KPMG

Super Insights Report 2017

How far we've come, the challenges, and potential for the future

KPMG.com/au/superinsights

Foreword

The Australian compulsory superannuation and retirement savings system is 25 years young, and as a sector it has a lot to be proud of.

With total assets invested as retirement benefits for Australian's now exceeding $1.9tn (based on APRA and ATO data as at 30 June 2016), 20% larger[1] than the market capitalisation of the ASX, KPMG is confident the system is heading in the right direction.

Much like our own lives, 25 is often a key inflection point, and in the case of the superannuation system, we are seeing significant change – some of this change is being debated in the public arena such as the purpose of superannuation, while other changes like advancement of core technology platforms and improvements to governance arrangements are happening quietly but with care and diligence.

Our analysis, as presented here in the 2017 Super Insights Report, is a combination of leading analytics applied to a proprietary dataset including 10 years of APRA and ATO-published statistics, supported by insights gained from our team of Wealth Management specialists working directly with our clients and peak representative bodies.

At a macro level, the sector is closer to reshaping from the traditional divide between retail, corporate and industry funds towards grouping based on the level of assets under management, and complexity of operating model and offerings.

The largest funds, in the main, continue to grow. They are supported by a large member base, strong Superannuation Guarantee (SG) inflows and outflows still tracking at the lower end of the range, due to concerns about longevity of funds in retirement.

Within this segment of the sector, the operating models of the industry and retail funds continue to converge, with both evolving member offers through the addition of advice and education offers, digital tools, in many cases, a refocusing of investment management to target member needs, and also a strong move towards building out a retirement product offering. Adding to the change is the ongoing pressure on capital management for banks and insurance companies, which in some cases is triggering internal reviews of the ownership and operations for bank and insurance-company owned wealth management capabilities.

Outside of the sector's largest funds, we are also witnessing a drive to establish identity and value at a fund level, with many funds dedicating resources to better understand, attract and retain members. These efforts are putting pressure on the technology and data management capabilities in place today, with many funds coming to the realisation that current technology is not fit for the future; detailed, defined and funded IT and digital roadmaps are required to support the target operating model that funds require going forward.

Commitment to new technology will likely be rewarded beyond better member analytics, as core technology is able to serve as the backbone for implementation of advanced analytics programs that enable cost efficiencies from straight-through processing and robotic process automation. These technologies can provide clearer, faster reporting to support improved risk management and governance.

From the investments lens, funds are working to identify appropriate investment opportunities in a continuing 'lower for longer' market environment. Funds have begun to ready themselves for the liquidity challenge presented by an increase in pension flows rising from the expected increase in retirees over the coming decade. Some funds are investigating the idea of formally appointing a Chief Retirement Income Officer (CRIO) charged with delivering outcomes desired by members in the pension phase. The CRIO will also steer the fund through the anticipated changes to Comprehensive Income Products for Retirement (CIPR).

Paul Howes,
Partner and Head of Wealth Management Advisory, KPMG

1. http://www.asx.com.au/about/historical-market-statistics.htm#End_of_month_values.

Methodology

Our analysis, as presented in this report and the accompanying *KPMG Super Insights Dashboard*, is a combination of leading analytics applied to a proprietary dataset including 10 years of Australian Prudential Regulation Authority (APRA) and Australian Taxation Office (ATO)-published statistics, supported by insights gained from our team of Wealth Management specialists.

At a macro level we have defined the market along APRA guidelines of retail, corporate and industry funds and included SMSF's to complete the landscape. KPMG has also applied a sizing segmentation to group funds into those with greater than $25b AUM, between $1b and $25b AUM and those funds with less than $1b AUM.

KPMG has relied on published statistics as the foundation of this report and such acknowledges that the data contained within is reliant on the accuracy of the underlying sources. KPMG has included all data contained within the APRA[2] and ATO[3] published statistics inclusive of null values.

APRA data explanatory notes

Superannuation funds included in this report represent the vast majority of superannuation assets regulated by APRA. It contains data for all APRA-regulated superannuation funds with more than four members. Pooled superannuation trusts (PSTs) have been excluded from the publication publications as their assets are captured in other superannuation funds. Exempt public sector superannuation schemes (EPSSS) have also been excluded.

Superann ation 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.

To protect the privacy of individual members, APRA has masked certain items in the publication. 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, the fund has been removed from analysis.

2. http://www.apra.gov.au/super/publications/pages/superannuation-fund-level-publications.aspx
3. https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/super-statistics/smsf/self-managed-super-fund-statistical-report-june-2016/?page=3

The *KPMG Super Insights Dashboard* which accompanies this report contains interactive versions of the charts and graphs included in this report, as well as many more. The interactive dashboard enables you to filter the data based on your own preferences, to view industry and fund metrics for a particular year or segment of the market. It also enables you to view metrics for an individual fund in comparison to a peer group.

The dashboard can be accessed via our website at kpmg.com/au/superinsights

Synopsis

At the end of its first quarter-century, Australia's superannuation sector is confronting both its own maturation and the retirement of the baby boomers.

It will meet those challenges if Australians engage in honest and well-informed discussion of the system's benefits and the challenges still to overcome. This report is designed to encourage our national conversation on what we have achieved, some of the challenges, and the best ways forward for superannuation.

Australia's superannuation system: Australia has a high-quality superannuation system, which will improve further over the next decade as compulsory employer contributions increase. But it needs continuing policy and design improvements.

The shape of the funds: Consolidation in fund numbers has been occurring for some years, and it is expected to continue. The market is likely to have many small- and medium-sized funds for many years to come.

The core challenges and opportunities

The superannuation industry must find the right answers to a series of challenges, while seizing potential, over the coming years:

Retirement income

Members who are being paid a retirement income have more complex and diverse needs.

Women and super

The lifetime income penalty paid for a broken employment history ends up reflected in many women's super balances.

Regulation

Changes to the system's tax and regulatory settings risk eroding member confidence.

Purpose

Formally defining superannuation's purpose may focus current and future policy discussions.

Operating models

Delivering increased productivity requirements and meeting responsibility expectations of trustee offices.

Member engagement

Funds are embracing technology to improve their services to members.

Technology and data

Digital technologies are focusing funds on the "member journey" – but they need returns on their investments.

Privacy and security

In a technological age, funds must look to cyber security measures to prevent breaches.

Additional challenges:

Insurance

Funds that have outsourced insurance services need to spell out the member experience they need.

Investment

Delivering long-term consistent returns with stable cashflow and liquidity.

The changing nature of work

As technology impacts employment, and people engage in more dispersed working patterns such as contract work or freelance, funds may need to educate members about self-accumulation. Regulation and tax rules need to accommodate these changing work patterns.

