Super Insights Report 2018

The impact of regulatory changes, scrutiny, evolving member expectations and technology on the sector

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Foreword

Paul Howes,
Partner
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Despite ongoing regulatory focus, legislative changes and media attention, Australia's superannuation system continues to deliver strong outcomes for members.

Superannuation continues to be at the forefront of change and ongoing media attention. The 2016/17 year saw superannuation trustees wading through a substantial number of Government and industry reviews, including the Productivity Commission Review into the efficiency of the industry, the Insurance in Superannuation Working Group (ISWG) review of default insurance, and more recently, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services industry.

The industry has navigated further guidance from the Australian Prudential Regulation Authority (APRA), the Australian Securities Investment Commission (ASIC) and the Australian Taxation Office (ATO), with highlights such as RG97, the member outcomes test, taxation changes surrounding contributions caps, and pensions and retirement product consultations.

In spite of this ongoing change, the industry continued to grow, with total system assets increasing by more than 20 percent to represent approximately $2.51 trillion in Assets Under Management (AUM), 40 percent more than the market capitalisation of the ASX, and almost double Australia's GDP for the year.

The evidence suggests that a two-speed economy is beginning to develop within the industry, with the larger funds demonstrating materially higher increases in AUM and greater contribution flows than many smaller funds – a number of which have experienced net outflows for the first time, through leaner contributions and greater transfers out.

Funds on the whole delivered strong investment returns to members, and the data indicates that this was done in an efficient manner, with fees reducing again (where the impact of RG97 was removed). Whilst fees across the industry appeared to rise as a result of the introduction of transparency measures through RG97, this resulted in the average fund's fee increasing by approximately 21 basis points, or $105 on a $50,000 account balance. With very few sectors of the industry in agreement surrounding the RG97 implementation, ASIC has announced a review.

Rising operating costs remain a key challenge, and with a smaller membership base across which to spread these given the reduction in accounts, KPMG believes that the management of these, and a fund's operational efficiency, continue to be the key determinants of scale, rather than the level of AUM or membership.

Insurance has again been at the forefront of discussion, with the findings from ISWG review of default insurance at the top of many trustee's minds. Funds continue to grapple with the concept of providing sufficient levels of cover to meet the needs of members at a cost that does not unduly erode retirement savings. KPMG's *Review of default group insurance in superannuation* paper examining the erosion issue supported the findings of the ISWG, suggesting that there continues to be an important role for default insurance given the benefits it provides to the economy and community. The report found that on average, default insurance remains reasonably priced and does not unduly erode the retirement savings, with the lifetime cost of insurance reducing the average member's retirement balance by 6.2 percent. With the average fund paying out more than 60 percent of the premiums deducted from member accounts over the year in the form of claims (and many paying in excess of 100 percent), this appears to be a small price for lifetime insurance coverage within superannuation.

Advances in technology and digital services, analytics and system integration are a key focus, with many funds attempting to streamline interactions and tailor the member experience. The use of artificial intelligence (AI), chat bots and robotics signifies a new order, which can been seen as the poor cousin of more advanced financial services. However, the use of these is not without risks.

Retirement income policy, particularly surrounding the launch of new pension and annuity-style products, continues to be a challenge.

The Government is yet to provide concrete guidance surrounding the structure and outcomes expected for Comprehensive Income Products for Retirement (CIPR), which has delayed product providers from developing solutions. Announcements in relation to the social security implications of these products has also resulted in hesitation from product manufacturers to invest in development.

Governance models continue to be under scrutiny with ongoing discussion surrounding the broader use of independent directors on trustee boards. However, many funds have begun to address diversity issues with a greater focus on the appointment of directors from a variety of backgrounds.

With 2018 shaping up to be another busy year for the superannuation sector, KPMG looks forward to supporting the evolution of the industry, and working with our clients to continue to deliver globally leading retirement outcomes.

Total superannuation system assets increased by more than 20 percent in 2016/17 to represent approximately $2.51 trillion in Assets Under Management (AUM), 40 percent more than the market capitalisation of the ASX, and almost double Australia's GDP for the year.

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 APRA and 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 SMSF's to complete the landscape. KPMG has applied a sizing segmentation to group funds into those with greater than $25 billion AUM, between $1 billion and $25 billion AUM, and those funds with less than $1 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.

We recognise that there remain challenges associated with reporting across the superannuation industry and the data presented within APRA's published statistics. To this end, KPMG believes that there needs to be broad industry agreement surrounding the manner in which superannuation statistics, performance reporting and comparative analysis is undertaken.

APRA data explanatory notes

Superannuation funds included in this report represent the vast majority of superannuation assets regulated by APRA. 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.

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.

1. http://www.apra.gov.au/Super/Publications/Pages/superannuation-fund-level-publications.aspx
2. https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-superannuation-funds--a-statistical-overview-2015-2016/

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

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 peers or competitor funds, or a tailored member outcomes test, taking into account the relevant data that APRA has suggested funds should include in their own analysis against these relevant metrics. Feel free to get in touch with one of the KPMG contacts in this report.

Synopsis

The superannuation industry, whilst still relatively immature given the Superannuation Guarantee obligation only hit 25 years of age in 2017, plays a material role in relation to both the public and private sector within Australia. With assets totaling close to $2.5 trillion, it continues to mature into one of the most highly regarded retirement systems globally.

That said, the industry faces a number of challenges, which for some will create significant opportunities, and for others will present material difficulties and test their sustainability.

Through discussions with funds, KPMG notes that the following themes remain relevant in 2018:

+ Digital innovation

Innovative solutions to drive greater efficiencies and to tailor the experiences of super fund members could create challenges for smaller funds lacking the ability to invest in these technologies.

+ Governance and trust

With continuing reputational issues and the Royal Commission bearing down on perceived poor practices, financial services (including superannuation) continues to struggle with building trust.

+ Scale and member outcomes

The new 'member outcomes' legislation is likely to have a significant impact on the ongoing viability of funds, particularly those that do not provide strong outcomes for members.

+ Insurance

The ISWG's proposed code is likely to be implemented by most funds, requiring many to re-configure their insurance designs.

+ Ongoing regulatory change

The Productivity Commission review into efficiency, the Royal Commission into poor financial practices, and a raft of regulatory amendments including business planning and expenditure proposals, product and advice assessments, and recent announcements on changes to franking credits and early release of super.

+ Member engagement

The broader use of data analytics and segmentation models is becoming more prevalent across progressive funds.

+ Technology and data

The use of technology and data continues to be critical to the delivery of a superannuation fund's outcomes. The integration of underlying platforms to deliver a wide range of data points continues to be a challenge.

+ Responsible investing

There is greater investor push for ethical investments, with many funds utilising broad screening of their investment universe to select appropriate assets.

+ + Click on each theme to read our insights

The super industry in 10 years

Whilst many commentators have suggested that the superannuation industry is at an inflexion point, KPMG believes that the coming 10 years are likely to see material changes to the number of funds, as well as the services and products that will be offered by the remaining funds.

In spite of it being difficult to predict the timing of industry change or overall impact, we believe that the policy settings and regulatory reviews provide the perfect backdrop for the acceleration of fund consolidation. Adam Gee, Partner, Superannuation Advisory, KPMG, says, "Whilst we have seen consolidation of the industry occur at a snail's pace in recent years, the competition within the sector and the uplift in many funds' products and servicing capabilities will leave many with little choice but to exit the system".

The Productivity Commission's review into the efficiency of the system is likely to place significant challenges upon smaller superannuation funds, should a recommendation surrounding the limitation of existing default monies to the plethora of funds emanate. Given many smaller funds continue to rely heavily on default award contributions to fund their livelihood and AUM growth, 'turning off this tap' could mean the death knell for many. Such change could also prove challenging for medium sized and even larger funds, with a backdrop of declining membership, increasing operating costs, along with closure of the contribution tap likely to seriously challenge the ongoing viability of some funds.

The member outcomes test, which APRA announced will replace the scale test in 2018, will place pressure on funds to justify that they are providing strong outcomes to their members across a range of metrics. We expect this will drive further consolidation across the industry as a number of funds struggle to deliver.

