2023/24 Superannuation Financial Year in Review

Australia's superannuation industry has seen significant growth and consolidation throughout 2023/24. We review the financial year highlights, trends and areas of focus.

July 2024

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WTW-958-AU

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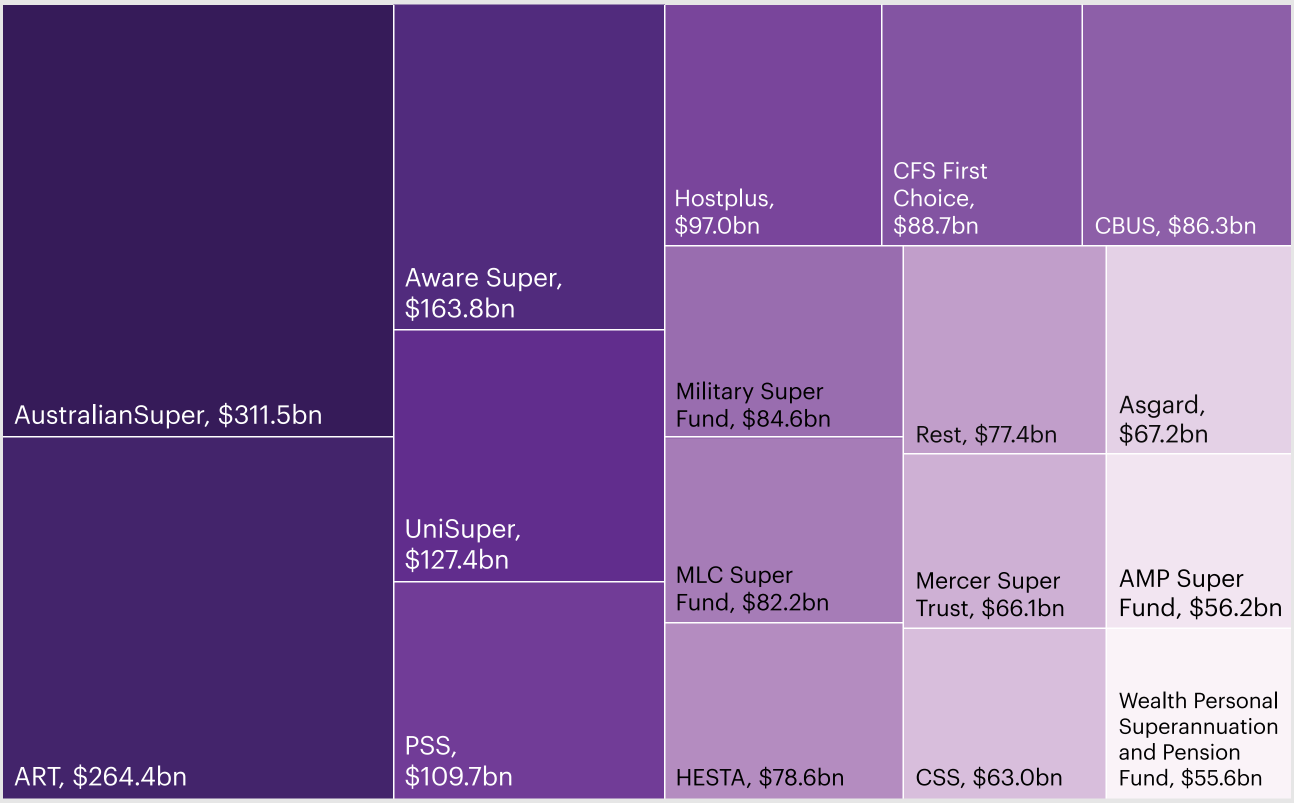
A focus on growth, and on consolidation

2023/24 is shaping up to be another year of growth and consolidation for the superannuation industry, an industry that had exceeded $3.5 trillion in total assets by June 2023. Both the number of funds and trustees continued their slow reduction, with at least seven fund mergers already completed or expected to be completed in 2024/2025. The largest superannuation funds, the so-called “mega-funds”, now comfortably exceed $100 billion in assets and 1 million members.