Australia's superannuation system

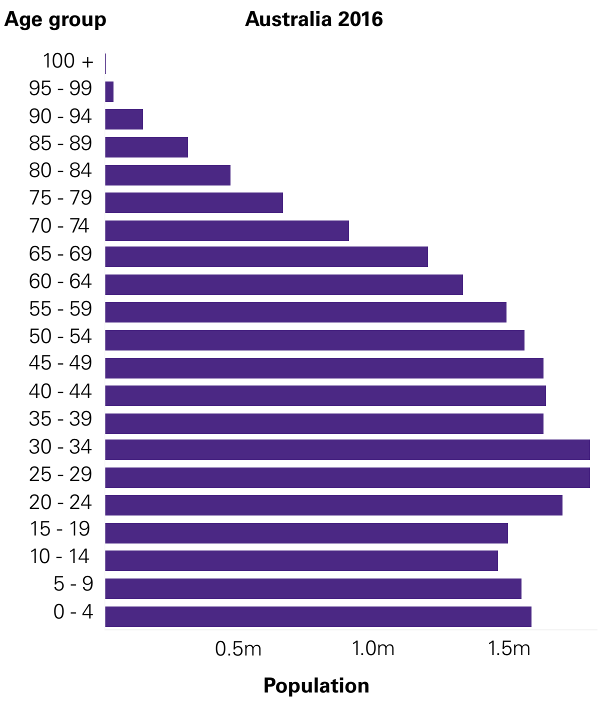
Australia's superannuation system is now in early adulthood and beginning to deal with a new challenge. After 25 years dominated by fund inflows, it is beginning to move to a different balance between inflows and outflows, and may need to anticipate a move to net outflow in time.

Demographics

Australia's population is one of the fastest-growing and fastest-ageing in the developed world. While younger elements of the population are being fed by a natural increase and a high immigration rate, the over-65 population is expanding as the 'baby boomers' born after World War II age while lifespans rise.

Over-65s, who made up just over 8 percent of the population in 1970, now make up 15 percent, and by 2030 they will be 18 percent of all Australians.

The baby boomers start retiring



Source: Australian Demographic Statistics, Jun 2016, Australian Bureau of Statistics.

This demographic transition makes the superannuation system even more important to Australia's future. It must provide for many of the needs of a growing segment of the population, efficiently and in a way that encourages the community to keep trusting it.

The system to date

Australia's compulsory superannuation is one of the world's most successful retirement income systems. It stems from a deal between the 1980s ALP federal government and the union movement. That deal traded off wage rises for a combination of tax cuts and compulsory employer superannuation contributions. It gave Australians a 'third pillar' of retirement income, in addition to the traditional pillars of government pension and voluntary savings.

The 2014 Financial System Inquiry report[4] credited the Australian system with having "a stabilising influence on the financial system and the economy" during the global financial crisis.

Over time, the system has been able to adjust and develop new solutions to problems as required – adding insurance to cover for death and Total Permanent Disability (TPD), building flexible payment solutions, and internalising investment capability as significant scale has been achieved.[5] This can be seen through the increased convergence between operating models and large retail and industry funds' advice, digital offerings and education.

The economic dividend

Australia's superannuation system also benefits from operating within one of the developed world's most consistent economies. Australia has had 25 years of uninterrupted economic growth, and it boasts a stable policy and political environment, respect for the rule of law and good governance within its capital markets.

Adele Thomas, Partner, KPMG Corporate Finance, underlines the importance of having both a regulatory environment and a broader business environment that investors understand and trust – and in which they can make confident investment decisions. For instance, if investors are considering construction of a road or the expected traffic on the road, she says "there needs to be a high degree of regulatory predictability".

Adequacy

The largest question-mark against Australia's superannuation system is the number of Australians to whom it can provide adequate retirement incomes.

The current 9.5 percent compulsory employer contribution is not set to build sufficient assets to provide the 65 percent of working income considered adequate for retirement. Michael Dermody, Partner, Actuarial, Insurance and Superannuation, KPMG, notes that at this level of compulsory contributions, the system requires participants to add their own voluntary contributions.

"9.5 percent is a good starting point," he says, "but you need to keep building".

Paul Howes, Partner and Head of Wealth Management Advisory, KPMG, adds that "we need to start using the super guarantee as a means and not an end".

It is important to note that over time, increases in the SG rate will improve the adequacy of member balances. Under current law, the compulsory employer contribution will remain at 9.5 percent until June 2021, increasing to 10 percent from July 2021, and eventually to 12 percent from July 2025. This means that the picture of adequacy does improve for those who start their working lives later.

KPMG has calculated[6] that a person on average earnings who starts their career after 2006 and works for 40 years will retire with a superannuation balance of more than $545,000. That is the level estimated to be needed for what the Association of Super Funds Australia (ASFA) has defined as a 'comfortable' standard of retirement living.

The concessionally targeted nature of the superannuation system means there are stringent rules on how much can be voluntarily contributed to the funds. Nevertheless, the Government has introduced rules that can encourage these. This includes relaxation of work tests and extending deductibility for voluntary contributions arising from the superannuation tax reforms of the 2016-17 Budget.

Damian Ryan, Partner, Tax, KPMG, notes there is an interesting new proposal in the 2017-18 Budget, to assist people over 65 currently unable to contribute all or any of the proceeds of the sale of their home into superannuation, because of the existing restrictions and caps. Up to $300,000 from the sale proceeds will be allowed as voluntary contributions.

4. *Financial System Inquiry Final Report*, Commonwealth of Australia, 2014 at p24
5. *Guiding members safely down a path in retirement*, KPMG, 2016
6. Paul Howes, *What are compulsory super contributions really for?*, KPMG 2017

The shape of the funds

A steady balance remains at the top of the market with an almost even split across retail and industry/public sector funds on both an AUM and number of accounts basis.

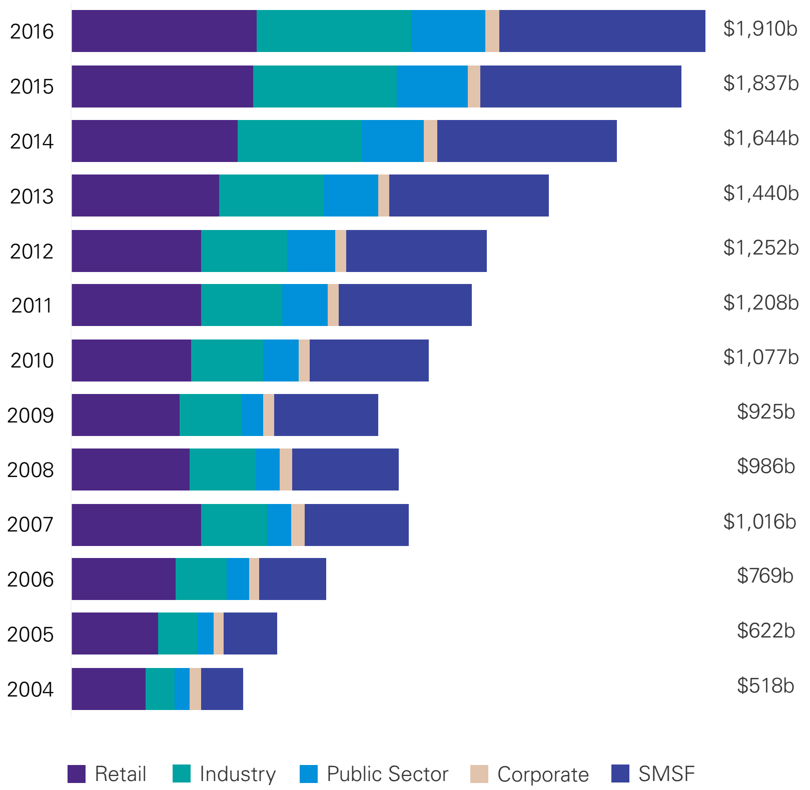
Australia's superannuation assets under management (AUM) now total $1.91 trillion as at June 2016. New entrants to the workforce and rising incomes will help push that figure higher over coming years. Also adding to the size of the system's assets will be the scheduled rise in the mandatory employer contribution from 9.5 percent to 10 percent in 2021.