"Whilst we have seen consolidation of the industry occur at a snail's pace in recent years, the competition within the sector and the uplift in many funds' products and servicing capabilities will leave many with little choice but to exit the system."

Adam Gee
Partner, Superannuation Advisory, KPMG

We believe there will be a material consolidation of funds in the coming 10 years, with the corporate fund sector likely to experience the greatest level of consolidation and the number of funds in the industry and public segments likely to halve.

Fund type	Current	2023*	2028*
Corporate	26	18	6
Industry	40	35	18
Public sector	37	33	16
Retail	125	106	68
Total APRA regulated	238	192	108
SMSFs	598,596	741,200	886,900

*Source: KPMG projections

As is evident from the graphic above, we believe there will be a material consolidation of funds in the coming 10 years. The corporate fund sector is likely to experience the greatest level of consolidation, given the smaller demographic they will service, as well as the additional requirements likely to be imposed on trustees in relation to member outcomes. We expect the remaining sectors to experience reasonable consolidation, with the number of funds in the industry and public sector segments likely to halve, and the retail segment reducing, but at a lesser rate.

Conversely, we expect the SMSF sector to continue to grow, albeit the rate is likely to slow as more funds close given the ageing population.

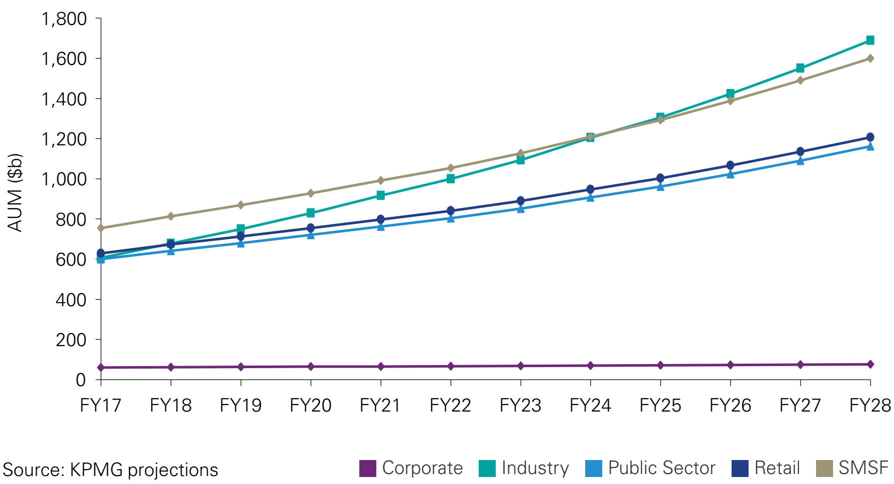
In terms of AUM growth, in spite of more funds moving to a net outflow position, assets within the superannuation industry are likely to continue to grow, topping $5 trillion by 2028. We expect the industry fund sector to overtake the SMSF sector to hold the largest share of the market at slightly less than $1.69 trillion, whilst the retail fund sector will experience slower growth, holding $1.21 trillion in assets. We also expect public sector funds to experience slower growth, maintaining AUM of $1.16 trillion, whilst the corporate funds will experience little-to-no growth over this time, holding $76 billion by 2028.

The chart below provides a graphical representation of these estimates.

KPMG believes that funds will be significant in scale, with the largest funds likely to maintain upwards of $250 billion in AUM. Membership is expected to peak and potentially contract, as account numbers consolidate and individual member balances grow.

With funds already diversifying into broader product offerings, KPMG believes that many of the industry fund sector will become diversified financial institutions offering non-superannuation products, aged care solutions and broader banking solutions, whilst the existing retail fund sector could move the opposite way, given the pressure on a number of banks' wealth businesses and the scrutiny being placed on banking practices and vertically integrated businesses by the Royal Commission.

AUM projection by segment



Source: KPMG projections

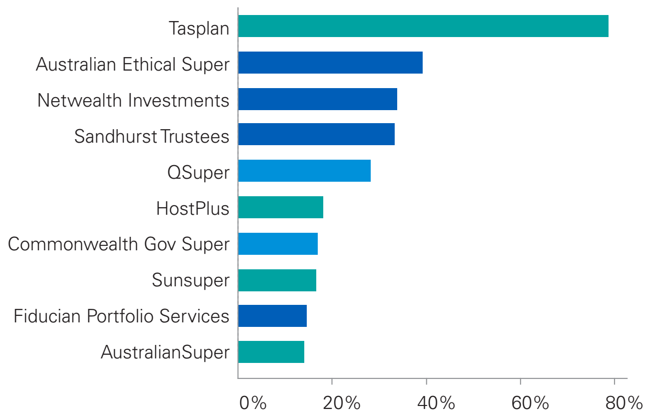
Superannuation funds in 2018

Superannuation funds generally had a strong year of growth in 2016/17. The average fund grew AUM by 9.3 percent, with one of the start-up funds growing AUM by more than 550 percent over the year.

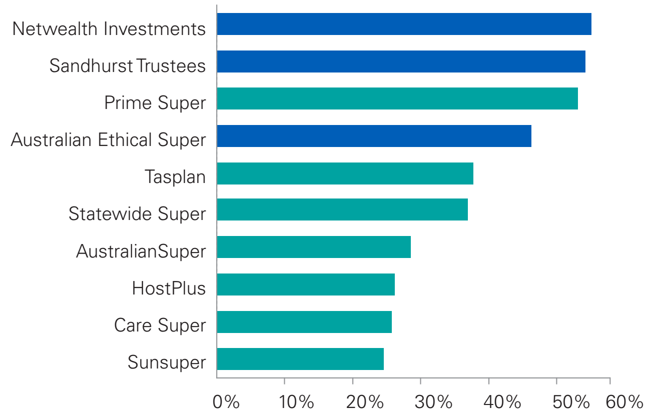
Whilst AUM continued to grow for the majority of funds, membership saw a further decline of 1.0 percent across the total industry (which was the sixth year in a row of account reduction), with a number of funds continuing to lose material portions of their members in recent years.