In 2021, then APRA Deputy Chair Helen Rowell noted what she described as an emerging industry view that any fund with less than around $30 billion in assets under management would be increasingly uncompetitive against the so-called “mega funds”[1]. It was not the last time that threshold would reverberate around the industry. But just three years later, the growth strategies of the medium sized funds are now targeting $50 billion, whether by organic growth or merger activity or both.

Figure 1: **Superannuation funds with Funds under Management (FUM) over $50 billion as at 30 June 2023**[2]



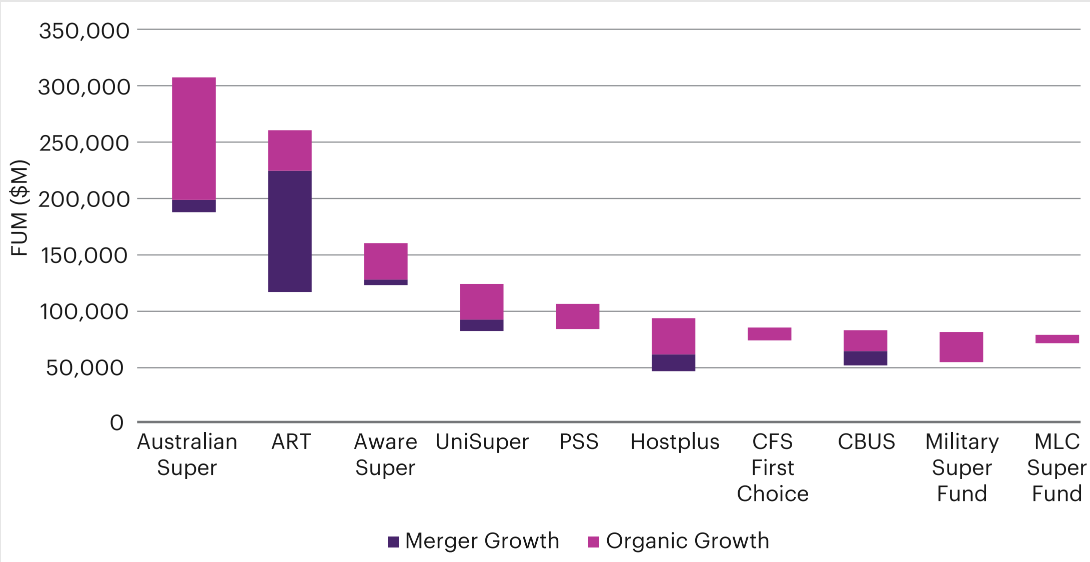
As can be seen from Figure 1, there were 17 superannuation funds with FUM of greater than $50 billion as at 30 June 2023 with five of them exceeding $100 billion. The four largest funds by FUM at 30 June 2023 were industry or “profit to member” funds.

[1] APRA Deputy Chair Helen Rowell - Speech to AIST Conference of Major Superannuation Funds, May 2021
[2] Annual Fund-level Superannuation Statistics, APRA, 2023