The number of funds, meanwhile, seems unlikely to rise.

Without anything else happening within the industry's structure, those dynamics would ensure the average fund size rises over time.

Growth history by sector

Total AUM 2004-2016



Bigger funds, fewer funds

Fund size – by number of members, funds and AUM, 2016 (excl. SMSF)

Fund size	No. of members	No. of funds	Total AUM	Change in no. funds	Change in AUM	Growth in AUM
> $25b	18.9m	14	$894b	→	↑	5%
$1 to $25b	7.0m	60	$379b	↑	↑	4%
< $1b	1.1m	40	$15b	↓	↓	-10%
Total	**27.0m**	**114**	**$1,288b**	↓	↑	4%

Fewer funds, more assets

Fund type – by number of members, funds and AUM, 2016 (excl. SMSF)

Fund type	No. of members	No. of funds	Total AUM	Change in no. funds	Change in AUM	Growth in AUM
Corporate	0.2m	24	$40b	↓	↑	0%
Industry	11.1m	41	$466b	→	↑	7%
Public Sector	2.6m	14	$224b	→	↑	6%
Retail	13.1m	35	$558b	→	↑	2%
Total	**27.0m**	**114**	**$1,288b**	↓	↑	4%

Corporate funds underwent huge consolidation in the mid-2000s; from more than 1400 in 2004, the number of Registrable Superannuation Entities (RSEs) in the corporate fund sector fell to the low double digits today.

Other fund sectors have also seen fund numbers contract. Stakeholders such as APRA not only expect that trend to continue, but have been encouraging it[7].

Smaller funds face proportionally higher costs for functions such as compliance, Howes says, which can raise product costs and make mergers more logical. APRA has highlighted its concerns about funds "being cash-flow negative or having declining net assets[8]".

Sean Hill, Partner and National Leader of Superannuation, KPMG, adds: "There's a point at which the cost of running a fund is quite prohibitive."

A drawn-out consolidation

Howes expects further consolidation, but notes that the pace has slowed in recent years, leaving almost 250 APRA-regulated funds still in the market.

"Despite predictions of consolidation happening quicker, we are yet to see it. This is the most disaggregated component of the financial services market. Banking and insurance don't look like this. In superannuation we are still spread incredibly thin across the market," he says.

The market will be full of medium and small players for many years yet, Howes predicts. It took many years since de-regulation for Australia to evolve into a market with just four big consumer banks, he adds.

Indeed, some smaller funds are still expected to thrive even as mergers continue.

7. Helen Rowell, *The super system - what is on APRA's watch-list?*, APRA 2015.
8. "Shrinking super funds under pressure to find merger partners", *Australian Financial Review* 5 August 2016.

"We don't think that every fund that is below a certain value of assets under management is lacking scale. You'll find there are a number of funds that are smaller than others that are the right scale to survive, and bigger ones that aren't," Howes says.

Even net outflow, he notes, does not necessarily show that funds are unsustainable or performing poorly. Functionality and performance efficiency are also important.

But Howes also suggests that the industry's prudential regulator will eventually have to consider whether funds should be allowed to continue. The threat of enforceable undertakings for breach of onerous regulatory requirements may incentivise trustees to consider merger options. The challenge then, he says, will be to create a public-interest test that can decide, "which funds have a social license to continue to operate?"

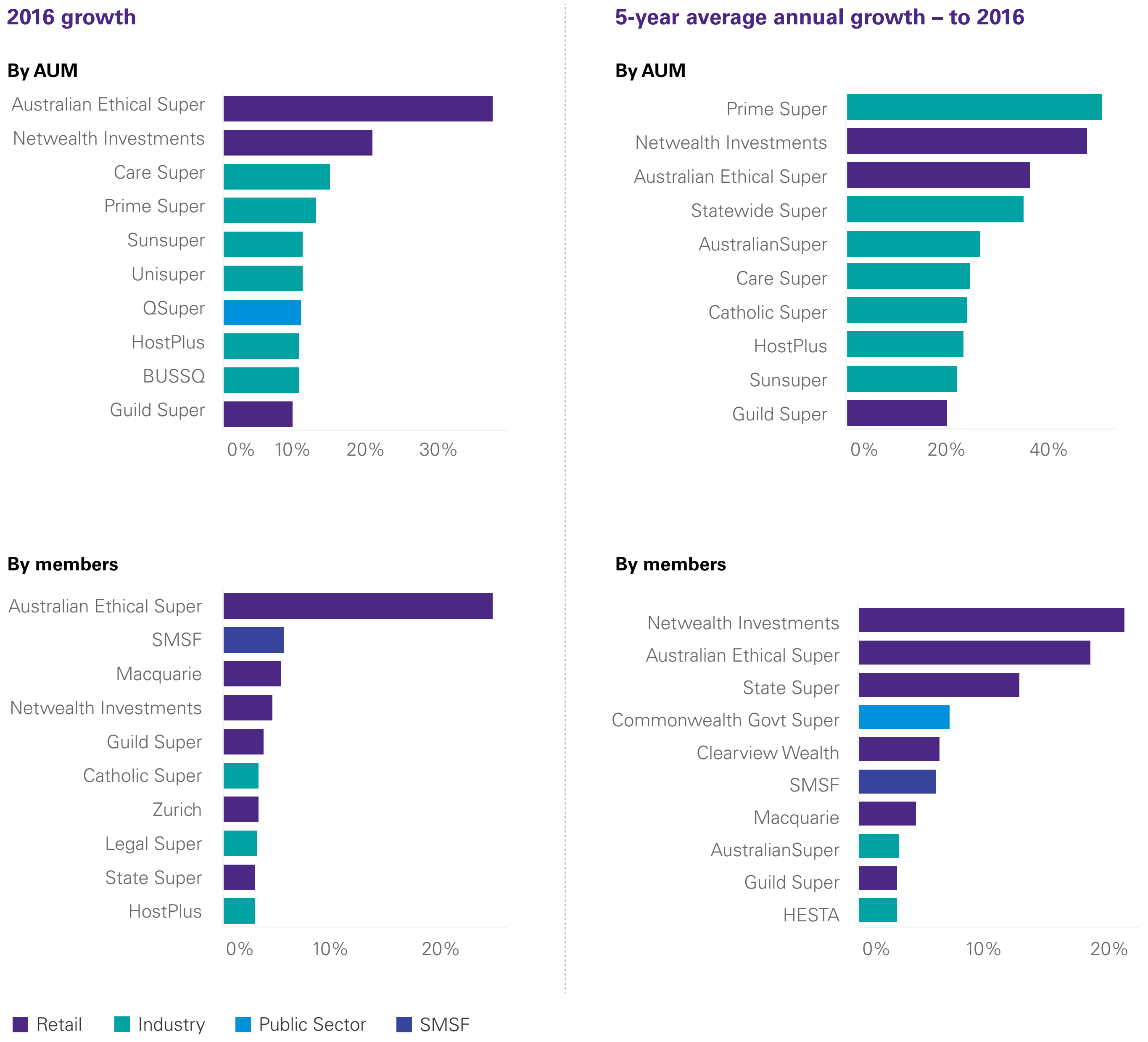
It is encouraging to note that the Government has seen fit to, at least temporarily, remove a potential impediment to further consolidation in the 2017-18 Budget. By extending capital gains tax rollover and tax loss transfer relief to merging superannuation funds for a further 3 years to July 2020, funds will be encouraged to continue exploring this option.

