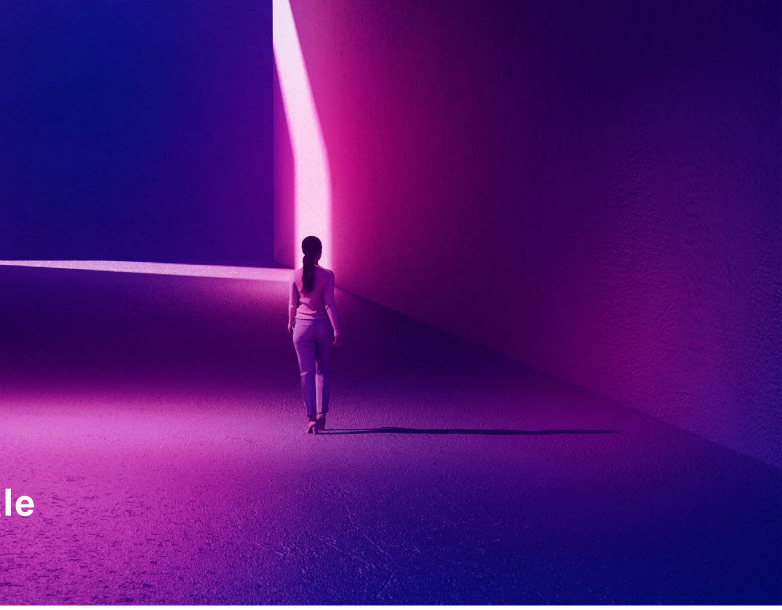

Super Fund Merger Insights

Part 1: Legal Pathways to Access Scale

October 2023

This **Part 1** of the **Super Fund Merger Insights** explores the different legal structures available to super fund trustees that enable potential merger partners to access the benefits of scale on the pathway to full integration via a successor fund transfer (SFT).

Part 2 takes a deeper dive into the key legal issues and challenges affecting SFT transactions.

Merger Activity and its Drivers

The *KPMG Super Insights 2023 Report*[1] and dashboard identify mergers as one of three competitive battlegrounds dominating the superannuation landscape. Funds of all sizes (other than SMSFs) have inorganic growth as a key strategic priority in the face of heightened competition.

The Report identifies the following key drivers behind this merger activity:

- the imperative for scale to deliver stronger member outcomes
- sustainability considerations in relation to investment performance, fees or net cash flow ratios
- strategic and business plan drivers, from addressing sustainability and contingency planning issues to strategic partnering to increase market positioning.[2]

Government policy continues to promote industry consolidation and the pursuit of delivering better member outcomes.

Likewise, the latest regulatory imperative is that the industry needs to more proactively prepare for merger opportunities, the merger process itself needs to be more efficient, and Boards need to be able to demonstrate (using metrics) that the merger has the potential to deliver better member outcomes.[3]

Merger Pathways: SFT

The term 'merger' has come to be used quite loosely in the superannuation industry to refer to the variety of methods used by superannuation funds to pursue inorganic growth.

Undoubtedly, the most well-known merger structure, the successor fund transfer (SFT), continues to be the dominant legal structure used by merger parties. In essence, an SFT involves a bulk transfer of members, their benefits and the assets supporting those member benefits from one superannuation fund to another.

A key attraction of an SFT is the full integration achieved (one trustee and one fund), and the potential to realize scale benefits by combining and harmonizing of administration, investment, custody and insurance arrangements.

The objective is to pass on the resulting scale benefits to the members of the merged fund in reduced fees, potentially higher net returns and new or improved product and service offerings.

At the same time, differentiation can be accommodated under the one legal structure, through the offering of different brands, products and services under the merged (successor) fund.

In this way, the transferring fund can retain its identity to some degree in the merged fund, where that is considered commercially important, or is required for legal or tax reasons.

[1] KPMG, *Super Insights 2023 – New competitive battlegrounds,* May 2023 accessible @ KPMG.com/au/SuperInsights2023.
[2] *KPMG Super Insights 2023 Report*, page 4.
[4] Ibid, page 6.
[5] APRA, *Discussion Paper – Superannuation transfer planning: Proposed enhancements*, November 2022.

The SFT tends to be the legal structure capable of maximising merger benefits, and so is often considered to provide the best outcome for members of both merging funds over the longer term.

The SFT is a legislative-driven process at its core. Members of the transferring fund must be provided 'equivalent rights in respect of benefits', as the *quid pro quo* for a transferring trustee avoiding the need to obtain the express consent of each member. This simply stated condition is a key reason SFTs can sometimes be complex and expensive, with a long implementation lead time.

As a rule of thumb, the more sophisticated the arrangements of the individual merger partners, the higher the degree of transaction complexity, implementation difficulty and the associated risks. Lengthy SFT transactions also tend to have the unwelcome side effect of distracting internal teams from BAU activity and involve heavy engagement with regulators.