Source of growth

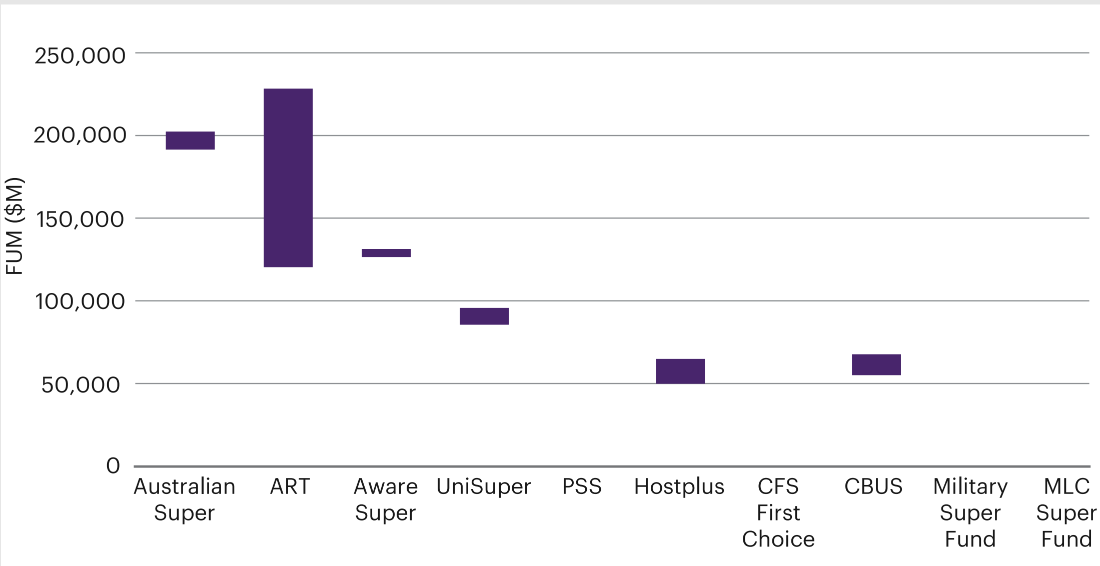
While scale remains a strong focus for both funds and APRA, it is important to understand the source of growth in considering the likely direction of funds over the longer term. Strong organic growth indicates that funds are likely to continue to grow, while growth from merger activity indicates that this trend may slow as the number of merger targets reduce over time.

Figure 2: **Growth from 30 June 2020 to 30 June 2023 for the 10 largest funds**[3]



Of the 10 largest superannuation funds, Australian Retirement Trust (ART) experienced the highest total growth (in dollars) over 2020 to 2023, however as shown in Figure 2, the majority of this was due to the Sunsuper and QSuper merger in February 2022.

Figure 3: **Merger growth from 30 June 2020 to 30 June 2023 for the 10 largest funds**[4]



Most of the large industry ("profit to member") funds have had merger growth in the last three years, with ART having the greatest as Sunsuper and QSuper merged making ART the second largest superannuation fund in Australia. The government schemes and retail funds shown, however, have not had any merger growth though we note that the Mercer Super Trust and BT Super merger lifted the Mercer Super Trust into the list of funds with FUM over $50 billion.

[3,4] Annual Fund-level Superannuation Statistics, APRA, 2023

Figure 4: **Organic growth from 30 June 2020 to 30 June 2023 for the 10 largest funds as a percentage of FUM**[5]