Ryan notes that it is disappointing this relief has not been made permanent, but that further opportunity to consider this offer may arise if the Productivity Commission concludes its review into the efficiency, competency and competitiveness of the superannuation industry.

How super funds are growing and where the growth is coming from

* SMSF data unavailable prior to 2009, and 2016 data is not yet published.

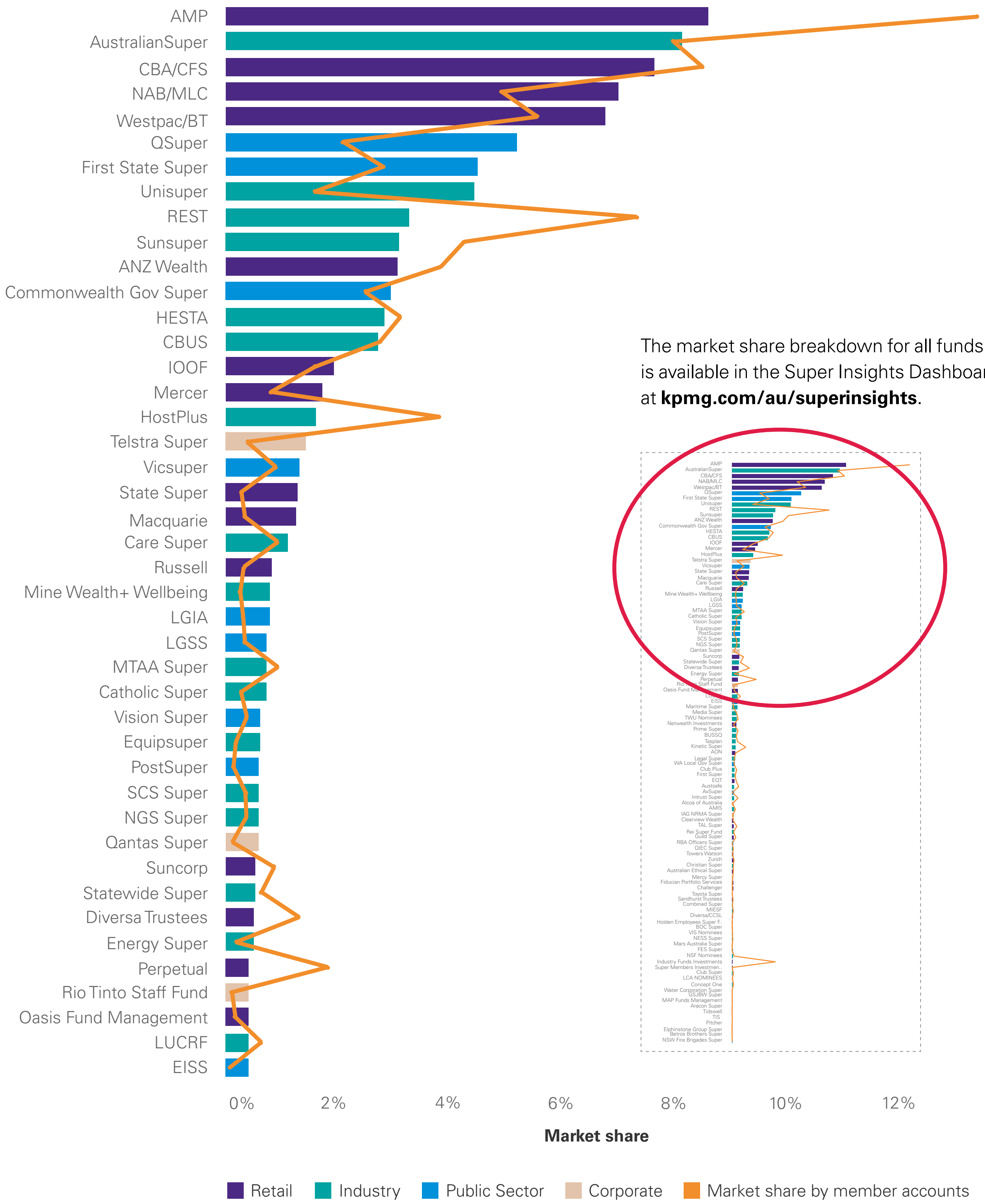
Top 10 funds by AUM growth and member growth (funds >$1bn AUM)



The large funds, in the main, continue to grow. They are supported by a big member base, strong Superannuation Guarantee (SG) inflows and outflows still tracking at the lower end of the range, due to concerns about longevity of funds in retirement.

How the funds line up

2016 market share by AUM and member accounts (funds >$5bn)



The market share breakdown for all funds is available in the Super Insights Dashboard at **kpmg.com/au/superinsights**.

Core challenges and opportunities

The industry has done a good job in the first 25 years of compulsory super in the accumulation phase of superannuation – but it has not yet worked out its approach to an environment where more members become income recipients rather than fund contributors.

Retirement income

The onset of the retirement income era means funds must now not just manage money as it comes in, but disburse it to clients as they age – a task which can be approached in several ways.

As previous KPMG whitepapers have highlighted, the industry is maturing and generally aware of its need to provide better solutions for members in retirement.