Top 10 funds by AUM growth

2017 growth

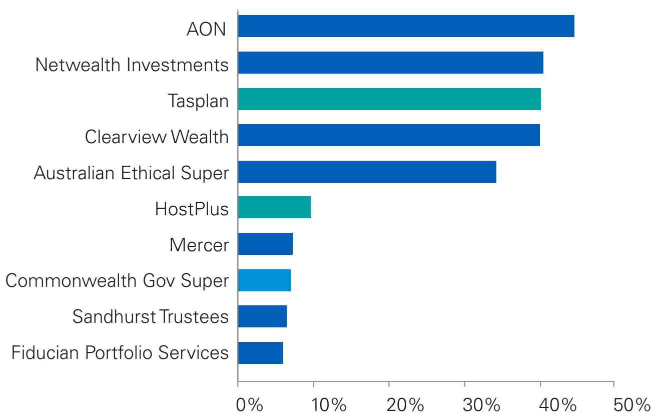


5 year average annual growth – to 2017

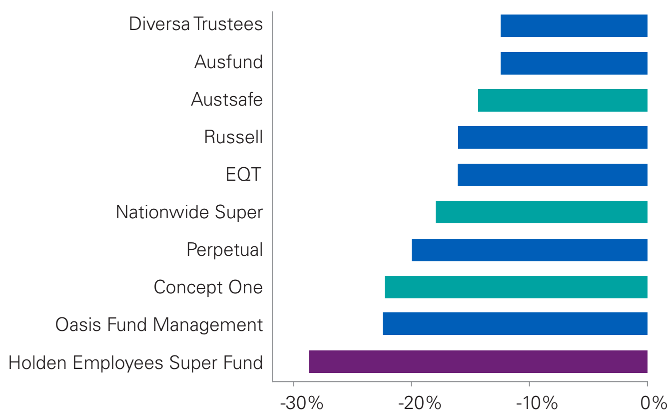


2017 top 10 and bottom 10 funds by member growth

Top 10 funds



Bottom 10 funds

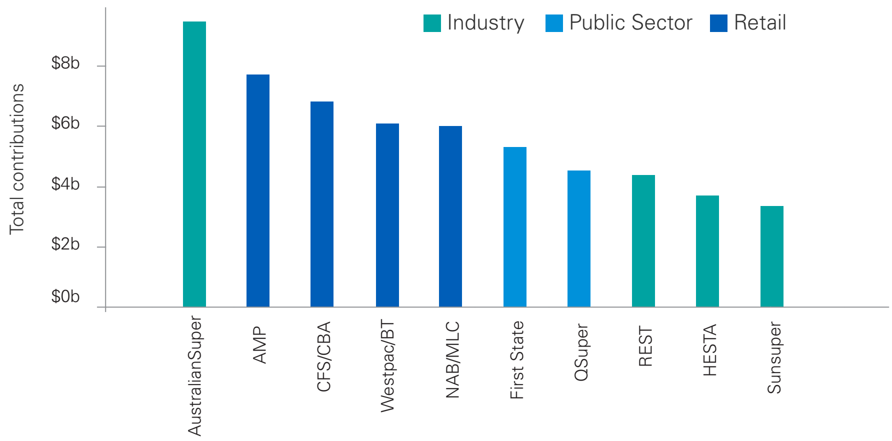


Corporate Industry Public Sector Retail

Contribution flows across the majority of funds showed a strong turnaround from 2015/16, with the impact of the Federal Budget changes, which lowered the contribution caps and placed a limit on the level of assets able to be transferred to pension phase. The average fund grew total contributions by 15.6 percent. Employer contribution growth remained stagnant at 4.8 percent, while personal after-tax contributions showed a material improvement with the average fund increasing these by 47.8 percent.

Top 10 funds by contributions

2017 contributions



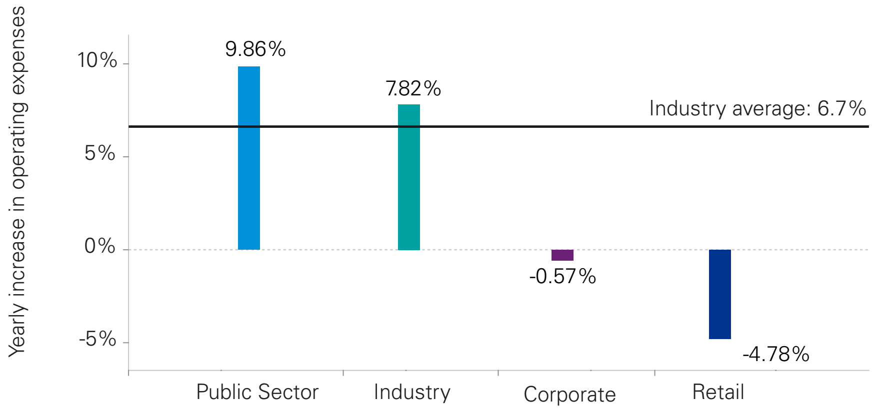
A fund's ability to manage its ongoing operational efficiency, such that it can continue to invest in new products and services, remains the key determinant of a superannuation fund's scale and long-term sustainability.

Operating expenses continued to increase unabated. The average fund experienced a 6.7 percent increase in total operating costs, suggesting the industry is continuing to invest in new products and services, with many experiencing challenges in managing ongoing increases in expenses. The chart below illustrates the average increase in operating expenses across each of the key industry sectors. It demonstrates the continued increase in operating expenses in the public sector and industry sectors.

A fund's ability to manage its ongoing operational efficiency, such that it can continue to invest in new products and services, remains the key determinant of a superannuation fund's scale and long-term sustainability. Funds that remain constrained by budget pressures will continue to fall behind peers that are investing in change and transformation.

Operating expenses

2017 increase



Whilst the level of AUM or total membership of a fund does not in itself determine whether a fund can maintain scale, in general, larger funds continue to grow at a greater rate than their smaller counterparts. The graphic below shows the growth in AUM based upon fund size and sector. It illustrates the key challenges that many of the medium and smaller funds face, and the growing dominance of the larger funds.

Bigger funds, fewer funds

Fund size*	No. of members	No. of funds	Change in no. funds	Total AUM	Change in AUM
>$25b	19.4m	15	↑	$1,031b	↑ 20%
$1–$25b	5.6m	60	↓	$384b	↓ -1%
>$1b	1.0m	31	↓	$13b	↓ -12%

Fewer funds, more assets

Fund type*	No. of members	No. of funds	Change in no. funds	Total AUM	Change in AUM
Corporate	0.2m	20	↓	$43b	↑ 8%
Industry	11.3m	40	↓	$543b	↑ 16%
Public sector	2.1m	13	↓	$240b	↑ 23%
Retail	12.4m	33	↓	$602b	↑ 8%
Total	26m	106	↓	$1,429b	↑ 13%

* by no. of members, no. of funds and AUM, 2017 (excl. SMSF)

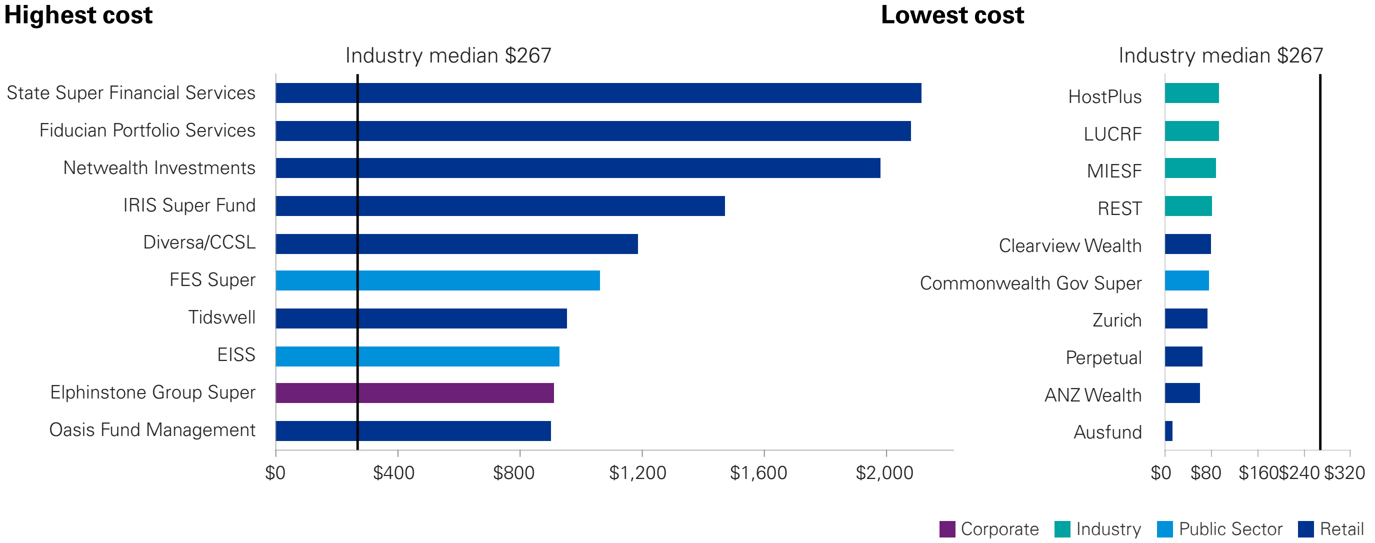
With regulatory change and Government reviews front of mind for many superannuation fund executives, 2018 is shaping up to be another busy year. APRA's new 'member outcomes' test will take prominence, which has been designed to ensure trustees assess the success of the outcomes that their fund has delivered to members, compared to certain objectives, benchmarks, or a peer group.

