J.P.Morgan

The Future of Superannuation: A Shared Perspective

Foreword

It was no surprise to us when Australia was named as the most successful pensions market globally in 2022[1].

As the fifth largest market by funds under management[1], Australia's superannuation funds are responsible for building sustainable retirement outcomes for more than 16 million people. An industry that 35 years ago, managed $41 billion in assets, now manages a staggering $3.4 trillion[2].

In our first Future of Superannuation report, we proudly share the views of senior executives across the superannuation community, as well as results from an industry-wide survey we conducted in partnership with the Association of Superannuation Funds of Australia (ASFA).

We are incredibly grateful to the executives who have taken part in this report, who have shared their current challenges, areas of focus and the ongoing opportunities for the sector in delivering optimal results to their members.

The future of super will be shaped by many of the trends outlined in this report, and here at J.P. Morgan we will continue to play our part in supporting the Australian superannuation industry.

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Executive Summary

Australia's $3 trillion-plus superannuation industry is at a crossroads as consolidation, regulation, increasing member expectations and a new investment paradigm change the retirement landscape. These are the views of funds surveyed for J.P. Morgan's inaugural Future of Superannuation report.

In addition, the report includes interviews with 12 senior executives, from 11 funds, managing approximately $1 trillion in assets to gauge the qualitative reasons behind these seismic industry shifts.

Australia now ranks as the fifth[1] largest pension system in the world, impacting the retirement outcomes of more than 16 million people.

The changes underway will also affect the economy, with super reducing the government's Age Pension obligations while providing capital for public and private market investments.

Australia was the fastest growing pension market in 2021 at 17.9% in AUD terms, with average growth of 1.8%[1].

Australia's retirement industry is consistently ranked among the best in the world, but these survey results show there are challenges ahead if it is to continue delivering a better retirement lifestyle for all Australians.

The trends shared in this report will help shape the sector over the coming decades as the Australian superannuation industry's influence continues to have an ever-growing global impact.

Top Ten Takeaways:

01

Half of industry executives believe the pace of mergers, which is already at record levels, is set to accelerate over the next few years. Almost one-quarter believe there will be fewer than 50 funds by 2025, which would mean two-thirds of today's funds disappear.

02

There were 15 mergers or alliances announced to the market in the year to October 2021 – the most activity ever seen in a single year. If the number of funds declines to fewer than 75 over the next four years (by 2025), this could consistently result in 20 mergers or more a year.

03

About three-quarters (76.8%) of funds surveyed think the Your Future, Your Super (YFYS) annual performance test will result in more benchmark-like returns. This new pressure comes as future returns are also being impacted by rising inflation.

04

Almost two-thirds (64.3%) of survey respondents rated new regulation requirements as their biggest challenge over the next three years, above growing member numbers and delivering strong investment returns.

05

While funds are generally supportive that new regulations are driving best practice, they remain concerned about the associated impacts on costs, people, and overall outcomes to their members.

06

A significant number of survey respondents believe new regulation to act in members "best financial interests" will lead to reduced sponsorship (55.4%), corporate entertainment (42.9%), and advertising (37.5%).

07

A war for talent is underway as the sector tries to attract a broader array of skilled employees to support technology, data and automation activities. Almost one in three survey respondents (30.3%) rated attracting and retaining talent as one of their biggest challenges in the next three years.

08

Almost one-fifth (17%) of surveyed funds said they had more members switching to conservative options, such as cash, during the initial COVID-19 crisis than during the Global Financial Crisis (GFC) in 2008-09.

09

Funds are tackling this issue by increasing engagement with members through digital channels (69.6%) and producing more educational material (42.8%) to help members make informed decisions.

10

With increasing regulatory pressure, funds are investing in data transformation, automation, and AI/machine learning, to increase their efficiency.

The rise of mega funds

The $3 trillion-plus superannuation industry is undergoing a rapid rate of consolidation in response to new regulations and increasing competition. There were 174 Australian super funds as February 2022, according to ASFA[3].

Almost one-quarter of respondents to our industry-wide survey believe there will be fewer than 50 funds by 2025, suggesting that there is a strong chance of a record number of mergers still to come.

In 2021, there were 15 mergers or alliances announced to the market – the most activity ever seen in a single year. 2022's consolidation activity has already begun with February seeing the completion of the merger between QSuper and Sunsuper forming Australia's second largest fund; Australian Retirement Trust.

If the number of funds declines to fewer than 75 over the next four years as our survey suggests, two-thirds of today's funds would disappear, and the industry could consistently see 20 mergers or more per annum.

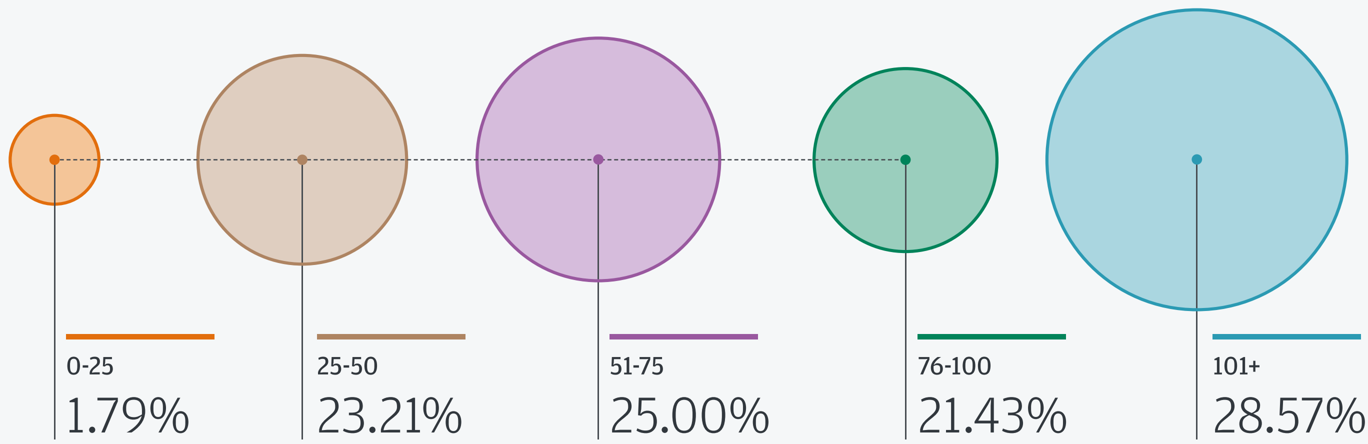
The creation of scale was cited as the number one reason to merge, but State Super Chief Executive Officer, John Livanas said that whilst larger funds are likely to dominate the market, size does not always equate to success.