Howes says, "The industry has done incredibly well over the last 25 years in resolving many questions that come up about the accumulation phase of superannuation. What we haven't answered correctly is how we resolve the challenges in the retirement phase."

Measuring success

How does a fund measure success in providing a retirement income solution? Some funds are already well advanced in building a retirement income framework, but their responses are only beginning to take shape. Howes says most funds have answered the questions of the accumulation phase in similar ways, but there is likely to be a significant divergence in how funds respond to decumulation.

"Pre-retirement, all members have the one key goal to maximise their savings on retirement. In retirement, it's a different story," Howes says.

Three examples of this include:

1. A member with a lower balance will use superannuation to supplement a full age pension entitlement. They may decide to withdraw their entire superannuation balance to retire high-priced debt.
2. A member may have sufficient non-superannuation savings to avoid worry about either investment or longevity risk. They may use their superannuation as an enhancement to their existing lifestyle, or they may keep it to bequeath to their children.
3. In the middle are members for whom investment and longevity risk are real issues and appropriate retirement decisions, based on sound advice, will be central to their wellbeing.

Most funds have answered the questions of the accumulation phase in similar ways, but there is likely to be a significant divergence in how funds respond to decumulation.

This does not mean that funds in the system will begin to shrink; continued member contributions and investment income will see to that. But the industry will change as more members become income recipients rather than fund contributors. Funds will have multiple audiences, members will have higher average ages, and more funds will have outflows that exceed inflows.

Howes also ties this retirement income challenge to the proposed primary objective of superannuation[9] – to provide income in retirement to substitute or supplement the age pension. Funds need to respond to purpose by helping members use their fund balances in the best way possible. He says this will usually mean helping members to spend funds judiciously and gradually – "to get people to ease themselves down the other side of the mountain instead of dropping off a cliff". It may also require regulatory change.

It will also be likely to require funds to involve themselves directly in the process of financial advice.

Hill says, "The best thing a member can do is take financial advice. That's just not about their superannuation balance, it's about their pension phase income streams, it's about their home, it's about aged care, it's about medical expenses, it's about how they want to live and fund their active old age, their passive old age, and their ill-health old age."

Assigning responsibilities

Some funds are looking at appointing a CRIO to take over responsibility for delivering retirement income to members. This shift would leave the Chief Investment Officer free to concentrate on maximising investment returns.

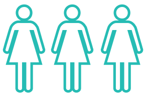
A balanced scorecard

KPMG's balanced scorecard approach assesses funds' retirement income performance. It asks key questions such as:

- Are member retirement income goals being addressed?
- How much do members worry about risk?
- Do members understand the proposition being put to them?
- How well does the retirement solution perform time diversification – sometimes called 'bucketing' – to meet spending goals?
- Does the solution provide funds as needed, particularly in emergencies?
- What is the allocation to growth assets?
- Does the member want to leave bequests?
- Does the solution protect the member from longevity risk – that is, does a long-lived member run out of money?
- Does it optimise overall income, including funds from the age pension and social security benefits?
- Does it deal with cognitive decline?

This list shows just how many goals a good retirement income plan must address. Some goals potentially clash, and retirees will place different importance on each.

9. The Superannuation (Objective) Bill, 2016.



Women and super

Income-earners with broken employment records and/or low incomes face unique challenges when it comes to accumulation of super. An interrupted employment history – perhaps due to maternity leave or other care leave – leaves them with lower average account balances for the same level of income when in employment.

This problem largely impacts the female population, and their longer lifespans mean they face a longer period in retirement.

The problem may become more severe and across both genders if Australia sees a rise in the proportion of workers earning incomes under contracts or through freelancing, rather than in an employer-employee relationship.

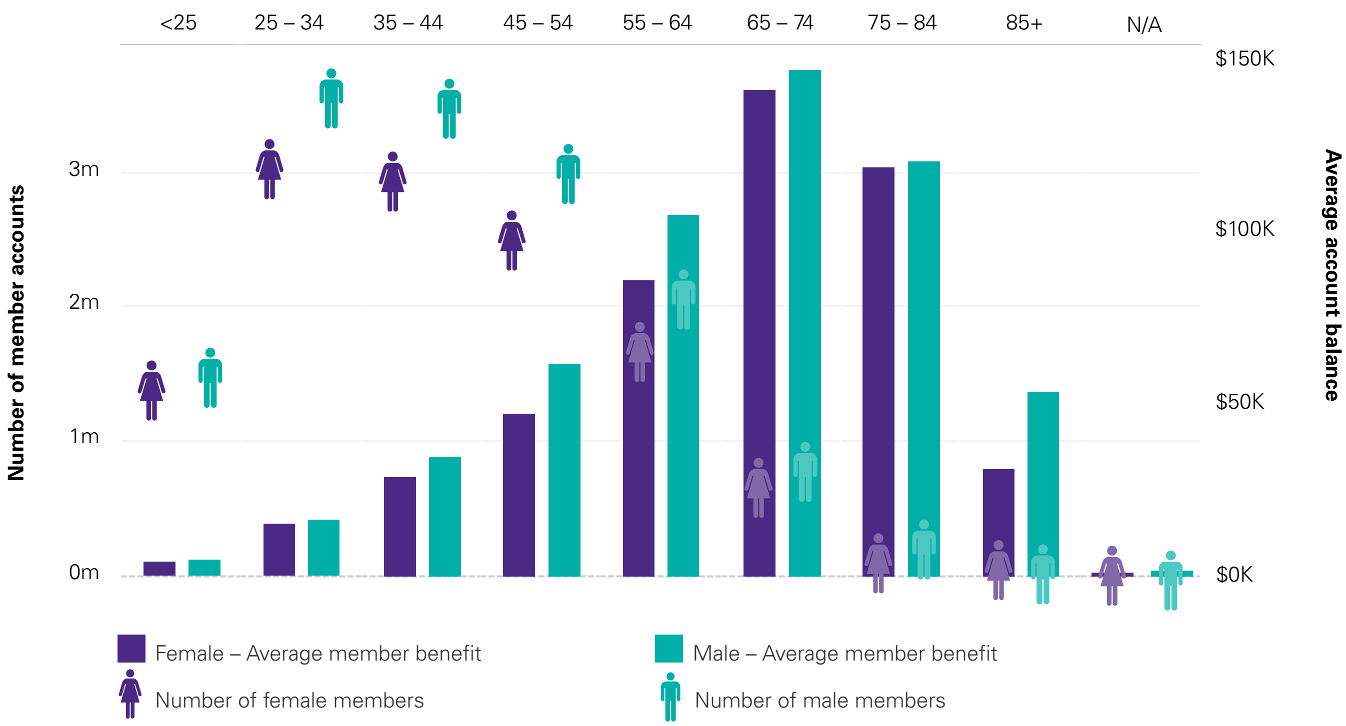
The government has announced some policy changes which will advantage some superannuants in this group. Notably, the 2016-17 Budget provided exemptions from the current capping arrangements to help compensate for their reduced contributions.