KPMG is broadly supportive of these assessments, which are expected to be undertaken across a range of metrics, such as:

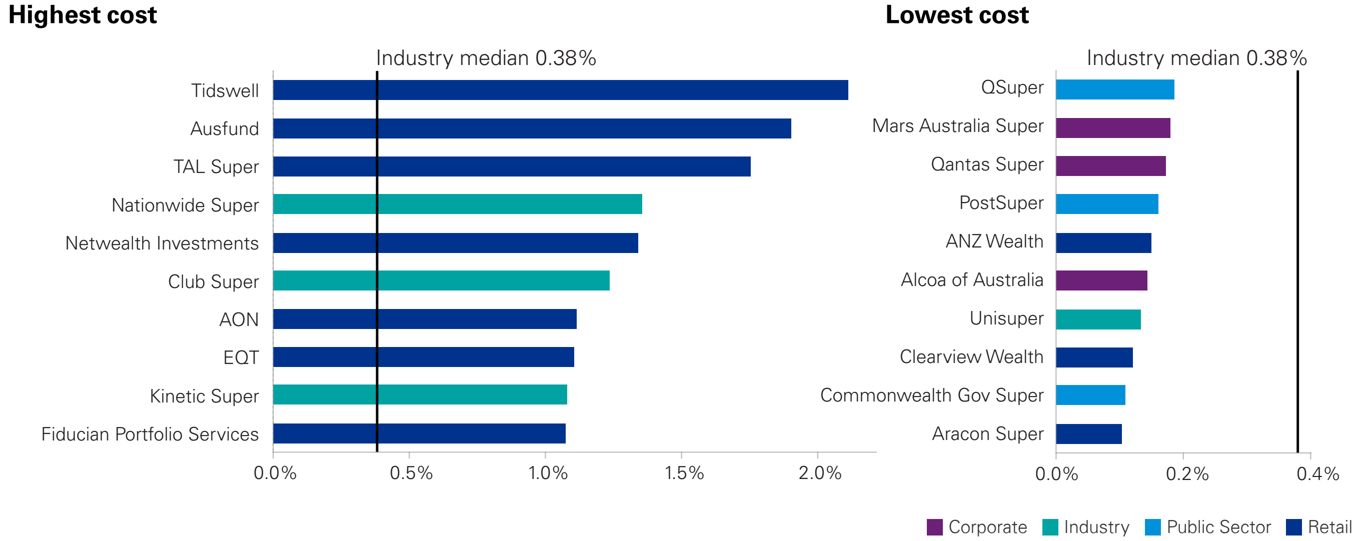
- net performance metrics
- fees
- costs per member
- cost of insurance cover
- net cash flows as a percentage of average assets
- net outflow ratio
- net rollover ratio
- membership movements
- active member ratios.

In this year's *Super Insights Dashboard*, KPMG has assessed a range of these metrics to assist funds to understand where they are positioned, as can be seen in the following charts.

Cost Per Member

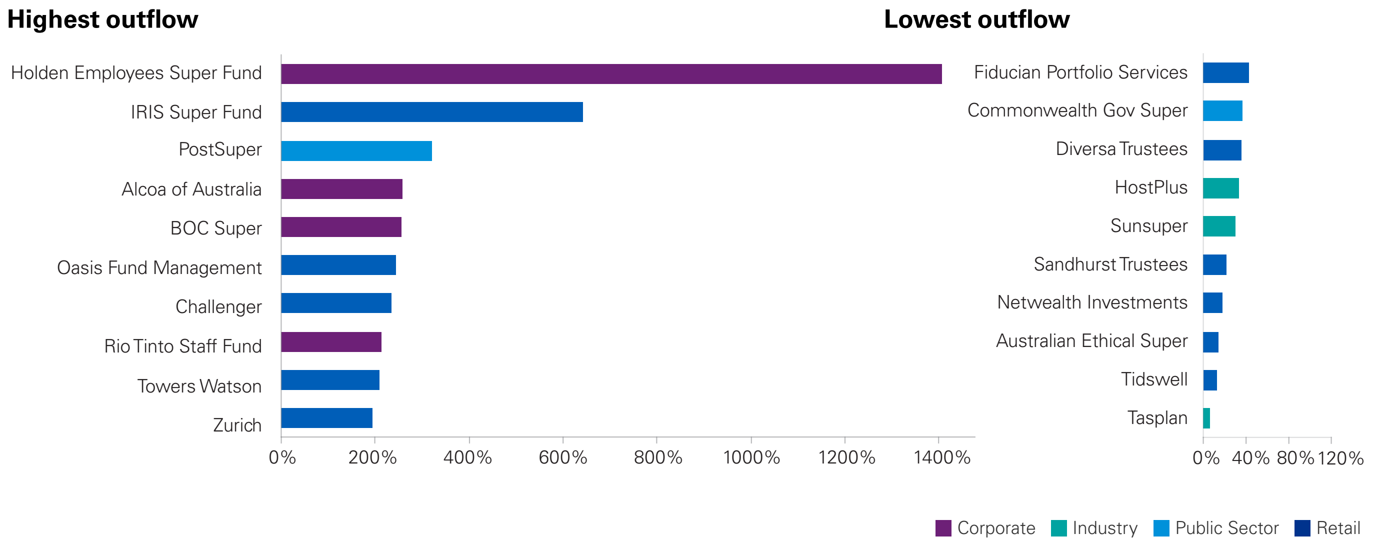


Operating Costs on an asset basis



These charts illustrate the divergence in operating costs, with a number of funds maintaining materially higher operating costs on both a Cost Per Member and AUM Cost basis, raising concerns in relation to their capacity to continue to invest in new products and services. In spite of an overall reduction in operating costs for retail funds (signified by the dark blue bars), they continue to maintain materially higher operating costs that their industry and corporate fund counterparts. Adam Gee commented: "The continued rise in operating costs remains a key challenge for superannuation funds as the member base across which these can be spread reduces – yet members expected more from their funds at a lower price."

Net outflow ratio



As can be seen from the charts above, there remains significant divergence between funds' net outflow ratios. A net outflow ratio of more than 100% means that more money is actually paid out of the fund in benefit payments, pension payments and rollovers out, than is paid into the fund through contributions and rollovers in. Whilst being in outflow may be of concern for some funds and may be a drain on overall liquidity requirements, this metric alone does not always mean that a fund is not sustainable.

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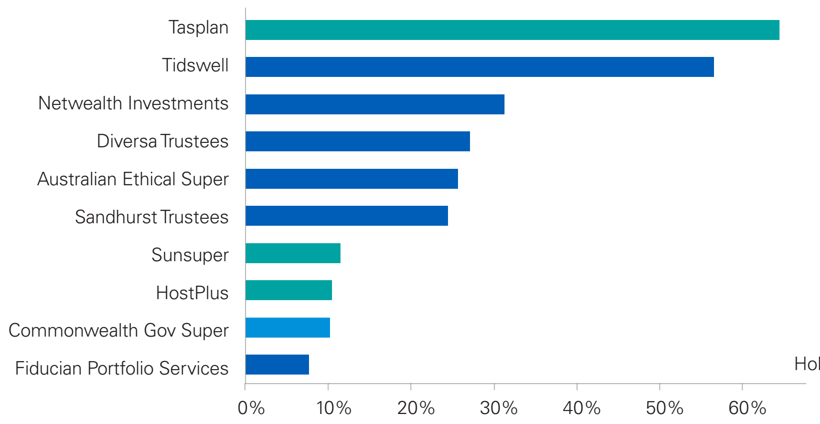
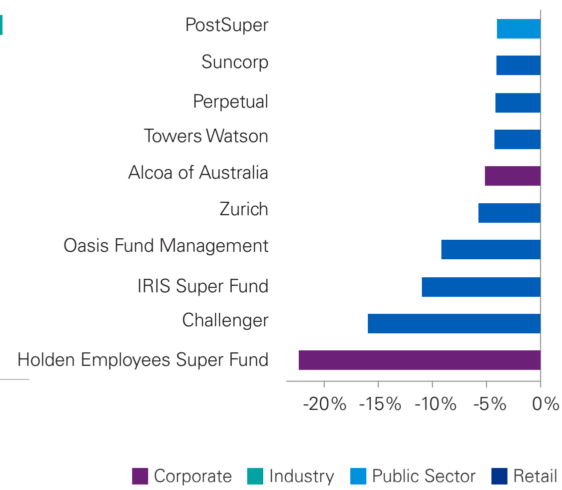
Adam Gee
Partner, Superannuation Advisory, KPMG