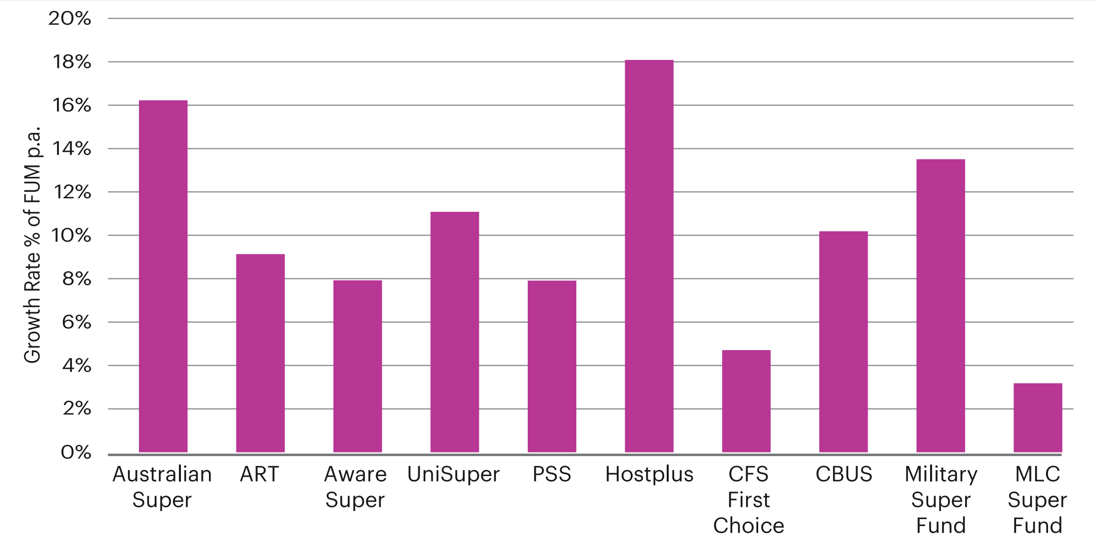


Figure 4 shows the organic growth rate experienced by the 10 largest funds, expressed as a per annum percentage of their FUM, at 30 June 2020. Hostplus appears to have experienced the highest organic growth over the three years to 30 June 2023 at around 18% p.a. followed by AustralianSuper with around 16% p.a.

Member retention is another issue at the top of the list of trustees' goals, particularly in the world of stapling where the flow of new members from participating employers is no longer assured. A number of funds are looking to enhance their member experience, including via the development and enhancement of online advice platforms, digital services and member education.

Figure 5: **One-year investment return to 30 June 2023 for MySuper products**[6,7]

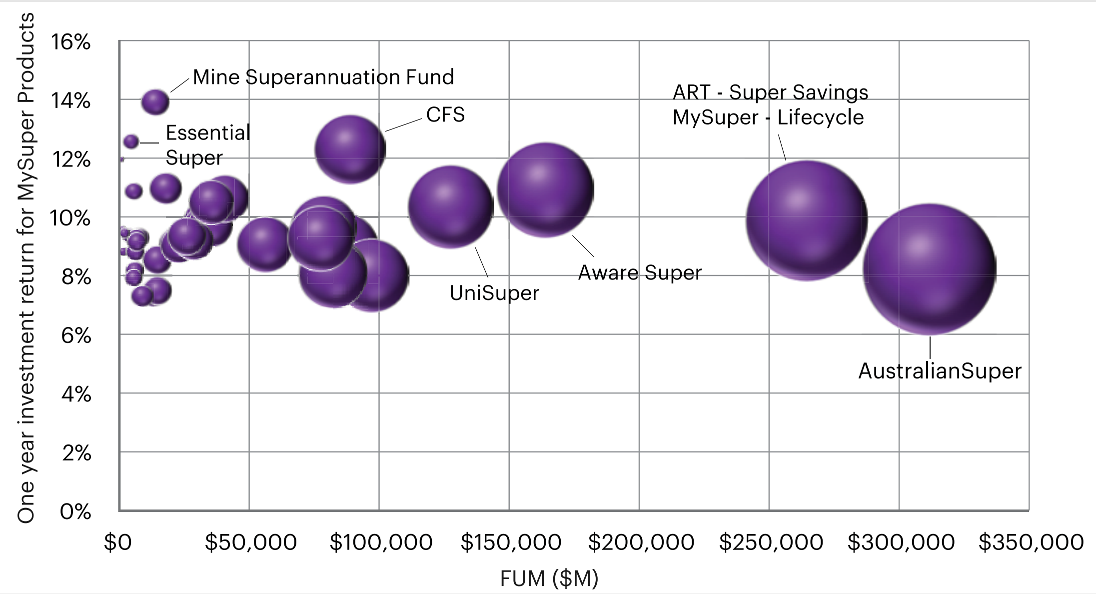


Figure 5 shows the one-year investment return for MySuper products. The size of the bubbles represents the relative size of the superannuation funds. There is no strong correlation between the size of the superannuation fund and the one-year investment performance to 30 June 2023. Some smaller funds have achieved great investment returns over the year to 30 June 2023 such as Mine Superannuation Fund and Essential Super. While it is not necessarily indicative of longer-term performance, it is an interesting data point which we plan to look at year on year in relation to fund size and see how this return changes or if there is any correlation over time.