However, these disparities begin with the underlying penalties that employees pay for breaks in their work history, as well as other pay disparities that are underpinned by wider socio-economic gaps.

The largest gender disparity in average member balances is between men and women aged 45 to 64. The gap decreases above the age of 65. This may be in part because prior to the 1992 introduction of compulsory superannuation, superannuation was predominately paid in industries such as education and healthcare where income disparities are smaller, and also more female-oriented industries. Above the age of 65, spouses may also be taking advantage of spouse contributions.

The largest gender disparity in average member balances is between men and women aged 45 to 64.

The gender gap



Funds with highest percentage of male and female members (2016)

	>$25bn	$1-25bn	<$1bn
Male	CBUS 92%	BUSSQ 94.2%	NESS Super 93.9%
Female	HESTA 80.7%	Guild Super 86.4%	VIS Nominees 74.1%

Regulation

One major threat to the superannuation system is the federal government's own continued changes to the system's tax and regulatory settings. Ryan warns of the danger of evolving a system where "the discretionary payments from members are putting less and less money into the system".

Governments need to be wary that tinkering too much with superannuation rules may reduce citizens' willingness to add the voluntary contributions that are needed.

Purpose

The proposed primary purpose of superannuation is to provide income in retirement to substitute or supplement the age pension. Defining superannuation in this way can help to focus current and future policy discussions – in particular, the debate over adequacy, outlined earlier, and the expanding discussion over management of the retirement income phase.

However, Australia still needs to carry through a national debate about the potential purposes of superannuation that this definition rules out, including:

- to build wealth that can then be bequeathed;
- to build a national savings pool that can be directed for national purposes, such as infrastructure; and
- to allow savers to buy assets such as houses.

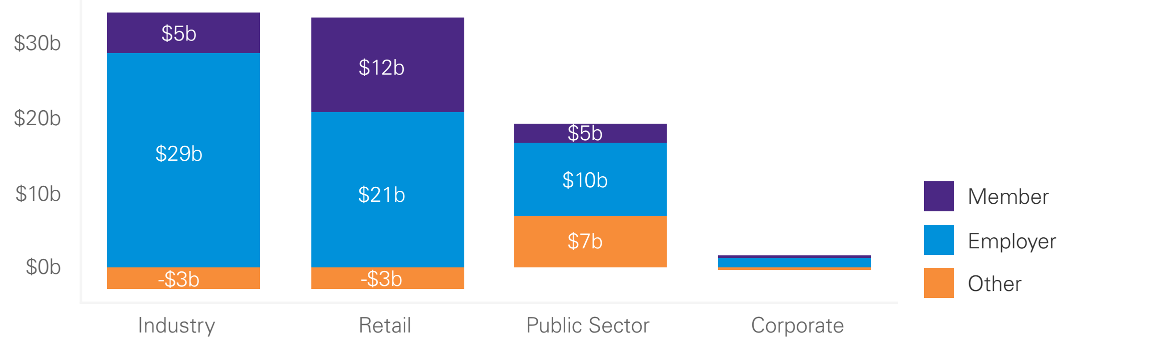
On this last point, it is difficult to reconcile the Government's proposed primary objective of superannuation with the announcement in the 2017-18 Budget to introduce a First Home Super Saver Scheme to allow individuals to make voluntary contributions to their superannuation account with the express purpose of being able to withdraw this for making a deposit on a first home. Arguably, policies to address housing affordability do not fit comfortably within their proposed primary subsidiary objectives of superannuation.

Governments need to be wary that tinkering too much with superannuation rules may reduce citizens' willingness to add the voluntary contributions that are needed.