Net cashflow as a percentage of assets

Top 10

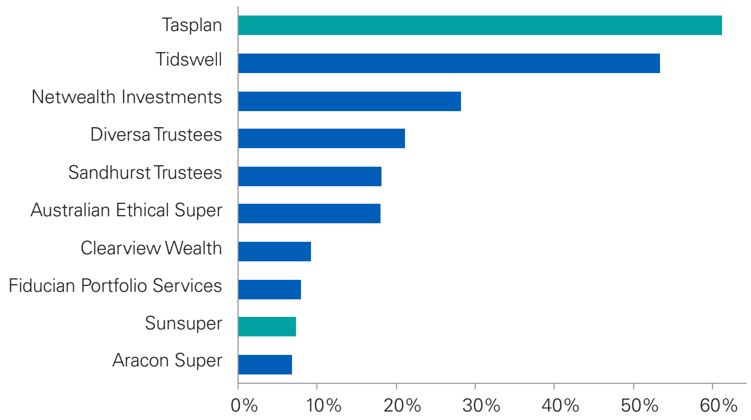


Bottom 10



Net rollovers as a percentage of assets

Top 10



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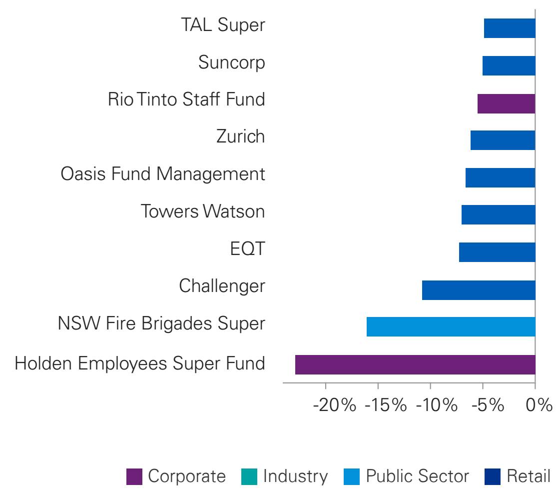
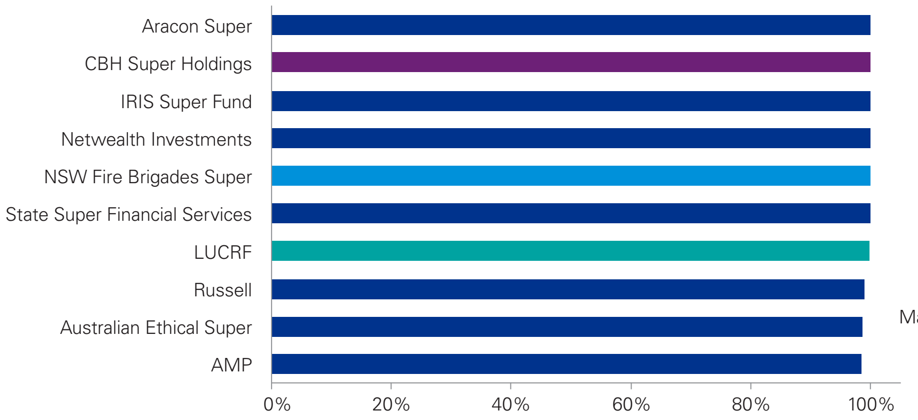


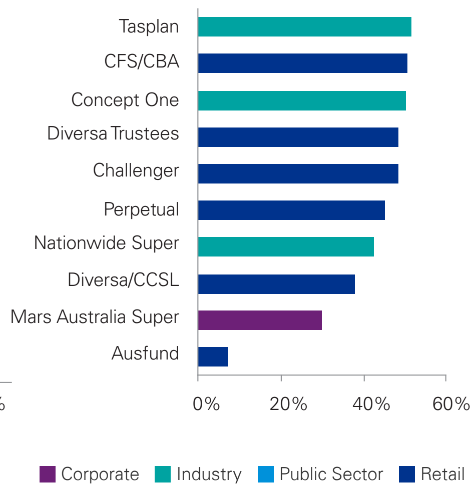
As is evident from the above charts, a number of funds have experienced very strong net cashflows in (some of which relates to successful merger activity), whilst others have experienced material cashflows out. These metrics continue to be a strong test of funds' ongoing viability.

Active member ratio

Top 10



Bottom 10



The above tables illustrate the divergence of active member ratios within superannuation funds. The average fund has seen an immaterial increase in this ratio, suggesting funds continue to have some way to go in fully engaging their members and ensuring they continue to contribute.

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Adam Gee
Partner, Superannuation Advisory, KPMG

Key challenges and opportunities

The Australian superannuation system remains the envy of many globally. However, there also remains substantial room for continued improvement in the outcomes delivered to members.

The following section outlines the areas within which KPMG sees opportunities for funds to differentiate their offerings in order to deliver stronger outcomes for members, and succeed in this highly competitive market.

Ongoing regulatory change

In our 2017 report we stated that continued changes in regulatory settings have contributed to the erosion of member confidence. It was anticipated that the Government's move in 2017 to enshrine the objective of superannuation into legislation would be an important anchor for the development of future reforms, and would provide stability, certainty and a framework for decision making. However, 2018 appears to be another big year for regulatory change.

Legislative and regulatory landscape in 2018 and beyond

The Royal Commission into banking and financial services, announced by the Government in late November 2017, is shaping as the key focus area. The Productivity Commission's inquiry into the competitiveness and efficiency of the superannuation system is also set to be finalised. The Royal Commission and the Super Inquiry place even greater scrutiny on the sector, with potentially wholesale impacts.

2018 is anticipated to serve up more short-term and ad hoc policy changes. A concern is that regulatory uncertainty continues to add complexity, imposes unnecessary costs, creates obstacles for innovation, and undermines member confidence.

Major reforms such as MySuper and SuperStream have been extremely beneficial. However, Sean Hill, National Leader for Superannuation, KPMG, says, "In order for us to maintain a transparent, effective and efficient system, above party politics, we need certainty from the government that future regulatory change will give consideration to costs and alignment with the enshrined objective of superannuation."

The superannuation regulatory framework and good governance are important for the ongoing protection of member interests, however this needs to be balanced with ensuring that funds are operating in a stable and sustainable environment, which is important for member confidence.

Risk management

The environment in which Australia's retirement income system operates has changed dramatically. Funds are now larger and more diversified, which has resulted in the creation of complex and sophisticated financial services entities that are both an important part of the financial services sector and the Australian economy.

They are faced with the challenge of mitigating a wider spectrum of operational risks that are both known (i.e. fraud and cyber risks) and unknown (i.e. geo-political risks).

Mergers

In 2016/17 a small number of successful fund mergers took place, however further consolidation was expected during the period. In October 2017 APRA identified a number of funds that lacked the scale to ensure they are operating in the best interests of members, and therefore did not appear to be consistently delivering member outcomes. As a result, APRA announced measures to strengthen superannuation member outcomes, and heightened regulatory requirements such as SPS 225, which will be quite onerous.

"Along with a further extension to CGT relief, and other measures such as greater successor fund transfer guidance, enhanced APRA directive powers, and any outcomes of the Productivity Commission review concerning the default market, will potentially advance fund consolidation in 2018 and beyond," Hill says.

> "In order for us to maintain a transparent, effective and efficient system, above party politics, we need certainty from the government that future regulatory change will give consideration to costs and alignment with the enshrined objective of superannuation."
>
> **Sean Hill**
> **National Leader, Superannuation, KPMG**

Insurance

Insurance within superannuation continues to be a key focus, subsequent to the release of the insurance code by the Insurance in Superannuation Working Group (ISWG). KPMG understands that, in spite of the code not being mandatory, the majority of funds have opted in, and will comply at a high level.