"My sense is that, just like most markets that evolve to maturity, the top five to ten superannuation funds will end up with perhaps the majority of the investment market share. Then, absent regulatory constraints, it's likely that there will be a fairly long tail of much smaller funds," Livanas said.

While bigger funds bring economies of scale, Qantas Super Chief Executive Officer, Michael Clancy said it also created a new challenge.

"As many super funds are challenged to grow and to get even bigger, there is a chance that as member organisations, you have more members to care for, but you have less focus on each person," Clancy said.

How many funds do you think will exist by 2025?



There are multiple factors driving mergers. Almost one in three respondents (30.3%) rated pressure to merge as the biggest challenge facing funds over the next three years.

The main reason funds are merging is to increase scale (83.9%), according to the survey.

UniSuper Chief Executive Officer, Peter Chun said the fund believed scale was a significant driver of member benefits.

"Scale gives us a lot of those really strong investment opportunities," Chun said. "It also helps us generate greater surpluses and that enables us to pass on either fee reductions or enable us to invest in stronger capability for our members in areas such as digital."

Chun said the fund would continue to explore merger opportunities. The $105 billion fund was in talks to merge with the $11 billion Australian Catholic Superannuation in December 2021.

Larger funds, such as Aware Super, are building a pipeline of mergers to maximise the chances of smooth integration.

"One of the reasons I'm told we're a destination fund for some of the other funds to merge with is because we've got a track record now of getting the deal done, and delivering on the promise of benefits to members," Aware Super Head of Investment Strategy, Michael Winchester said. "For example, for the VicSuper members who joined us last year, we've been able to deliver a 20% reduction in administration fees."

However, HESTA Chief Operating Officer, Stephen Reilly said some of the smaller funds that do not merge could find a way forward with fewer members.

"Technologically advanced funds like HESTA are going to draw most of their scale from the cloud and from data automation. I think that the way we engage with members will be increasingly predictive-driven and we are going to be anticipating questions and engagement before the member even thinks to log in or pick up a phone. I think that our relationship with members will be more personalised, more contextualised, more social and instant."

The second most popular reason for mergers cited in the survey was to maintain long-term sustainability. The majority of super funds were in net cash outflow in 2019-20 according to industry data, which puts pressure on funds' ability to invest in long-term assets and manage risk.

What do you think are the main reasons funds are pursuing mergers?*

83.93%
To increase scale

58.93%
To maintain long-term sustainability

53.57%
Because regulators encouraged the merger

*Respondents were able to choose up to a maximum of 3 answers. Top 3 responses shown.

The benefits of mergers are not guaranteed, particularly if strategy and culture are not aligned. HESTA's Stephen Reilly said larger funds had to closely analyse whether a merger with a smaller fund would benefit their own members, given the lower cost of technology.

"If you're on a modern technology enhanced platform, you're able to tap into the economies of scale in the cloud, and that is going to make a big difference to your efficiency and responsiveness," Reilly said.

The third most popular reason survey respondents gave for mergers was regulator pressure. APRA has previously said that funds with less than $30 billion in assets will become increasingly uncompetitive against mega-funds.

However, it is unclear what the optimal number of funds and their size will be at the end of this round of consolidation, according to Mine Super Chief Executive Officer, Vasyl Nair.

"What would be helpful from a regulatory perspective, or even a government perspective, is what are we actually driving towards? All we know right now is that we're being told to just drive in this particular direction at a certain speed in a certain way, but we haven't been told where we're going," Nair said.

The impact of regulations

Meeting new regulations is rated as the biggest challenge funds are facing over the next three years, according to 64.3% of survey respondents.

Telstra Super Chief Financial Officer, Executive General Manager, Strategy, PMO & Investment Operations, Paul Curtin, said it was placing huge demands on funds.

“The amount of change in regulations is certainly something that’s a real challenge for funds at the moment in terms of resources and in the way we collect, analyse and report our data,” Curtin said.

HESTA’s Stephen Reilly said legislative changes will lead to more advertising, despite the “best financial interests” regulation.

“The new regulations will almost certainly result in more advertising, not less, and this will clearly be in their members’ best interest. Because funds will need to compete for members to protect their scale and they will not be able to leverage the previous employer-based distribution model, which was more efficient and tailored to the common needs of very large member segments.”

In your view, what are the top challenges facing funds over the next three years?*

64.29% Compliance/ Meeting new regulations

53.57% Retaining or attracting new members

51.79% Net investment performance

*Respondents were able to choose up to a maximum of 3 answers. Top 3 responses shown.

Super industry adapts to new regulations

The governing regulations for the superannuation industry have gone through a myriad of changes over the past few years, however recent changes have gone even further, shifting the foundations of the entire system.

The Your Future, Your Super (YFYS) reform package came into effect on July 1, 2021, and has mandated a suite of changes aimed at raising efficiency, transparency and accountability.

The most high-profile change is the annual performance test APRA now applies to MySuper products. Funds that underperform over the long-term will be required to inform members and, if they underperform the following year, will be barred from accepting new members.

Other key changes include super account stapling when workers change jobs to cut down on inadvertent multiple accounts, while trustees’ obligation to act in members’ “best interests” has been changed to “best financial interests” to ensure fund activities continue to meet the sole purpose test in providing retirement benefits.

