution to address key privacy risk consideration

Fund data and digital capabilities

As the consolidation in the superannuation fund sector continues at pace, many fund executive management teams are asking their technology teams to increase their investment and efforts in digital and data capabilities to make certain the fund is prepared to harness the value and synergies of the merged entity. We show what technology leaders should consider to ensure that their investment in the fund's future data and digital capabilities pay off

Evolving capital management practices and expectations

The financial stability of superannuation funds is critical to providing strong and stable outcomes for members. To this end, effective capital management is critical to protect members from unexpected, adverse outcomes and fund significant growth and transformation initiatives. We argue that a holistic and dynamic approach to capital management and reserving that is tailored to the individual risk profile and appetite of a fund and that abides by a set of key principles is most effective in identifying the purpose and sources as well as management and deployment of capital and reserve categories required in the superannuation industry.

Key focal points in 2022

Four key capabilities of member-centric operating models

Member-centric operating models remain highly relevant and commanding in the face of unceasing regulatory demands, escalating member expectations and pressures to reduce costs and increase platform agility and resilience. In this article, we focus on four key capabilities and show how they contribute to breaking down cross-functional silos and to building journey-based squads that focus their attention on clearly defined member needs and wants, customer pain points and value creation.

Trustee Governance and Accountability: Regulatory Change

Trustees, by their nature, are the sole responsible decision-making entity for superannuation funds and it’s evident that trustee directors and senior executives are subject to an ever-increasing degree of responsibility and accountability. In this article, we discuss the recent law reforms impacting the member best financial interest duty (including reversal of evidentiary onus of proof), indemnities and penalties, the need for trustees to raise capital in their own (corporate) capacity as well as the Financial Accountability Regime (FAR) bill, and show what trustees need to consider to comply with these reforms.

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