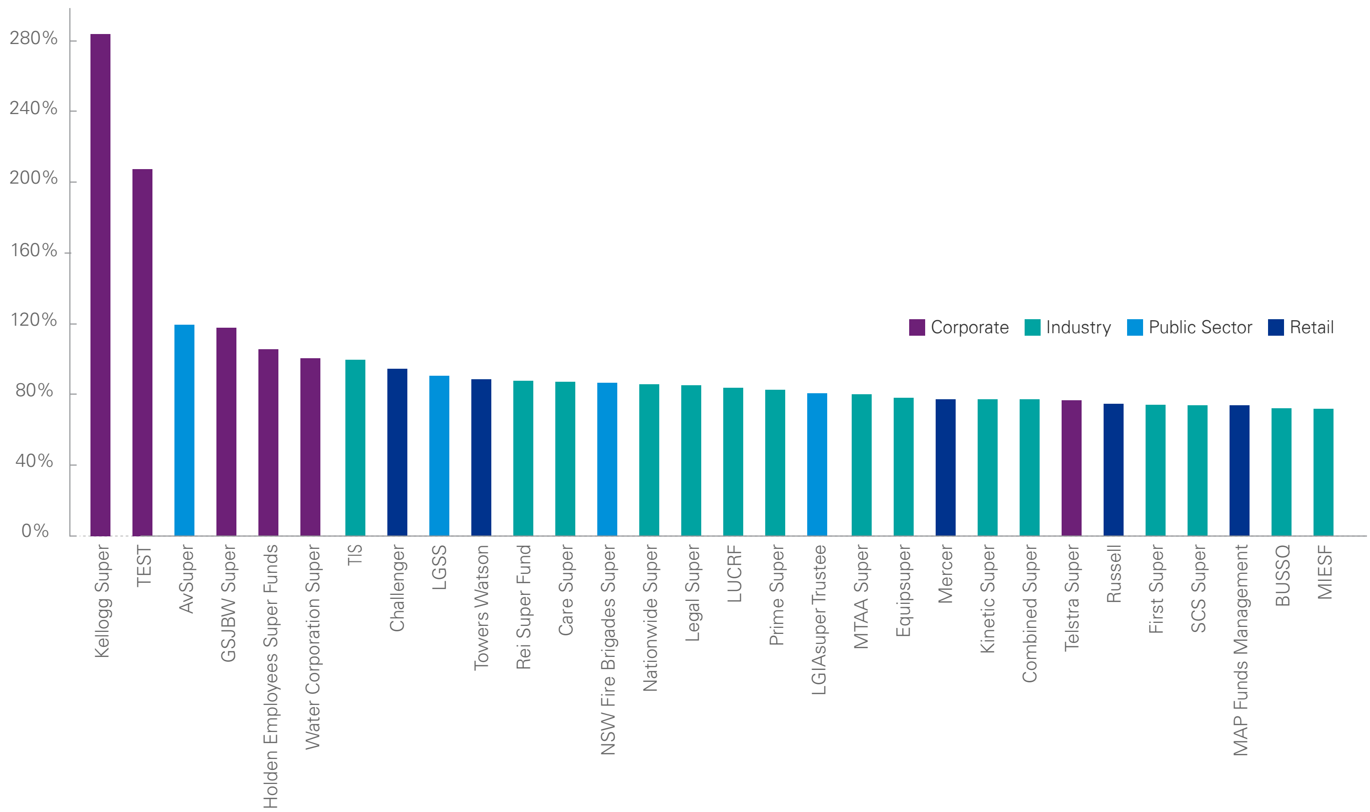
Adam Gee says, "The ISWG code is a strong first step to what will no doubt be a range of changes to the design of insurance within superannuation in the coming years.

"With benefit erosion as a result of insurance premiums a key concern for the Government and funds, and the ongoing focus of media in relation to the payment of insurance claims, the code is a timely initial outline of the future of insurance in super."

The provision of default insurance continues to be a balancing act. The levels of cover offered need to be assessed against the affordability of the insurance premium to ensure that a member's account balance is not unduly eroded. Most funds will need to review their existing insurance designs to ensure that the levels of cover offered are appropriate for the fund's age demographic, income levels and occupational categories, whilst addressing benefit erosion as a result of insurance premiums.

KPMG's research has shown that there remains a place for default insurance within superannuation given the underinsurance issues across the population. The use of group insurance as a tool to maintain more affordable insurance premiums when compared to retail policies also assists in keeping overall premiums materially lower for many Australians. However, there remains work to do for funds to ensure these are appropriate, based on a fund's underlying demographics.

Insurance payout ratios – 2017



"Unlike three or four years ago when it was almost impossible to garner any competitive tension within the insurance tender market, the re-emergence of a number of players ensures that funds are receiving strong interest in their market testing activities."

Adam Gee
Partner, Superannuation Advisory, KPMG

Whilst there remains conjecture across the industry and media attention in relation to claim approvals, the majority of funds pay legitimate claims in a reasonably efficient manner. As can be seen from the table below, the average fund paid out 60.3 percent of insurance proceeds to members in the form of claims, with some funds paying well in excess of premium inflows to members.

There remain material benefits associated with the provision of insurance within superannuation, however, there is need for further analysis of the underlying terms, conditions and definitions to ensure arrangements continue to meet community expectations and provide for the payment of genuine claims.

The marketplace for group insurance has again become highly competitive in terms of both rates and underlying terms and conditions. Gee says, "Unlike three or four years ago when it was almost impossible to garner any competitive tension within the insurance tender market, the re-emergence of a number of players (both insurers and re-insurers) ensures that funds are receiving strong interest in their market testing activities."

Furthermore, insurers continue to invest heavily and develop their online portals to streamline both the underwriting and claims experience processes for funds and their members. Whilst integration of these systems with a fund's registry and ancillary systems remains challenging, this should assist funds in engaging with their members around insurance.

Member engagement

There are significant challenges affecting funds from a member engagement and experience perspective. As in many other industries, the battle for the member will increasingly be fought on the ability to meet and exceed their needs, consistently deliver the desired experience, and to differentiate products and services where they drive engagement, maximise value and reduce churn. From a member perspective there are a range of factors influencing the future success of funds.

Issues

Member experience expectations: Members have heightened engagement expectations, driven by positive experiences in other sectors. Poor experiences are galvanising new entrants and disrupters into redefining member engagement strategies and capitalising on these needs.

Service and product differentiation: Whilst the core super product is becoming commoditised, the service provided to members should be a key differentiator. Members are seeking and needing additional services and products beyond basic super and standardised insurance agreements, and are expecting to be educated and well informed about choices.

Ongoing member engagement: Maintaining a relevant role with members throughout their journey with a fund is essential. Funds that recognise that member engagement strategies are key to unlocking a step change in performance metrics will see a transformation in member advocacy.

As a result of these drivers, funds have been taking action, addressing key pain points by attempting to improve the member on-boarding experience, easing self-service transactions, and providing more information and education on member portfolios.

Macro changes

A number of macro-changes mean funds need to act fast to grow and retain their member base. These include:

- The likely erosion of default super, meaning funds that are reliant on default as a primary revenue stream, will feel the pressure of more member choice.
- The movement to open banking, which will quickly include super and will open the market up to new competitive forces.
- The New Payments Platform (NPP), which enables new services and benefits to be achieved. Quick-adopting funds that embrace this opportunity will be a competitive threat.
- Fintech providers, which are active with digital-only entities in banking and other services. These organisations have low-cost, efficient operating models which will offer potentially greater returns.

"Member experience needs to change from simple ease of transacting, through to proactive support and advice. Education, robo-advice, portfolio analytics and retiree experiences are being trialled in an ad hoc fashion, but should be viewed as part of any fund's long-term strategy."

Mark Hassell
Partner, Customer, Brand & Marketing Advisory, KPMG

Priorities

KPMG's experience from other industries shows the benefit of acting fast to address market changes. We see funds preparing for the next stage of their member experience ambitions in a range of areas.

Mark Hassell, Partner, Customer Brand & Marketing Advisory, KPMG, says, "Member experience needs to change from simple ease of transacting, through to proactive support and advice. Education, robo-advice, portfolio analytics and retiree experiences are being trialled in an ad hoc fashion, but should be viewed as part of any fund's long-term strategy."

Funds typically have a range of legacy platforms, and are now preparing to move to modern, open technology platforms that enable seamless innovation and experience management.

Business models need to be more flexible, allowing funds to be listening to and analysing the data they get from their members and the market. Funds can sense demand change, experiment with new customer acquisition approaches, test new products and services, and then quickly scale or retract, depending on feedback.

Most importantly, members, employers, funds' staff and third parties need to be taken on the journey. Without the support of all parties in the fund's ecosystem, large-scale change, and the disruption that often goes with it, is likely to result in sub-optimal outcomes for the fund and the member.