Having said that, we have also seen simple and straight forward SFT transactions completed in a time and cost-efficient way.

In all cases, these transactions require careful planning, project management, detailed due diligence, structured decision-making, and the use of metrics to support the business case in favour of the merger with a focus on delivering better outcomes for the combined membership.

Alternative Legal Structures

The SFT is not the only way merger partners can access scale benefits. Other legal structures have been used by super fund trustees, including:

- strategic alliances
- joint ventures
- common trustee, and
- corporate trustee acquisitions.

In this way, the parties may be able to extract some scale benefits (for example, reduced fees), which can be passed on to members while resolving the challenges to undertaking a fully-fledged SFT in the future.

Strategic Alliance

Strategic alliances between funds can provide a way of realising some scale benefits while maintaining the legal separation and independence of the merger partners: that is, retaining the separate trustees and separate funds.

This is achieved through the negotiating power that typically follows size as a commercial driver when negotiating fee arrangements with fund administrators, custodians, investment managers, insurers and other service providers.

A strategic alliance provides a relatively straight forward way for potential merger partners to explore and then share any scale benefits they can extract from leveraging their commercially combined bargaining power in their negotiations with a rationalised set of common service providers.

Joint Venture

In a sense, a joint venture structure is a more formalised version of a strategic alliance. This legal relationship may be warranted where there is an imperative to merge but there are legal, tax, legislative change or timing constraints to full integration using an SFT.

Joint ventures are more likely to be used where the potential merger parties co-invest through pooled vehicles or use a common self administration platform where they need to formalise the governance and map out the sharing of benefits, costs and risks associated with their co-investment or shared platform.

Common Trustee

With the appropriate RSE licence and authorisations (public offer or an Extended Public Offer (**EPO)** licence from APRA), potential merger partners can enable both funds to nest under the same 'family tree' while retaining their separate identities.

This can be used to bring two super funds under the one governance model (one trustee company, board and management team) whilst retaining their separate registered super funds under separate brands.

This is the model used by professional trustees, who hold one RSE licence covering several RSEs with separate brands and distribution channels.

However, it can also be used by merger partners as the first step to explore and develop their operational pathway to full integration via a later SFT under the one governance structure using a common trustee.

Assessment of the cost efficiency for a "two step" hop, and the identification and management of potential conflicts of interests between funds with a common trustee and directors, are key considerations for this model.

Corporate Acquisition

The trustee acquisition structure is commonly used where a corporate group that owns the superannuation trustee company is looking to sell its superannuation business through a share sale (as opposed to transferring members and assets of the super fund through an SFT).

For the shareholder/vendor, a share sale avoids the risk of triggering the State-based secret commission legislation (Crimes Act). However, care needs to be taken to ensure the prohibition on secret commissions is not triggered through the indemnity arrangements that are linked to a subsequent change of trustee or SFT by the acquiring shareholder.

This structure has been used successfully by both retail and industry fund trustees to acquire a retail fund trustee as both an alternative to an SFT or as the first step towards full integration via an SFT.

There have been a number of recent examples involving the sale of wealth management businesses that included retail superannuation funds.

An innovative recent example is the purchase of a retail super business by an industry super fund and its subsequent mutualisation for the benefit of the combined membership.

Where the acquiring trustee uses fund assets in this way to acquire the shares in the target trustee company, the shares form part of the assets of the receiving fund. Accordingly, care needs to be taken to ensure that there are no unintended tax and other consequences of using this structure where the shares are acquired using fund assets.

This form of merger will also likely trigger the requirements for APRA approval for holding a controlling stake in an RSE superannuation trustee. Approval must be sought before ownership or control transfers. In this context APRA is concerned to ensure that an RSE superannuation trustee will continue to be in a position to perform its obligations.

Food for Thought

It’s a truism that no two mergers are the same! While the merger structures outlined in this article may provide a useful construct for analysis and comparison, they are simply examples illustrative of the range of possibilities. The structure used for any merger transaction will invariably need tailoring to suit the circumstances and arrangements of the merger parties. In other words, these structures should be seen as simply a starting point.

At the same time, less commonly used structures may have a role in some cases. An example is a 'consent transfer' where the membership of the transferring fund is very small. A consent transfer for a small group of members might also be combined with an SFT for the rest of the membership.

To facilitate discussion, this article focuses on the most common merger structures while cognisant that the optimal solution for any merger scenario may involve significant tailoring.

How we can help

Fund merger transactions require careful planning, project management, appropriate due diligence, appropriate resourcing and specialist knowledge and skills to support your Board and management team navigate the issues, risks and challenges they entail. We have a dedicated and experienced team to support you in these inorganic growth strategies.

Part 2: SFT Deep Dive

The SFT continues to be the dominant merger structure, and to generate complex legal issues. Accordingly, Part 2 will focus on the SFT by offering fresh thoughts on, and nuanced approaches to some old chestnuts, with some surprising but sensible outcomes, and some emerging trends will also be examined.

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