[5] Annual Fund-level Superannuation Statistics, APRA, 2023
[6] Survey published by SuperRatings Pty Limited 19 July 2023. This is not financial product advice; independent professional advice must be obtained before making any financial decisions. www.superratings.com.au
[7] For Lifecycle MySuper products, we have taken the investment return for the cohort aged 45

How does the future look?

Figure 6.1: **Fund Rankings at 30 June 2023**

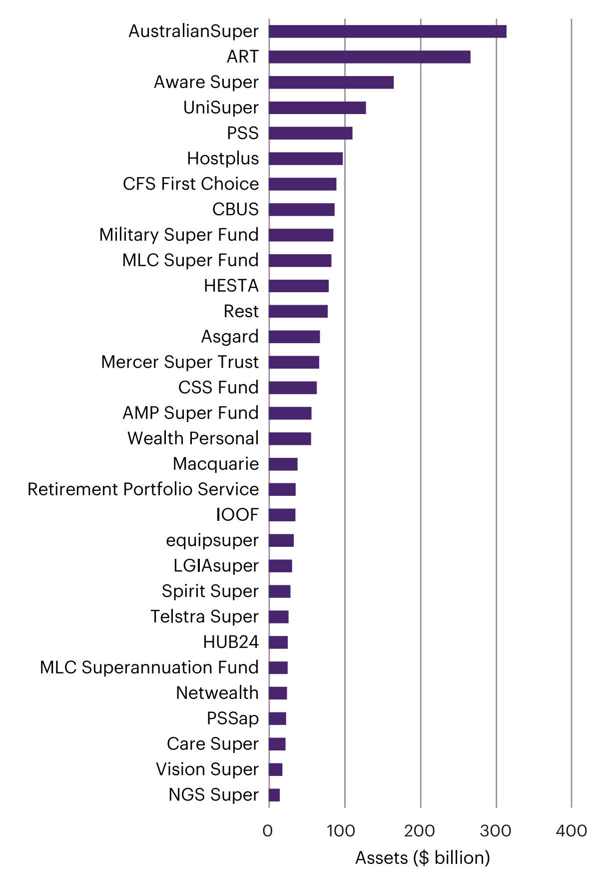
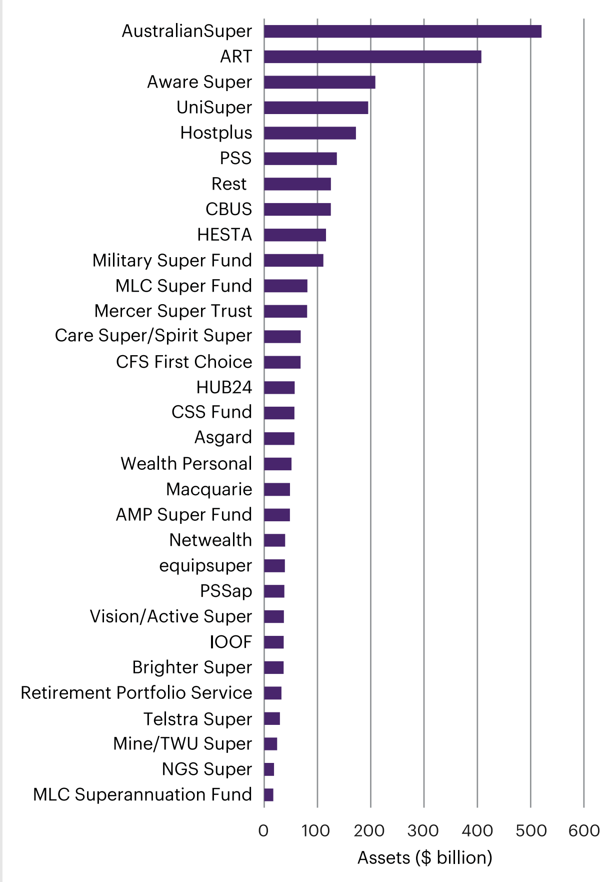