Technology and data

Technology continues as a key strategic focus of operational investment for superannuation funds and industry participants, with boards and executives requiring the effective use of technology to enable the fund to achieve its strategic goals.

The use of technology and data has become more pervasive in the execution of the objectives of funds, and is seen as a key enabler of many strategic focuses.

The strategic imperative

In terms of strategic alignment, the use of technology and data has become more pervasive in the execution of the objectives of funds, and is seen as a key enabler of many strategic focuses, including:

- **Improved member service** – Meeting the evolving needs of members (and employers and other stakeholders) now requires a personalised, integrated, easy-to-use, secure, real-time experience, where the member receives the required information when and where they choose. Member experience is no longer judged against superannuation industry services norms, but against the numerous digital service experiences from other sectors.

- **Improved insights** – Increasingly deep and complex relationships are being sought to enable more productive member, employer and investment relationships, which require increasing levels of sophistication in data analytics, cognitive and machine learning solutions.
- **Operational efficiency** – Cost to serve pressures remain front of mind, with the need to balance the opportunities of technology and the increasing cost of technology (including scarce technology resources).
- **The competitive landscape** – Member acquisition and retention, ease of doing business, new products, investment internalisation, changing distribution models, and new challenger fintechs are some of the components of the competitive landscape, with technology both part of the challenge and integral to a holistic response.
- **Governance and control** – With the web of technology enabled third party connections (which now form the basis of the modern fund), ensuring risks are understood and managed on a timely basis has become more complex, and vital to sustainable fund operations.

The demand to do more with the same or less has continued, and technology remains a key solution.

Current wealth technology themes and challenges

When considering technology, funds are faced with a number of challenging and often competing factors, including:

- **Planning choices** – The strategic, mid-to-long-term investments in technology are important to get right, to refresh and maintain at the right cadence.
- **Leadership and operating model** – Whilst utilising third-party expertise is the path for most technology sets, funds must ask, what capabilities do we need internally to manage the strategic direction of our technology investments? What provides competitive advantage, versus what is commoditised? How funds attract and retain the right technology team can be challenging, and in the current market, increasingly expensive as scarce technology resources (for example, data scientists, solution architects, cyber security specialists) are in demand.
- **Approach** – How should we invest in technology enablement, including making the right choice of strategic partners, understanding and matching the funds' internal speed to market (demand, changing fund operation models, digitisation and digital operating models), and dealing with the external pace of change (member expectations, competitors, regulation)?
- **Risk management** – How do we manage and effectively report the increasingly complex risks of our use of technology, and how do we help stakeholders understand and balance these against other organisational risks?

Within the above challenges, funds are finding current hot topics being data (what do we have, what do we need?), picking the best third parties for long-term success, and managing the significant uplift in risk around cyber security and privacy.

Popular current technologies in the sector are Customer Relationship Management (CRM), data analytics (often as-a-service) and digital solution frameworks.

To summarise the current state of technology in the sector:

- all funds are increasing their investment in technology
- most funds are establishing strong foundations for future technology investment
- some funds are moving to more mature and sustained IT operating models but there still remains much to do.

> "Looking to the future, most funds would see their technology strategy comprising a balanced and timely investment in technology, with strong change execution aligned to the strategic direction of the fund."

Matt O'Keefe
Partner, Technology, KPMG

> "Developing a framework to effectively engage with start-ups (including FinTech and BioTech start-ups, accelerators, incubators and venture capital firms) can help position an organisation to remain competitive."

Kristina Craig
Director, Innovation & Digital Solutions, KPMG

Digital innovation

Digital disruption presents the industry's greatest threat and opportunity. Members are embracing digital channels and digital acquisition, engagement and advice models, whilst employees are embracing new ways of working.

Here are some of the emerging and exponential technology trends:

Platform business model innovation

- Platform business models have disrupted almost every industry – including retail, hospitality, transport, media and technology.
- Ecosystems have given rise to platform business models, through which organisations can create new revenue streams by connecting supply and demand. It extends the role of organisations in their customer eco-systems with adjacent products and services.
- Superannuation providers could build platforms and leverage network effects by moving beyond financial retirement outcomes towards providing services across health, aged care, leisure and experiences.

The rise of ambient computing

- Ambient computing is transforming customer engagement. It is intuitive, effortless, and immediate. This represents a broader shift to more natural interfaces that allow humans to remain present.
- Voice, gaze, gesture, touch and even thought are innovating the way that companies engage with their customers by creating contextual experiences.
- Triggering services and highly customised experiences delivered on demand anytime and across any channel. A customer can re-balance their portfolio from the couch, and explore products and services through gestures.

Artificial emotional intelligence

- Natural language processing, voice analytics and machine vision can form a 'passive' and real-time baseline of a member's experience.
- This becomes more powerful when it can interpret the emotional state of humans, triggering human interventions, or deploying chat bots that adapt their communications based on the emotional state of the user. This is referred to as affective computing.
- Affective computing could be applied to member education programs, which enable eLearning presentations to self-adjust based on whether the learner is bored, interested, frustrated or pleased.

Robotic Process Automation (RPA) – cutting repetition

- RPA has the potential to enhance operational efficiency. It could help those looking to provide a differentiated member experience through faster and error-free delivery of routine services.

- Applying RPA to middle and back office operations is key – for example account rebalancing, compliance and regulatory reporting, member on-boarding, and for engaging with and providing robo-advice to members.

Crypto-currency

- Crypto-currency has potential to disrupt transaction-heavy industries.
- Consumers have increasing investment preferences, and have a demonstrated interest in the market, therefore, the viability of offering members the ability to invest via superannuation may be worth exploring.

The path forward is collaboration

Given the relatively nascent use of technology within the industry, collaborating with the start-up community may be the optimal path to help address current business problems, rejuvenate culture or expand into future markets. Kristina Craig, Director, Innovation & Digital Solutions, KPMG says, "Developing a framework to effectively engage with start-ups (including FinTech and BioTech start-ups, accelerators, incubators and venture capital firms) can help position an organisation to remain competitive".

Responsible investing

Responsible investing (RI) is an investment approach that takes into account non-financial factors such as environmental, social and governance (ESG).

The five commonly used RI investment approaches include:

- **negative screening** – excluding specific industries such as tobacco, weapons, fossil fuels
- **positive screening** – investing in companies with positive ESG or sustainability performance relative to industry peers
- **ESG integration** – systematic inclusion of ESG risks and opportunities in the financial analysis
- **sustainability themed investing** – investing in industries such as clean energy
- **impact investing** – investing in organisations with the intention of generating a social and environmental return in addition to a financial return, which can range from below market to market.

The RI market continues to grow, increasing to $622 billion at 31 December 2016 representing approximately 44% of total assets under professional management in Australia.

Mark Spicer, Director, Sustainability Services, KPMG, says that RI is close to a business-as-usual method of valuing and selecting investments.

"One of the key detractors to RI growth has been the perception that RI options underperform the wider market. Our research indicates that the opposite appears more likely with the RI approach of incorporating ESG performance into investment decisions appearing to drive long term sustainable value and outperform equivalent funds. "

Mark Spicer
Director, Climate Change & Sustainability, KPMG

"Climate risks are foreseeable, material, actionable now, and distinctly financial in nature."

Geoff Summerhayes
Executive Board Member,
APRA

"Company directors who fail to properly consider and disclose foreseeable climate-related risks to their business could be held personally liable for breaching their statutory duty of due care and diligence under the Corporations Act."

Noel Hutley SC
President,
Australian Bar Association

"Fund managers are becoming increasingly confident in the link between ESG performance and value, members are increasingly seeking assurance from super funds that investments are 'doing no harm' and regulators are demanding better management of non-financial risks."

RI performance

KPMG's analysis of 49 super funds with greater than $5 billion in AUM shows the following key trends:

- 59 percent of super funds have shown their commitment to responsible investing by signing the United Nations Principles for Responsible Investment (UNPRI); and
- In a sample of 16 super funds who offer an RI option and where both whole-of-fund and RI fund performance data were available, average returns from RI funds for FY17 was 11.05 percent with a whole-of-fund return of 9.83 percent.