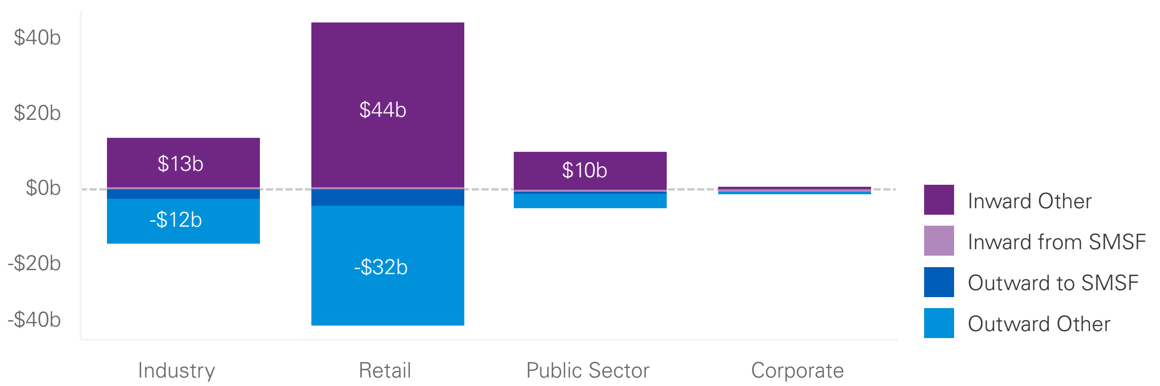
How the funds grow

2016 cash flow by fund type

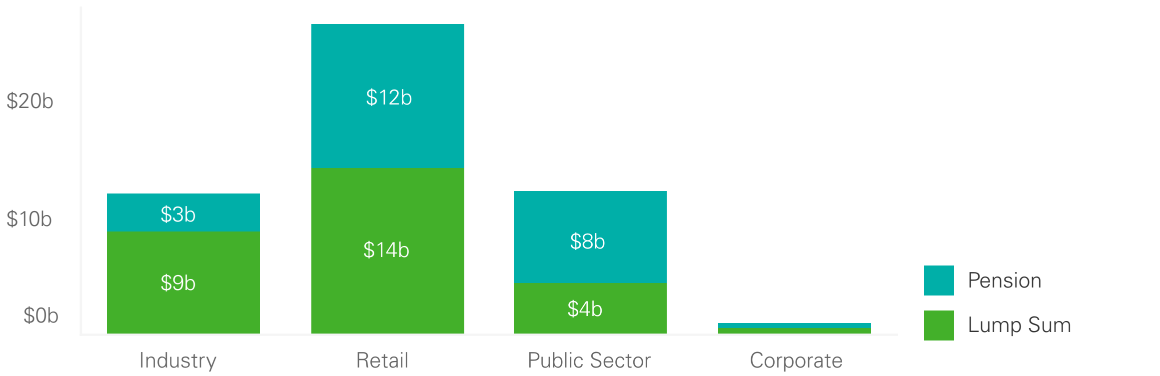
Contributions



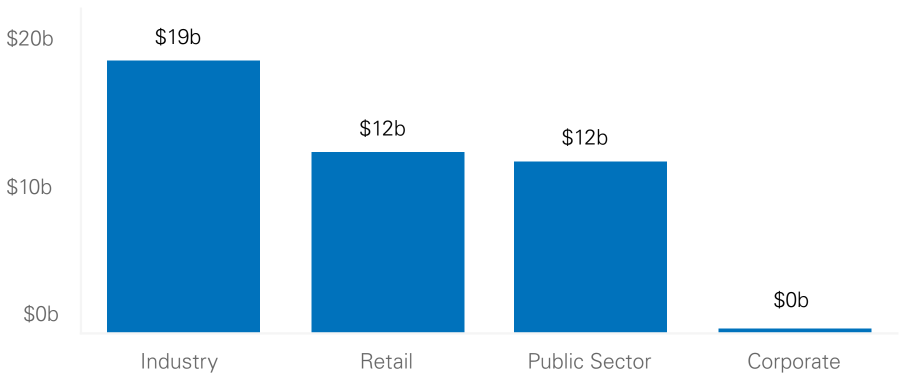
Rollovers



Payments



Net flow



The realities of trying to deal with the challenges of retirement and longevity and sustainable retirement incomes will mean that funds will have to have multiple operating models for their membership.

Operating models

A fund's operating model describes the capabilities that exist, or that should exist, within the fund: how it manages itself (dealing with issues such as talent, governance and risk), how it invests, how it deals with members, and how it ensures it has the infrastructure needed to support its activities. It also explains why the fund needs these capabilities to deliver on its mission to its members.

As the job of providing retirement income grows larger, funds are likely to evolve divergent models.

"There is no one correct operating model. The realities of trying to deal with the challenges of retirement and longevity and sustainable retirement incomes will mean that funds will have to have multiple operating models for their membership," Howes says.

Risk management continues to be an important element of fund operations. Funds are building out their risk function and developing their risk frameworks, at substantial cost, as part of continuing efforts to better manage growth risk, investment risk and the many forms of risk that could arise from failure of IT systems (cyber risk).

Member engagement

Engagement with customers is among the most sought-after targets for most services business. By engaging with customers, providers can sell them extra services and, by demonstrating their abilities, build customer loyalty.

Superannuation funds seeking to engage with their members, however, face a challenge.

Matt O'Keefe, Partner, Technology Risk & Assurance, KPMG points out[10] that wealth management is a "low engagement environment"; and that most of the industry's customers appear happy to have minimal interactions with their funds.

Wealth management organisations still have work to do to implement powerful engagement strategies. Digital services, notably phone apps, typically play a key role in this area.

To succeed, funds need to both understand their customers, but also to collect and analyse sufficient customer data and to keep that data safe and use it appropriately, while providing services through websites and apps.

They will also need to constantly adapt to new digital trends, such as the new generation of voice interfaces – not only in phones but in home devices.

Challenges for small funds

Many funds are dedicating resources to better understanding their members, and to attracting and retaining more. Hill rates this as one of several key challenges for smaller funds. Other special challenges for small funds include the quality of investment returns, and minimisation of costs.

10. See John Havers and Matt O'Keefe, *Super funds: Embrace innovation by engaging with members*, KPMG 2016.

Hill says it could be expected that bigger funds provide higher returns and lower costs, but that this is not always the case. Some smaller funds manage costs well and outperform on returns; some improve service levels by building alliances and outsourcing some of their service delivery; a few are looking at mergers to create larger entities.

These funds will be encouraged by the 2017-18 Budget announcement to extend tax relief for a further 3 years, affording a bigger window of time to explore and conclude mergers in ta tax effective manner.

Digital interfaces

The design of digital customer interfaces, only recently considered a minor technical task, has taken centre-stage as their potential to engage customers has become apparent.

"If funds are thinking, 'how do I win new members?' some major funds have developed online tools for the member to use," O'Keefe says.

However, those tools need to be expertly implemented. O'Keefe notes that today's member is accustomed to the level of sophistication delivered by firms like Apple and Uber.

The design of digital customer interfaces, only recently considered a minor technical task, has taken centre-stage as their potential to engage customers has become apparent.

Technology and data

Digital technology is both changing the funds' IT operating model and improving their understanding of the customer journey. Member services which previously required face-to-face interaction can now be delivered anywhere, at any time. Digital tools bring new techniques to identify potential members. And technology also holds the promise of cheaper, faster automated processes, including more effective reporting that can support improved fund governance.

Data analysis has always been crucial in the modern investment business, but it has usually been deployed in the service of making better investment decisions. Now, O'Keefe says, higher-performance funds are training their instruments in the other direction, focusing on the "member journey". Their aim is to use advanced analytics to identify 'triggers' for member activity such as a move to switch funds, and offerings that can be made to aid member retention.

Analytics technologies are highly complex and advancing rapidly. These technologies include predictive analytics, which helps business analyse huge amounts of data to make performance-enhancing predictions.

Cost control

Implementing new technologies can put pressure on funds' technology and data management capabilities. O'Keefe says this can lead to a rising share of funds' administration costs.

Without a clear roadmap to their technological end-point, funds risk investing in the wrong things. And the new data analytics technology has not yet turned its huge volumes of customer data into actionable insights that funds can use. The industry must ensure that it does not blow out its expenses with huge investments in unproductive technology.

New data analytics technology has not yet turned its huge volumes of customer data into actionable insights that funds can use.

The evolution of the new fund IT operating model is being encouraged by the efforts of funds' IT officers to rein in the costs of their systems. These efforts are encouraging funds to explore models that deliver technology through brokering of outside providers' services, 'orchestrating' the efforts of internal and external IT providers, and integrating existing solutions from IT partners. These techniques allows systems to be put in place more quickly, requiring less actual ownership of assets.

Another solution replacing costly in-house resources is cloud technology. For some years funds resisted the idea of storing data off-site in large data centres. As cloud solutions have matured, funds have found it hard to resist cloud's promise of reduced 'total cost of ownership' – the combination of initial costs and lifetime operating costs. But as O'Keefe notes, funds still need to make good decisions on IT governance and talent.

Privacy and security

Funds also need to invest time and resources in privacy and data security, O'Keefe adds. These are areas where funds need to be sensitive: they possess a great deal of personal information, and a string of high-profile privacy and security breaches over recent years have underlined the potential for damage to a fund's reputation.

Digital identity frameworks must be established to keep track of each customer's privacy preferences and seek their consent for data to be used in different ways. For example, using LinkedIn data to anticipate a member's change of job could be used by a fund to trigger a new round of engagement with a member – but unless this is done with member consent, it could feel invasive.

Additional challenges

Insurance: Boosting the experience

Over recent years many funds have increased their resources and capability in insurance while focusing on the insurance product benefit design and the member experience.

Notably, funds have needed to develop and clearly articulate the claims philosophy and customer experience they want their members to have.

Dermody asks funds, "How do you seek to treat members when you're insuring them as part of your offering? How do you ensure alignment with your insurer?"