Figure 6.2: **Projected Fund Rankings in five years**



Using WTW's Fund Navigator™ model we have projected each fund's membership, assets and cashflows for the five years from 30 June 2023. The list of funds at 30 June 2023 is based on the APRA-regulated superannuation funds included in the Annual Fund-level Superannuation Statistics 30 June 2023 publication[8]. We have consolidated the funds that have merged and those that have announced mergers since 30 June 2023 for the five-year projection. We have also removed funds that have wound up since 30 June 2023, and funds with significant data which was not disclosed in the publication. SMSFs and non-APRA regulated funds are also excluded from the results.

The projections are based on a number of assumptions regarding economic outcomes and member behaviour. We have developed cash flow assumptions for contribution levels, fees and insurance premiums as well as demographic assumptions (i.e. assumptions on member movements such as exits, transfers and new entrants) based on our analysis of APRA data, supplemented by other data published by the Australian Bureau of Statistics (ABS). Importantly, the projections only allow for organic growth and have not considered potential unknown mergers.

It is not surprising that Rest is expected to be one of the biggest beneficiaries from organic growth as a result of stapling and is expected to move up five positions in the fund rankings over the next five years. Retail funds such as AMP and CFS are expected to fall in the overall rankings. Based on AustralianSuper's higher expected organic growth, we project that AustralianSuper will remain Australia's largest superannuation fund in five years' time. However, potential unknown inorganic growth from the other mega funds could see this change. Notably, HUB24 Super Fund is expected to move up 10 positions in the fund rankings over the next five years. This expectation assumes that the significant recent growth in HUB24's FUM continues over the next five years so it will be an interesting "watch".

[8] Annual Fund-level Superannuation Statistics, APRA, 2023

Value outside of scale

The question for small funds resisting the industry tide of mergers is: "is there value for members in features outside of scale?".

While the financial incentives of scale cannot be overlooked, funds which don't attain the status of a mega fund endeavour to differentiate themselves with their members through alignment of values and product design that cater to their members' financial needs.

Whereas Australia's modern day "profit to member" superannuation funds originated with trade unions, merger activity over the past few years has left only a handful of funds tied to a single industry. The financial needs of one industry of workers may vary significantly to those of another, particularly when it comes to insurance where considered product design may present members with products catered to the needs of their industry.

"The financial needs of one industry of workers may vary significantly to those of another, particularly when it comes to insurance..."

The merger is just the beginning

A merger, whatever form it takes – successor fund transfer, acquisition, change of trustee – includes several steps. But the most critical is choosing the right merger partner. This isn't just a matter of identifying the target fund with the cheapest fees, though obtaining an arrangement that is in the best financial interests of members should be the primary goal of the trustee. Mergers can fail at any one of a number of points, and alignment in ethos, culture and approach between the two trustees is an important starting point. On the other hand, eliminating prospective merger targets too soon can also lead to a less than optimal outcome.

For transferring trustees who have not undertaken a project of this nature before, finding a merger advisor with the right experience and capability can smooth the path considerably. They can assist in presenting the fund in the best light by: ensuring key stakeholders are aligned; preparing the tender request; reviewing responses and preparing a shortlist for trustee consideration; guiding the trustee through the due diligence process through to data cleansing; advising on strategies for special groups such as defined benefit members or pensioners; and developing effective communications strategies.