"One of the key detractors to RI growth has been the perception that RI options underperform the wider market," Spicer says. "Our research indicates that this is not the case. There is no need to sacrifice performance when investing responsibly. Instead the opposite appears more likely with the RI approach of incorporating ESG performance into investment decisions appearing to drive long term sustainable value and outperform equivalent funds.

"We expect that as information on RI and investment performance becomes more widely available and accepted, the number of funds with RI options in the marketplace will only increase."

Member demand

The second driver for growth is that investors are more likely to choose options that are consistent with their own values. Results of the recent RIAA consumer research[3] show that nine in 10 respondents expect their money to be invested responsibly and ethically. Four in five would consider moving their investments to another provider if their current fund engaged in activities not consistent with their values.

Spicer says, "Member responses, particularly those from millennials (under 35) are indicative of a key shift in societal priorities, awareness, and action. Public awareness and sensitivity to megatrends such as the impacts of climate change, water scarcity, and human rights, and a desire to align investment strategies with personal values or beliefs, is continually increasing."

Technological advancements and digitalisation of IT platforms are providing members with greater access to information. These advancements are also enabling members to quickly and easily change super funds and align investment strategies with their own personal values, and away from funds that have negative impacts on the environment and communities.

Reporting frameworks

The third driver of RI is the development and promotion of specific reporting frameworks, providing more accurate timely and comparable information to investors.

3. https://responsibleinvestment.org/wp-content/uploads/2017/07/Responsible-Investment-Benchmark-Report-Australia-2017.pdf

Company sustainability reporting and integrated reporting are providing greater insight into the impact of non-financial performance on overall company value. A good recent example is the Task Force on Climate-related Financial Disclosures (TCFD).

The financial implications of climate change are one of the most significant risks facing financial markets. Major organisations, however, are failing to adequately disclose their climate-related risks and opportunities. This lack of transparency has been identified as a key inhibitor of the financial markets pricing risk accordingly.

In response, the Financial Stability Board (FSB) set up the TCFD to consider the climate-related risks to organisations, and what constitutes effective financial disclosures of these risks. In June 2017 the TCFD released recommendations for increased disclosure around four key areas: governance, strategy, risk management, and metrics and targets.

Whilst the recommendations of the TCFD are voluntary, they represent best practice and are supported by companies (including Cbus Super), investors (Blackrock and Vanguard) and regulators (APRA[4] and the RBA[5]). Globally, over 240 companies with a combined market capitalisation of over $6.3 trillion have publicly committed to support the TCFD.[6] This includes over 150 financial firms, responsible for assets of over $81.7 trillion.

"The message is clear," Spicer says. "The regulator and policy developers are concerned about the stability of financial markets and hence are pushing for more transparency regarding climate-related risks and opportunities so that markets can price them accordingly."

As a result, the increased importance placed on ESG risk is flowing into more RI-style investments in the market, Spicer says.

"Boards not only need to understand these recommendations and how they impact their own superannuation funds, but they should be looking more widely to their own asset and fund managers and asking the same questions of them. What is your strategy for managing climate related risks, and what governance processes do you have in place?"

"Your company's strategy must articulate a path to achieve financial performance. To sustain that performance, however, you must also understand the societal impact of your business as well as the ways that broad, structural trends – from slow wage growth to rising automation to climate change – affect your potential for growth."

Larry Fink
CEO,
BlackRock

Case Study: Australian Ethical Super

Australian Ethical Super (AEI) is a purpose driven ethical super fund which invests based on its ethical charter. Below are a few fund performance results which highlight the financial benefits of an ESG focus. As shown below, AEI has managed to capitalise on the growing ESG trend, exponentially increasing its AUM and members over the last 2 years.

Membership 2016:	Membership 2017:		AUM 2016:	AUM 2017:	
26,342 members	35,352 members	↑ 34% growth	$1.032b AUD	$1.460b AUD	↑ 42% growth

4. http://www.apra.gov.au/Speeches/Documents/CPD%20Speech%2029Nov2017.pdf
5. http://parlinfo.aph.gov.au/parlInfo/download/committees/commrep/af4a01ce-cf3b-4e4e-a214-3522214a8e01/toc_pdf/Standing%20Committee%20on%20Economics_2018_02_16_5908.pdf;fileType=application%2Fpdf#search=%22committees/commrep/af4a01ce-cf3b-4e4e-a214-3522214a8e01/0000%22
6. https://www.fsb-tcfd.org/wp-content/uploads/2017/12/TCFD-Press-Release-One-Planet-Summit-12-Dec-2017_FINAL.pdf

Governance and trust

The 2018 Edelman Trust Barometer Report released in February 2018 showed a continuation of the downward trend in Australians' trust in all institutions that began in 2016.

"Super fund governance is in the spotlight. The scrutiny facing the wealth industry means swift action to triage reputational issues, followed by persistent efforts to build and maintain trust, must be a priority."

Mike Kaiser
Partner, Corporate Affairs Advisory, KPMG

"The results from the *2018 KPMG / AICD trust survey* revealed that almost half of directors reported that their board had to deal with issues that can affect trust in their organisation over the last year. A proactive approach is needed to build trust with key stakeholders."

Richard Boele,
Partner, National Leader,
Human Rights & Social Impact Services
KPMG

Like other industries, the Australian superannuation sector faces trust and reputation-related challenges. Financial services remains the least trusted business sector, both globally and in Australia. This has been driven by issues dating back to the global financial crisis, and has resulted in increased scrutiny and regulation.

Domestically, while we would expect the widely popular superannuation system to be somewhat insulated, the Federal Government's willingness to consider governance in the sector, and its inclusion of super funds in the Royal Commission's terms of reference, suggests this is changing.

As a result, super fund governance is in the spotlight. For retail funds, the departure of at least one of the major banks, and the greater scrutiny facing the wealth industry as a whole, means swift action to triage reputational issues, followed by persistent efforts to build and maintain trust, must be a priority.

For industry funds, the emphasis on governance from Government, the Royal Commission and the media represents an unprecedented reputational challenge, and further scrutiny and regulatory action on governance should be expected. In the context of declining membership and growth in contributions, existing and potential members across segments can be expected to become more engaged and literate. Aside from costs, performance, and governance, increased engagement will also mean more emphasis on ethical and environmentally sustainable investment portfolios, especially among younger members.

Adding to the challenges is a lack of policy certainty. Addressing the 'superannuation gender gap', whereby women retire with significantly lower (some estimates suggest 47 percent lower) superannuation balances than their male counterparts, will also be a key factor in building and maintaining trust.

When it comes to the role of superannuation in our economy and society, the debate is not over. As some funds look to expand into financial services, calls for the superannuation system's repurposing to help fund members with housing or education costs, or to bankroll investments in nation-building infrastructure, have not abated.

Australia's interlinked challenges of housing affordability and intergenerational equity are unlikely to be resolved in the near future, and will need to be addressed without undermining the superannuation system. This means that policy debate around taxation of superannuation will persist. The superannuation system shouldn't be off-limits in policy debate, but it is critical that the intent of the system remains clear: to provide income in retirement and reduce pressure on the age pension.

Conclusion

Whilst the majority of superannuation funds have continued to deliver strong outcomes in recent years, with double-digit returns and competitive fees, there is no doubt that competition is increasing.

With the outcomes of the numerous Government reviews and regulatory announcements, 2018 is likely to be a watershed year, with some material structural changes expected. In spite of ongoing oversight by regulators and greater competitive pressures, fund consolidation remains painfully slow – albeit we believe we may see an increase in activities given the changing regulatory requirements.

To ensure funds continue to demonstrate scale and are able to invest in new products and services, the management of operating costs will be crucial. Similarly, funds must find efficiencies, whether this be via automation, technological innovation or the streamlining of back office functions, to keep up with member needs, whilst continuing to use data analytics and segmentation in order to appropriately engage with their membership bases.

Similarly, the ongoing management of a fund's compliance and risk management obligations will be important given the media focus on financial services within Australia and globally.

KPMG looks forward to continuing to work with our clients to deliver industry best practice initiatives, which support the longer-term objective of delivering strong retirement outcomes for all fund members.

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