New design and distribution obligations (which do not apply to MySuper funds) are placing new restrictions on funds to stop potential mis-selling of products. Portfolio Holding Disclosure laws, which require funds to publish their underlying portfolio holdings to improve transparency and empower members, began on January 1, 2022.

Meanwhile, APRA’s Superannuation Data Transformation project is placing new data collection demands on funds. APRA is collecting more granular data about fund activities, as well as information about choice and investment products. The Australian Tax Office (ATO) has also become more involved in data collection in recent times.

The wide impact of regulation

The impact of regulation is far reaching with survey respondents citing cost increases across infrastructure (e.g., technological and system changes); governance and disclosure, including design and distribution obligations (DDO); and resources for activities (e.g., compliance, training, updating procedures, testing).

However, funds also believe the range of new regulatory assessments, and greater transparency will drive positive benefits, according to the survey.

APRA's Superannuation Data Transformation will impact members in a number of ways. In your view, what are the top considerations?*

62.50%
Increased costs

51.79%
Increased transparency

37.50%
Standardised industry best practice

*Respondents were able to choose up to a maximum of 3 answers
Top 3 responses shown.

Survey respondents believe the APRA Superannuation Data Transformation project will increase costs (62.5%) but also bring benefits such as transparency (51.79%) and accountability (37.5%).

Telstra Super's Paul Curtin said the impact of the APRA data requirements had largely flown under the radar given the amount of change the industry was adapting to.

"The recent APRA reporting requirements have added more complexity," Curtin said. "It's added to inconsistencies in what funds are reporting to APRA. There's a lot of clarification still required in this area and it's taking up quite a bit of resourcing within the funds."

Portfolio Holdings Disclosure

Almost four-in-five survey respondents (83%) said portfolio holdings disclosure (PHD) will not be an accurate or useful measure for fund members to make decisions, while three-in-four (75%) think it will not be in members' best financial interests.

Funds were evenly split about whether it will negatively impact their Strategic Asset Allocation (SAA).

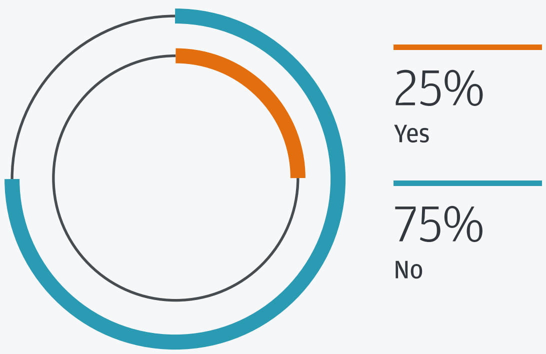
PHD laws began on January 1, 2022, after several years of delays following industry concerns about whether it would jeopardise commercially sensitive deals involving large individual infrastructure, property or private equity assets. However, the final regulation met this concern by allowing for a range of assets to be disclosed on an aggregate basis.

Super fund members and investors will now be able to see all of the assets their fund holds at June 30 and December 31 each year[4]. Funds will publish this information on their website within 90 days. Large funds such as AustralianSuper have already been voluntarily publishing this information for some time.

"We were the first out with portfolio holding disclosures which is now part of the regulation," AustralianSuper Group Executive Finance & Operations, Peter Curtis said.

"There's nothing we've seen in the regulation which is going to inhibit us from the overarching strategy of improving the retirement outcomes for our members. It just continues to make the system better for everybody," said Curtis.

APRA's Superannuation Data Transformation will impact members in a number of ways. Do you think the receipt of this information is in the members' best financial interests?



Best financial interests

The new requirement to act in member's best financial interests (rather than "best interests") looks set to have a major impact on industry funds. It requires trustees to justify the costs and benefits of all actions, and to demonstrate that the anticipated financial outcome is in the interests of members.

Survey respondents said funds will consider reducing sponsorship (55.4%), corporate entertainment (42.9%), and advertising (37.5%).

Cbus Chief Investment Officer, Kristian Fok said the legislation would force a rethink about procurement processes and could dampen innovation.

"There's no threshold amount, so you need to have a process around every small thing because it could at some point in the future be deemed to be non-compliant – that reverse onus of proof does make for a lot of red tape," Fok said.

"The regulatory requirements require a different level of capability, resourcing and alignment with good processes and technology because you just can't keep throwing bodies at the problem to report. You need to industrialise the way that super funds work."

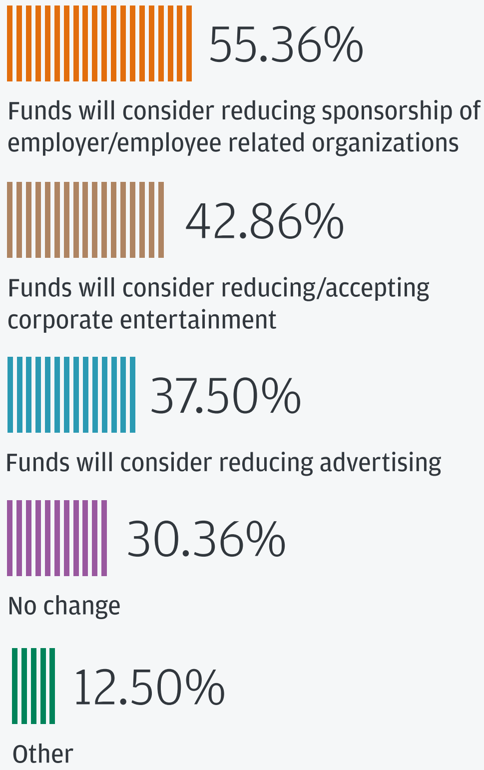
Australian Retirement Trust Chief Executive Officer, Bernard Reilly, said funds would need to clearly measure the payoff from its activities. "You really need to have a clear return on that investment for the financial benefit of members. Those metrics around how you measure are really critical."

Mine Super's Vasyl Nair said the legislation doesn't mean you can't spend money, it just has to be more targeted.