Merging with another fund is just the first stage in fully utilising the advantage of scale and achieving the desired outcomes for members. The next, and most important, step after a merger has occurred is digesting it – simplifying or aligning the multiple products, investment options, fee levels, insurance structures and underlying systems and processes that the merger resulted in. This could be nearly as big a task as the merger itself, but it is essential if those outcomes for members are to be achieved and the transferring members are retained. The longer it takes a fund to digest a merger, the greater the risk that inefficiencies will continue and indeed be compounded if they are still not resolved when new merger opportunities present themselves.

With over 20 years' experience and over 100 transitions, WTW has developed a best-practice approach to all phases of a fund merger, from market insights and due diligence to integration planning and execution. Our recent experience spans 15 fund mergers and transitions covering $28 billion in assets, and includes large complex corporate funds. Our Merger Advisory team has walked in the shoes of the trustee as directors of RSE licensees over the last 20 years. We understand the challenges that transitions bring to a fund. We also have a focus on the key issues that trustees need to be focused on to ensure future strategic success. The following explores just a few of the issues that WTW believes will be the most important to ensure strong and competitive member outcomes are delivered by a fund.

Will 2024 be the year focus finally moves to retirement?

At the start of December 2023, the government released a new discussion paper on how the superannuation system can best provide for Australians as they live longer and healthier lives in retirement. There have been a number of inquiries over the years that have touched on the retirement phase, including the Financial System Inquiry in 2014 and the 2020 Retirement Income Review. As far back as 2010 the Super System Review (or "Cooper Review") recommended that its MySuper product should be a whole of life product including a retirement income stream product. The Quality of Advice Review highlighted the unmet need for affordable and quality advice as individuals move from the accumulation to the retirement phase.

"There is mounting evidence that many retirees do not utilise their retirement savings effectively to support their standard of living in retirement."

After attempts to develop comprehensive income products for retirement (CIPRs) from 2014 and changes to encourage innovative lifetime income stream products in 2017 failed to generate meaningful progress, the enshrining of the retirement income covenant in the Superannuation Industry (Supervision) Act (SIS Act) from 1 July 2022 finally forced trustees to develop retirement income strategies for their members in or approaching retirement. But a review of the implementation of the covenant by APRA and ASIC released in July 2023 found that while trustees were improving their offerings of assistance to members, there was variability in the quality of approach taken and a lack of urgency in embracing the intent of the covenant. The triggers for this latest discussion paper would seem to include not only these review findings but also the need to assist the 2.5 million members expected to move to the retirement phase over the next 10 years[9] and mounting evidence that many retirees do not utilise their retirement savings effectively to support their standard of living in retirement.

Both APRA and ASIC's review and our own experience indicate that many trustees are turning their attention to the retirement phase. The establishment of Chief Retirement Officer roles at the executive level by a number of funds makes this change of focus clear. A number of funds have retirement income products, including those with a longevity component, in development. But these exercises are not quick. Trustees are fully cognisant of the risks of undertaking significant expenditure to develop a product that does not attract sufficient interest from members. Further, there remain regulatory roadblocks in terms of the provision of advice by funds and in other areas, as the December discussion paper recognised. The discussion paper presents an opportunity to address these roadblocks. Perhaps 2024/2025 will be the year that funds fully embrace Australia's retirement challenges.

[9] Source: The Australian Government the Treasury Retirement phase of superannuation (page 6), December 2023

The performance test – a wakeup call for some trustees

APRA released the results of the first Choice product performance test in August 2023, along with those for the third annual MySuper test. In the MySuper space there was only one product that failed, compared with five in 2022 and 13 in 2021. 96 Choice products failed the test, 76 of which were platform products. 75% of those Choice products that failed were operated by just four trustees.