This focus is likely to be ongoing with what Dermody calls "unprecedented scrutiny". Separate parliamentary committees are holding inquiries into the life insurance industry.

An APRA review of life insurance claims released in 2016 raised what APRA referred to as "issues of concern in relation to higher claims denial rates and claims handling procedures". This scrutiny is raising further questions, including whether funds should be required to bundle life insurance in superannuation policies (as they currently are required to do). Responding to this, industry bodies representing a broad cross-section of the superannuation industries have formed the Insurance in Superannuation Working Group, with the stated aim of developing new standards for trustees and insurers to set benchmarks for industry practice in the future.

Another particular area of concern has been volatility in premium rates charged by their insurance partners and the associated impact on member accounts. Superannuation funds are actively considering what can be done to manage this better.

One fund, which was advised by KPMG, has now fully insourced its insurance business, citing benefits in risk assessment, product features, claims management and pricing and terms.

Superannuation funds are considering what can be done to better manage the volatility in premium rates charged by their insurance partners and the associated impact on member accounts.

Global yields are expected to stay low for some time yet – a diagnosis known as 'lower for longer'. This means that funds' search for returns is more intense than ever.

Investment: Coping with 'lower for longer'

Global yields are expected to stay low for some time yet – a diagnosis known as 'lower for longer'. This means that funds' search for returns is more intense than ever. Since neither cash, bonds nor public equities look particularly attractive, funds are keen for private equity deals. But such deals are in limited supply.

As Thomas points out, infrastructure assets are particularly sought after. Airports, toll-roads, ports and similar assets have a highly desirable combination of steady income flows, good yields and capital growth potential. They are also scarce, making up just 5 percent of a typical fund's asset allocation.

Beyond brownfields infrastructure

As the supply of privatisable 'brownfields' infrastructure assets shrinks, funds are taking a closer look at other asset types with similar characteristics. Some are eyeing 'greenfields' investment in new infrastructure projects, despite their typically higher level of regulatory and execution risk. A few such assets have been funded, including desalination plants and hospitals. Thomas says investors are aware of the opportunities in energy where the industry is going through technology transition towards renewable energy such as wind farms and solar.

"People are starting to cast their net far and wide," she says.

The other unlisted market, property, has recently seen some dramatic price rises, but Thomas warns of the need for funds to avoid over-leveraging their exposure.

"If the economy deteriorates rapidly, then pressure on capital value and interest rate exposure can negatively impact the asset class," she says.

Thomas says the search for infrastructure-like assets has taken local funds well beyond Australian shores.

"You'll have funds that are invested into Europe, into the UK, into the US, into Poland or Germany – wherever the opportunities are."

The changing nature of work

As technology takes a more central place in organisations across all industries, the way people work, when and where they work, are dramatically shifting. As organisations nurture adaptable employees, they can also be open-minded about how they boost their resource pool, drawing on what Bernard Salt, Partner, Demographics, KPMG, calls the "cloud of talent". With a growing marketplace of freelancers, contractors, consultants and teams for hire, along with the ability to reach people around the world with technology, it is easier to top up teams with additional skills, support or creativity.[11]

"Think of a 'human cloud' where employers are able to 'reach into the cloud' and draw on talent as required," Salt says.

However as employees and employers embrace this new model of working, there is potential that SG payments could be more intermittent, or that people will have to take even greater ownership of putting money into their funds. An opportunity could exist for funds to focus on this style of working arrangement, offering products or support to this growing pool of workers.

Ryan says changes to allow for personal deductible contributions from 1 July 2017 will assist members with this style of working arrangement.

As employees and employers embrace new models of working, there is potential that SG payments could be more intermittent. An opportunity could exist for funds to offer products or support to the growing market of freelancers, contractors and consultants.

11. Rethinking talent management for an agile, robotic and entrepreneurial world, KPMG, 2017 https://home.kpmg.com/au/en/home/insights/2017/02/talent-management-agile-world.html

Conclusion

The sector has begun to identify that change is needed across many aspects to meet the newly emerging vision of solving the accumulation and retirement challenge simultaneously. This new dual challenge will require new ways of thinking and working to ensure success.

After 25 years, and from modest beginnings, the Australian superannuation system has a lot to be proud of. As one of the largest superannuation and pension systems globally it is well on the way to meeting its ultimate purpose of supporting all Australians as they move toward their retirement years.

As the stewards of Australian retirement savings, the sector has begun to identify that change is needed across many aspects to meet the newly emerging vision of solving the accumulation and retirement challenge simultaneously. This new dual challenge will require new ways of thinking and working to ensure success.

Size and scale while remaining important, from an operational perspective, will be nuanced with productivity and service efficiency. Vendor arrangements increasingly become partnerships with cost being balanced with insight and capability. Technology will move increasingly to the centre and function as the key tool for managing risk and refining operations. The challenge of member centricity and the pursuit to serve a 'segment of one' will be met with the deliberate integration of advanced data science and cutting edge digital capability.

In short, funds will need to embed a two-speed operating model. They must continue to focus on incremental advancement across trustee operations, risk management, member services and investment management, whilst also investing in multi-year transformational initiatives to meet the rapidly evolving regulatory landscape, address and shape member expectation and stave off threats of disruption.

Contact us

John Teer
Partner
National Sector Leader, Wealth Management
T: +61 2 9335 7569
E: jteer@kpmg.com.au

Paul Howes
Partner
Head of Wealth Management Advisory
T: +61 2 9346 6073
E: paulhowes@kpmg.com.au

Sean Hill
Partner
National Leader, Superannuation
T: +61 3 9288 6948
E: seanhill@kpmg.com.au

Damian Ryan
Partner
Tax
T: +61 2 9335 7998
E: dryan@kpmg.com.au

Dana Fleming
Partner
Tax
T: +61 3 9288 5871
E: dfleming@kpmg.com.au

Matt O'Keefe
Partner
Technology Risk & Assurance
T: +61 3 9288 5430
E: mokeefe@kpmg.com.au

James Collier
Partner in Charge
Actuarial, Insurance & Superannuation
T: +61 2 9335 8933
E: jamescollier@kpmg.com.au

Michael Dermody
Partner
Actuarial, Insurance & Superannuation
T: +61 2 9335 8141
E: mdermody@kpmg.com.au

Jacinta Munro
Partner
Risk Consulting
T: +61 3 9288 5877
E: jacintamunro@kpmg.com.au

Sam Kim
Partner
Risk Consulting
T: +61 2 9335 8633
E: samanthakim@kpmg.com.au

Adele Thomas
Partner
Deal Advisory
T: +61 3 9288 6139
E: athomas1@kpmg.com.au

Ian Jedlin
Partner
Deal Advisory
T: +61 2 9335 8207
E: ijedlin@kpmg.com.au

Manish Prasad
Director
Wealth Management
T: +61 2 9346 6334
E: mprasad4@kpmg.com.au

KPMG.com.au