"Even though there's a significant amount of additional overhead associated with managing these frameworks and structures, having people think about the expenditure, and tying it back to member interest can only be a good thing," according to Nair.

Colonial First State Superannuation Chief Executive Officer, Kelly Power said the member best financial interest legislation would work well with the stapling legislation, as stapling may prompt some funds to increase advertising expenditure to win new members to drive growth and reduce fees paid by existing members.

New regulations have changed the requirement for funds to act in 'members' best interests' to 'members' best financial interests'. What impact do you think APRA's Best Financial Interests Duty will have on funds?



"The potential to spend a lot of money on that, and the cost that creates for the industry and members, that's a real a possibility," Power said.

However, the best financial interest duty makes it clear to all super funds, retail, which may be funded through investment by a parent group or shareholders, or industry funds, where costs are more directly funded by members.

"Regardless of who is funding investments or expenses, the key is to ensure the fund is acting in line with the guidance around expenditure and meets the regulator's expectations," Power said.

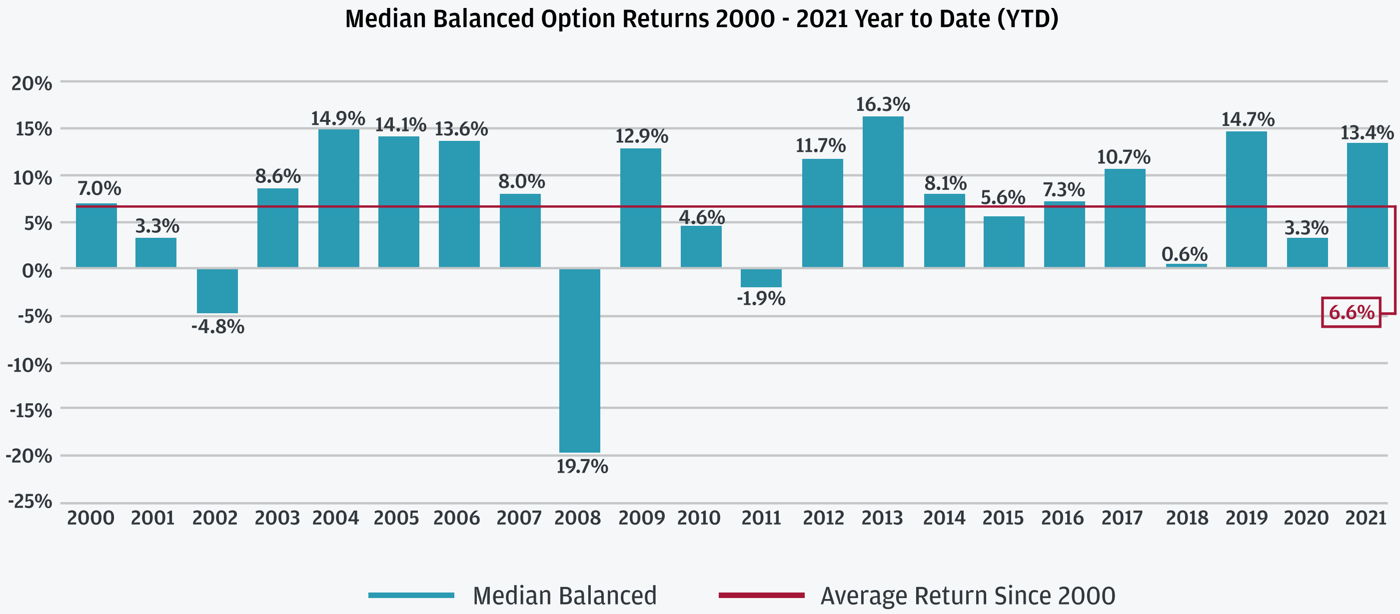
Investing

The investment return challenge

Generating strong net investment performance was rated as the third biggest challenge facing funds over the next three years (51.8%), according to the survey (see page 9).

This is despite the median balanced investment option posting a 13.4% return in calendar year 2021, according to SuperRatings[5].

Over the past 21 years, funds have only posted an annual negative return in three instances (calendar years 2002, 2008, and 2011). The average annualised return of 6.6% has slightly outpaced most funds' objectives of outperforming inflation by at least 3% over rolling 10-year periods.



Most major asset classes have been boosted by supportive monetary and fiscal policy since the 2008 Global Financial Crisis, which accelerated into new territory since the advent of COVID-19 in 2020.

However, new challenges could be on the horizon as inflation has climbed, prompting central banks around the world to raise rates and curtail quantitative easing policies (such as purchasing government bonds and other assets) and begin raising rates. U.S. inflation recently hit its highest level in 40 years.

"I think the investment environment is going to be increasingly difficult going forward," according to Cbus' Kristian Fok. "So our ability to generate returns in a manner that has occurred over the last decade is going to be much harder, particularly if you've got this situation where we've got ultra-low interest rates and now inflation that's coming through."

The Reserve Bank of Australia cut its cash rate from 4.75% in November 2010 to a record low of 0.10% in November 2020. However, J.P. Morgan Chief Economist Ben Jarman said it expects the RBA to hike the cash rate in late 2022.

"Our U.S. colleagues expect the Fed to hike the policy rate at the next nine consecutive meetings," Jarman said. "If these forecasts are realised the RBA-Fed policy spread will diverge to historic extremes, though will begin to narrow again in 2023."

The Bank of England, Bank of Korea, and Reserve Bank of New Zealand had already lifted rates by early February 2022.

New benchmarks may challenge returns

While generating healthy investment returns may be more challenging in this environment, about three-quarters of funds surveyed think the Your Future, Your Super (YFYS) annual performance test will result in more benchmark-like returns.

Funds that consistently underperform will be prevented from enrolling new members, who are initially informed of the underperformance via email or letter.

Mine Super Chief Investment Officer, Seamus Collins said most funds in the industry are well ahead of the benchmark, which means it will have little impact on the majority.

"If funds are close to the to the boundary, they're probably going to take less risk, because it's a very punitive benchmark," according to Collins. "There'll be a cohort of funds that will consider active risk and it's probably more benchmark-aware than benchmark-hugging."