At the end of November 2023, the individual product results were released. Only 44% of member accounts in platform products covered by the Choice performance test were in products that outperformed their investment benchmark. Nearly 30% were in products that underperformed by more than 0.5%. These results were materially worse than those for non-platform products covered by the Choice performance test, where 84% of member accounts were in products that outperformed their investment benchmarks. For administration fees and costs, the other component of the performance test, APRA found that MySuper administration fees had declined over the nine years covered by the data used in the test, reflecting competitive pressures and fund mergers. Platform choice products assessed generally had the highest administration fees, with the metric fee level ("BRAFE" – Benchmark Representative Administration Fees and Expenses) roughly twice that of non-platform Choice products and MySuper products.

APRA identified several reasons for these disparities[10]. Administration fees for non-platform Choice products offered by trustees that also offer a MySuper product tend to be lower than for those trustees without a MySuper product. This is because many trustees use one Product Disclosure Statement for their MySuper product and non-platform Choice products (i.e. their non-MySuper investment options) and apply the same administration fee to all. In contrast, platforms offer more flexibility and charge different fees to individual members depending on their investment decisions, services received and how they access the investment option. But regardless of product or provider type, APRA identified that smaller funds tended to have higher administration fees than larger funds, although with considerable variation. APRA concluded that while larger funds are likely to be more efficient due to scale, and so pass on lower fees to members, smaller funds could offer greater agility and more control over governance processes and internal culture than larger funds and in some cases could still operate efficiently.

Another year of regulatory change

The last year has continued to be another year of regulatory change for the superannuation industry.

The government's plans to extend the financial reporting and auditing requirements that apply to public companies to super funds are now law and apply to reporting periods commencing on or after 1 July 2023. The Financial Accountability Regime bills were passed in September 2023, although the regime will not commence for super funds until March 2025. The legislation for an objective for superannuation is now before the parliament, as is that for the initial response to the Quality of Advice review and the government's proposal to reduce the earnings tax concession for individuals with more than $3 million in super ("Division 296 tax"). Consultation has been completed on payday super, although the relevant legislation has not been introduced to parliament. In December 2023 consultation commenced on how the super system can best support Australians in retirement; the beginning of a conversation that will continue throughout 2024 and beyond.

APRA's 2023 year began with the commencement of updates to prudential standard SPS 530 *Investment Governance*, with the related guidance released in July 2023.

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[10] Insights paper - 2023 Performance Test, APRA, November 2023

CPS 511 *Remuneration* commenced for super funds that are significant financial institutions on 1 July 2023 and applied to all other funds from 1 January 2024, with new disclosure obligations applying for financial years beginning on or after that date. CPS 190 *Recovery and Exit Planning* was finalised in May 2023 (together with new CPS 900 Resolution Planning, which will only apply to an institution if APRA notifies it accordingly), although the related prudential standard CPS 190 will not commence for super funds until 1 January 2025. CPS 230 *Operational Risk Management* was finalised in July 2023, although it will not commence until 1 July 2025.

If that wasn't enough to keep trustees' heads spinning, APRA and ASIC released the results of their joint review of the implementation of the Retirement Income Covenant in July 2023[11], and found a lack of progress and insufficient urgency from trustees in embracing the covenant. ASIC has continued its enforcement focus during the 2023/24 year, commencing Federal Court proceedings against four large funds and obtaining decisions involving substantial penalties against a number of other industry participants. Several funds were also hit with infringement notices for alleged greenwashing.

Meanwhile, consultation continued during the financial year on major updates to SPS 515 *Strategic Planning and Member Outcomes* (and the related guidance) and SPS 114 *Operational Risk Financial Requirement*, and consultation commenced on the next round of the Data Transformation Project in late November 2023. It looks like 2024/25 will be another busy year ahead on the regulatory front.

Our WTW team of experts has a deep understanding of the current state of the superannuation market, including how to help funds navigate the important future regulatory issues to ensure your fund's current and future success.

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[11] Information report - Implementation of the retirement income covenant: Findings from the joint APRA and ASIC thematic review, APRA and ASIC, July 2023.

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Working shoulder to shoulder with you, we uncover opportunities for sustainable success—and provide perspective that moves you.

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