Aware Super's Michael Winchester said it would be difficult for funds that weren't top performers to attract members.

"If you're not a top performing fund, you're going to face an uphill battle to convince members that they should choose you," Winchester said. "From my perspective, it seems likely that the best performing funds are probably going to be those that take an active approach to investing. I'd say benchmark hugging might be a viable strategy for some funds, maybe to buy time, but I don't think that's how you win."

Thirteen of the 80 MySuper products, which held $56 billion in retirement assets, failed the first performance test in 2021.

The composition of the indices in the benchmark has also been criticised.

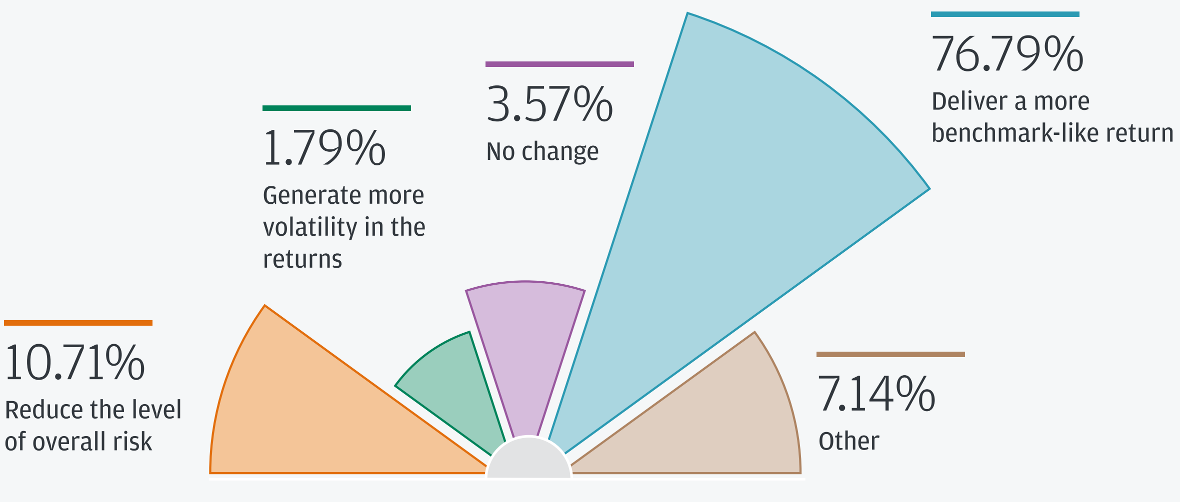
UniSuper's Peter Chun said the low rate of return on some asset classes included in the performance test could be an issue.

"Benchmarking against some of these generic indices can be quite problematic because they don't necessarily deliver to the member outcome we're looking for," according to Chun. "It may mean over time that the exposure to some of those defensive equities may fall because we will have greater basis risks." It could also affect UniSuper's $13 billion in ESG thematic funds once the performance test is applied to other investment options beyond MySuper, he said.

State Super's John Livanas said the fund's average member was about 55 years of age and were in defined benefit products, which made the sequence of returns more important than for younger members in accumulation funds. Its impact on actual returns received by members may not be reflected in MySuper benchmarks.

"We are generally careful about how we utilise benchmarks to assess our fund performance," Livanas said. "In the case of our funds, their negative cash flow impacts performance, with volatility becoming a key determinant in the dollars a member will see on exit. For example, a negative cashflow fund with a lower percentage return can actually provide a greater dollar return if this fund also has a much lower volatility."

The Your Future, Your Super (YFYS) legislation applies a performance test to funds.
What do you think the long-term impact of this legislation will be on funds' asset allocation?



Insourcing investments

Almost two-in-three surveyed funds (62%) believe the insourcing investment trend is being driven primarily by cost reduction. It allows funds to spread largely fixed investment management costs across their growing funds under management, whereas external managers tend to charge a flat percentage based fee.

AustralianSuper's Peter Curtis said the fund expected to go from about 44% internally managed to 60%.

"If we were trying to run the fund on a fully outsourced model at our size, then we would be a much more expensive proposition to members," Curtis said.

The fund saved about $200 million in the last financial year due to running internal teams and $750 million since it began the program in 2013, he said. Funds such as AustralianSuper that have built extensive investment management experience are now also opening international offices as they increasingly invest offshore.

Australian Retirement Trust's Bernard Reilly said funds considering insourcing should first understand what their competitive advantage is. Reilly said some of the strengths of his fund, are its strong cashflows and ability to partner[6].

"It's an ongoing and open discussion at the moment for us but it's not a straightforward answer of just because you get bigger you take more in-house," Reilly said.

Mine Super's Seamus Collins said insourcing was a risk for funds and required scale and time to pay off.

"It's a big fixed cost in people, but it's also a cultural cost in how you remunerate staff, and a huge uplift in risk frameworks and oversight and compliance."

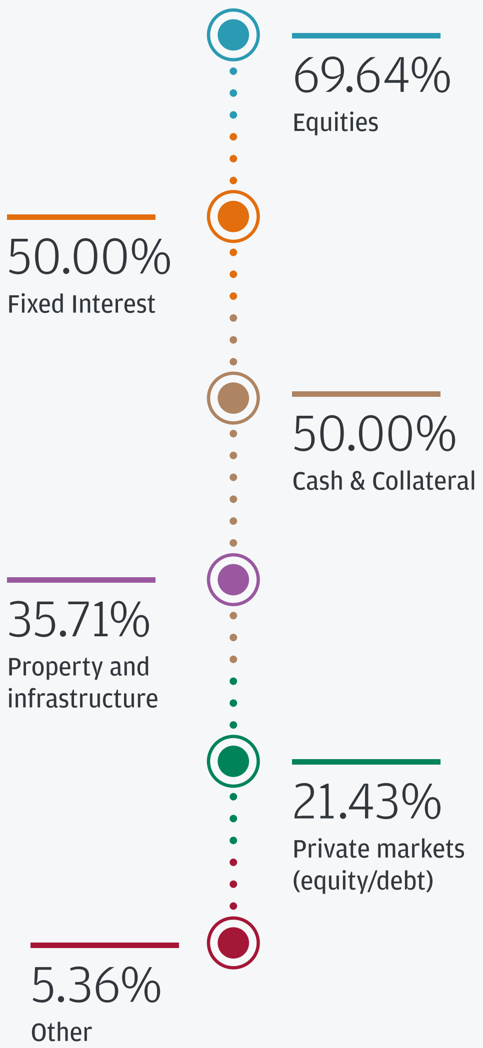
Many funds that began insourcing began with cash and Australian equities. The survey results show there is now a wider range of asset classes being insourced, suggesting funds are building significant internal expertise to invest in complex assets.

AustralianSuper's Peter Curtis said it had started its insourcing program in 2013 by targeting the most expensive asset classes.

"Over time, we've expanded across all the asset classes where we invest. As the capability grows, your ability to bring on other strategies just becomes easier because you've got the scale, and you've got the basic systems and infrastructure in place."

AustralianSuper managed 44% of funds internally at June 30, 2021 including Australian and international shares, private equity, property, infrastructure, credit, fixed interest, cash, currency overlays, and reserves[7].

When funds consider insourcing investment management, which asset classes are they most likely to manage in-house?*



*Respondents were able to choose up to a maximum of 3 answers.

Funds endorse climate change battle

Environmental, Social and Governance (ESG) factors are increasingly being incorporated into funds, which are adopting net zero carbon emission targets. Only 10.7% of survey respondents said funds should not adopt a net zero position.

Australian Retirement Trust's Bernard Reilly said about half of member questions at Sunsuper's annual meeting were on ESG issues[6].

"As well as it being a societal problem, it is an investment problem," Reilly said. "If we think about the cost of capital for some of these organisations, critically, their cost of capital is going to go up, their potential returns in either the short term or longer term can be impacted."

AustralianSuper's Peter Curtis said the fund was committed to achieving net zero carbon emissions across its portfolio by 2050. It has been measuring the carbon footprint in the listed equities portfolio since 2013, the fixed interest portfolio from 2018, and is now looking at property and infrastructure portfolios.

The proportion of asset owners practising responsible investment practices rose to 42% of total superannuation assets in 2021 from 28% in 2019, according to a report by the Responsible Investment Association of Australasia[8].

Funds are increasingly engaging with portfolio companies rather than divesting as they transition to net carbon zero. Cbus' Kristian Fok said the fund wanted to work with companies undergoing that transition.

"Our view is to be aware of transition risk, but not to de-fund companies that are willing to transition their business," according to Fok. "So you might find a little bit of variability in our carbon exposure from time to time. We're actually investing money to transition the business. I think that's the key thing that we're looking at."

48.21%

of respondents believe funds should be committed to a net zero target

ESG goes mainstream

Environmental, social and governance (ESG) principles are changing the way asset owners value their investments as regulators, markets and members push for greater change. J.P. Morgan Head of Australian Research, Australian Equity Strategy & ESG, Jason Steed, said tackling climate change is the fastest growing sustainability theme although all ESG factors are now being integrated by investors.

"The focus on ESG integration is up significantly across the fund management industry as a whole and that's very encouraging," he said.

A more integrated ESG approach (where investors encourage change through greater engagement), is now more popular than negative screening (where investors exclude companies such as high emitters of greenhouse gases), according to J.P. Morgan research.

This included encouraging companies in their portfolios to transition to cleaner energy as the world attempts to reach net zero carbon emissions by 2050.

Close to 10% of total economic value could be lost by 2050 if climate change continues its current trajectory, according to the Swiss Re Institute[9]. Local regulators such as APRA have made it clear that financial institutions can no longer ignore climate change.

Meanwhile, super funds have long been advocates for better governance, publishing their proxy voting records on their websites. Social issues are also increasingly on the agenda, such as improving diversity, while modern slavery laws have recently prompted funds to investigate supply chains.

Member Centricity

Investment switching still an issue

About 17% of surveyed funds said they had higher levels of member switching during the initial COVID-19 crisis than the during the GFC in 2008-09.

However, other evidence suggests switching levels varied significantly between funds.

Super funds increased their cash holdings by about $51 billion over the March 2020 quarter. About half of that was caused by members switching into cash, according to the RBA[10].

That increase in cash was the equivalent of around 1.5% of funds under management, although some large funds recorded flows of 3-4% into cash and one medium-sized fund recorded 8%.

Aware Super's Michael Winchester said only around 2.7% of the fund's members switched during the initial COVID-19 crash in 2020, however they were older and had higher balances. "Members over the age of 55 were around three times more likely to switch than the average," Winchester said. "And we know from the GFC experience that members who switched during a period of market volatility, they're very unlikely to switch back and this can have a really significant impact on their retirement outcomes."

Around two-thirds of Aware Super members who switched during COVID were still in the more defensive option six months later. They have missed out on the significant market upswing. Aware Super's analysis shows that about 15% of the money spent by retirees during the pension phase comes from the investment earnings during retirement.

The bulk of switching across the industry occurred when investors were not receiving financial advice.

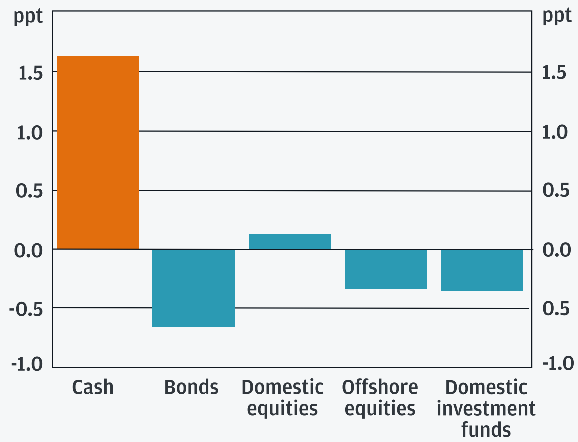
Colonial First State's Kelly Power said they saw an increase in switching to cash as well as investors asking questions about their super.

"Typically, it was in the non-advised products where members are no longer advised or not advised, because they would be responding to what they're reading in the press or what they think is happening in markets. Whereas in the advised space they typically call their financial planner."

Cbus' Kristian Fok said the fund had more members with larger balances than during the GFC, and members felt the impact more directly as they struggled with lockdowns.

Superannuation Funds' Financial Flows

Change in share of total assets, over March quarter 2020*



*Excludes valuation changes; direct-holdings only

**Shares and other equity issued by non-money market financial investment funds plus net equity of pension funds in life office reserves

Sources: ABS: RBA[10]

You've got technology, which makes switching easy, so we saw a lot more switching," according to Fok. "And then on top of that, you had a change in the regulations to allow people to access their money." Cbus saw more than $500 million switched to cash in one day just as the market hit its lowest point.

Qantas Super's Michael Clancy said the fund's switching levels were similar to levels during the GFC and other crises. "I think we need to continue to work to improve financial capability in the Australian community because retiring is a complex affair," Clancy said.

State Super's John Livanas said the fund never went into negative territory through the COVID crisis and it particularly manages risk given its defined benefit obligations.

"We need to manage the tail risks thoughtfully. To do so, we need to understand the evolving risks in the portfolio that may arise as a result of unexpected market conditions. We manage these risks through a combination of derivatives and asset allocation changes," Livanas said. "We also use machine learning or AI to provide another perspective on short-term market behaviour."

Just over 80% of survey respondents said funds will engage with members differently by producing more educational material. They also plan to communicate more frequently.

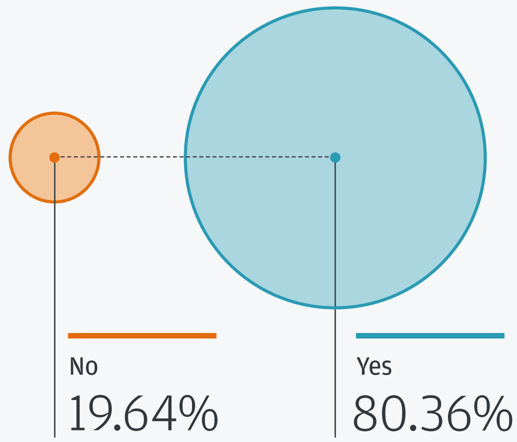
HESTA's Stephen Reilly said a key post-COVID lesson is how to use language to help members make good financial decisions. "I think that's the biggest learning from COVID: how do you translate all of the confusion, all of the chaos, all of the pressure into something that helps a member feel more comfortable and confident that their money is in the right place?"

Most funds were inundated with member queries during the COVID downturn, which was exacerbated by a new super early release scheme. Members withdrew about $35 billion in super, according to APRA.

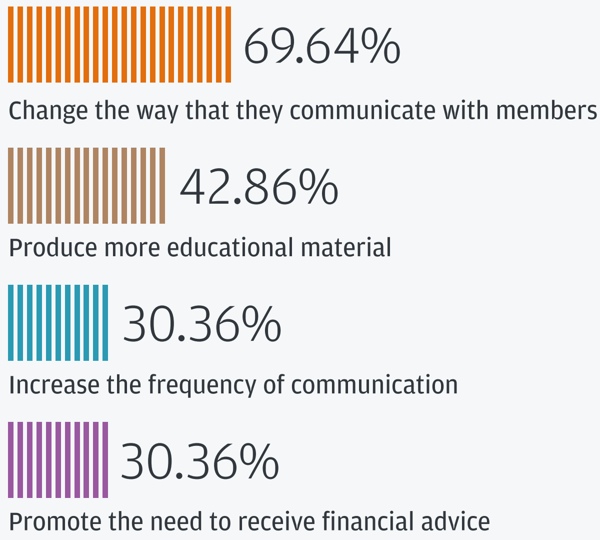
Australian Retirement Trust's Bernard Reilly said prior to their merger with QSuper, Sunsuper had a more engaged member base among over 50s. About 10% of member interactions are now coming through its live chat facility which has doubled since pre-COVID. Online access for employers and advisers has nearly doubled from 12.5% to 22%.

"We're monitoring that to see whether it is sustainable, and that we've also got the right tools online for members to be able to access that," Reilly said. "It's not just young members who are using that service. Older people – and I put myself in that category – are now digital savvy."

Do you think funds will engage with members differently following the COVID-19 pandemic?



If yes, how?



Helping members make informed financial decisions

Low levels of financial literacy are correlated with a range of negative financial outcomes such as short-term saving plans and low super balances.

While raising financial literacy remains an ongoing challenge, financial education will play a key role.

U.S. Army personnel enrolled in a mandatory eight-hour financial literacy course found participants then cut their debt and had better financial outcomes[11].

Qualitative research completed for Super Consumers Australia also found that people wanted help making better decisions. "Financial advice and guidance may be more likely to improve decision making," according to the recent Retirement Income Review.

Yet only about one-quarter (26%) of 55-64 year olds seek financial advice at retirement, according to Adviser Ratings. A range of super funds are now expanding their advice services including building low-cost digital advice channels, given the cost of advice is the most often cited barrier.

Technology and automation

With increasing regulatory pressure, funds are finding new ways to increase their efficiency and innovation. The top three areas are data transformation, automation, and AI/machine learning, according to the survey.

Automation is being used to remove manual touch points across the industry and to make portfolio rebalancing more efficient. However, an ongoing key challenge for the industry is to amalgamate multiple data sources from providers, creating a consistent source of data to provide a better view of the portfolio. Most funds said they had 6 to 10 data sources.

"The whole data landscape is just getting increasingly difficult to navigate with the volume of data available today," according to AustralianSuper's Peter Curtis.

UniSuper's Peter Chun said it was using chatbots to help fulfil lower value member requests such as password resets. AI was being plugged into its systems to help contact centre staff provide better responses to members; and it was piloting technology to prompt members to take personalised actions.

"I think being a large fund enables us to really leverage technology and try some of these things which other industries such as banks, for example, have done really well that I think super funds can definitely apply," according to Chun.

Australian Retirement Trust's Bernard Reilly said it planned to put members into different cohorts and use AI to anticipate their behaviour and serve them better. "It can be competing challenges trying to keep your costs low and increase the service to your members so we've got to try and see if there's a way we can use technology to help us achieve that," Reilly said.

Colonial First State's Kelly Power said technology is also set to play a role in bringing financial advice to investors with lower levels of savings, but advisers would always be required. "I don't just think it's one particular piece of technology that addresses the need for financial advice – I think it's the whole kit. Sometimes it's really tough, particularly when we're talking about your life savings or retirement, just to give that over to a computer without having someone you can call or someone you can talk to, having a strength of brand that you can count on. That's why financial advisors will always have a key role to play."

In terms of efficiency and innovation, where are funds deploying their efforts?*

73.21%
Data transformation

69.64%
Automation

21.43%
AI/machine learning

*Respondents were able to choose up to a maximum of 3 answers. Top 3 responses shown.

Funds employ technology to create more efficient workflows

Complex financial services businesses such as super funds typically rely on multiple IT systems. These produce manual touch points (MTP) where staff need to format data so that it can flow between systems.

For example, one J.P. Morgan super fund client racked up 2.29 million MTPs in less than one year, with 82% produced by just three systems out of a possible 23.

After a review, the fund launched multiple initiatives, which cut their MTP score by 234,000. This creates more efficient and accurate workflows, freeing up staff to work on higher value-add activities.

Funds are also shifting from moving data between Excel spreadsheets and email, replacing these manual processes with more secure, dedicated software solutions. Data from multiple sources is being centralised within funds while data visualisation tools are allowing for deeper analysis.

People

Aware Super's Michael Winchester said there were challenges ahead in the war for talent. "We expect to see increasing competition for staff in tech, for example, and across investments. Something we're keen to drive proactively is the entry and re-entry of more women in the sector, particularly in middle management and senior roles."

State Super's John Livanas said Australia has a shortage of people with a background in STEM skills.

"There is a massive shortage of people interested in and studying STEM. And yet technology is creating the future, and creative innovation more than likely requires STEM skills. Our people also need to understand what technology is capable of and how it can transform the future, and importantly, which companies and which countries will provide the fertile environment to allow this to happen. Without this understanding, it becomes harder to choose which technology, which company and which country to invest in."

Flexibility has also become standard across the industry in the wake of COVID-19 although all funds are still exploring exactly what forms flexibility will take.

"We've had a number of staff move interstate during COVID and are currently working remotely. As we return to working in the office in some capacity, we will need to work with staff to develop acceptable ways of working with the best outcomes for the organisation and the staff, " Curtin said.

UniSuper's Peter Chun said the expected "great resignation" – where masses of people leave their jobs after fatigue and burnout following pandemic lockdowns – is more likely to be a "great realignment".

"Employees are now thinking about who they want to work for, it's much more about that full life experience – companies that have a deep purpose, life balance and true flexibility," according to Chun.

UniSuper is seeing huge demand for staff across technology, risk and ESG roles.

30.3%

of respondents rated attracting and retaining talent as their biggest challenge in the next three years.

Conclusion

J.P. Morgan's inaugural Future of Superannuation report shows the many challenges and opportunities that funds are facing, which will reshape the industry.

It comes after another year of strong returns despite funds grappling with economic and investment uncertainty following the COVID-19 pandemic; a renewed public focus on the sector; and a host of new regulations.

Yet the way funds have adapted to these changes while ensuring members best interests are being met is cause for optimism.

Funds are now merging at an unprecedented pace under regulatory scrutiny and new mega-funds are emerging. Some are insourcing investment to lower costs and increase control while ESG factors are reshaping portfolios and investment considerations.

While most funds have outperformed their long-term benchmarks, they now face an uncertain investment environment characterised by rising inflation.

A war for talent is underway as the sector tries to attract a broader array of skilled employees to support technology, data and automation activities as well as investment specialists.

This report shows the innovative ways funds are tackling these seismic shifts to maintain Australia's enviable position as one of the strongest retirement systems in the world.

Funds have built a strong record of delivering results that improve Australians' retirement over decades.

As Australia's largest custodian, J.P. Morgan will continue to support the industry as superannuation funds navigate through this new paradigm and deliver enhanced retirement outcomes for all Australians.

Footnotes

[1] https://www.thinkingaheadinstitute.org/research-papers/global-pension-assets-study-2022/

[2] https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/0910/ChronSuperannuation

[3] https://www.superannuation.asn.au/ArticleDocuments/402/2202_Super_stats.pdf.aspx?Embed=Y

[4] https://www.allens.com.au/insights-news/insights/2021/11/portfolio-holdings-disclosure-regulations-key-aspects-of-the-revised-regime

[5] https://www.lonsec.com.au/super-fund/2022/01/25/super-funds-deliver-400-billion-windfall-to-members-in-2021

[6] The interview was conducted before the merger of Sunsuper and QSuper was finalised to create the Australian Retirement Trust.

[7] https://www.australiansuper.com/superannuation/superannuation-articles/2021/10/2021-annual-report

[8] https://responsibleinvestment.org/resources/super-study

[9] https://www.superannuation.asn.au/ArticleDocuments/270/211001_ASFA_Climate_Change_Paper.pdf.aspx?Embed=Y

[10] https://www.rba.gov.au/publications/fsr/2021/apr/pdf/box-c-what-did-2020-reveal-about-liquidity-challenges-facing-superannuation-funds.pdf

[11] https://econpapers.repec.org/article/eeejeborg/v_3a95_3ay_3a2013_3ai_3ac_3ap_3a159-174.htm

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