Mergers and Megafunds: The Superannuation Landscape in 2024

Morningstar Manager Research
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Executive Summary

Australia's superannuation system, often called "super," stands out as a global success in retirement solutions. Fueled by over three decades of compulsory employer payments, the sector's rapid growth has led to it playing a pivotal role in the Australian economy and, increasingly, in global capital allocation.

However, challenges persist. While consolidation has enhanced scale and efficiency, regulatory pressures remain ever-present and fresh hurdles continue to emerge. The quest for superior returns and peer outperformance has led to a shift toward diverse asset classes and geographies. For members, super is a long-term commitment; investment decisions made today will impact retirement decades later. Choosing a fund that balances robust returns with competitive fees can make a substantial difference to financial outcomes at retirement.

This landscape paper delves into the current state of the Australian superannuation sector, tracing its evolution and highlighting contemporary trends. It also highlights the importance of evaluating the forward-looking investment merits of super funds and key factors that matter through a member lens.

Key Takeaways

- Regulatory Performance Testing: Recently introduced super fund performance tests reflect the growing emphasis on improving member outcomes, which can be enhanced with forward-looking analysis.
- Decline in Number of Funds: The super industry has experienced a sharp, sustained two-decade decline in the number of funds. Despite a quadrupling in assets since 2004, over 90% of funds have departed the sector over that period.
- Rise of "Megafunds": Several funds have eclipsed A$100 billion in assets, with a trillion-dollar fund a real possibility in the 2030s. This is a double-edged sword; while megafunds can lower costs and better access nontraditional asset classes, they also face capacity and investment process challenges.
- Concentrated Net Fund Inflows: Strong net inflows can support long-term viability but are concentrated within a few large industry funds, which must absorb and deploy billions in net flows each year.
- Good Governance Matters: Funds face close regulatory scrutiny. Industry funds—many of which retain close ties to their industry patrons—must evolve to ensure their boards and leadership are well-placed to implement good governance and cater to a broad cross-section of Australian society.
- Transparency in Unlisted Assets: Sectors such as infrastructure and property are long-standing components of profit-to-member fund portfolios but require higher transparency given their opacity.
- Insourcing and Offshoring: While funds are increasingly insourcing investment functions, all APRA-regulated funds use external managers and nearly all profit-to-member funds engage asset consultants. Insourcing can lower costs but may not always compare favorably with external managers.
- It All Adds Up: Performance and fees are good starting points for members evaluating their super fund, but a number of additional factors matter, including the quality of the fund's people, the ability of its investment process to balance scale and investment nimbleness, and its governance.

An Introduction to Super

Short History, Large Impact

Historically the preserve of government and trade union-negotiated remuneration agreements, superannuation went mainstream in 1992 when employer contributions became compulsory for the broader Australian workforce. Designed to reduce an aging population's reliance on the government-funded pension, it started at 3% of worker pay and has steadily increased, reaching 12% in 2025.

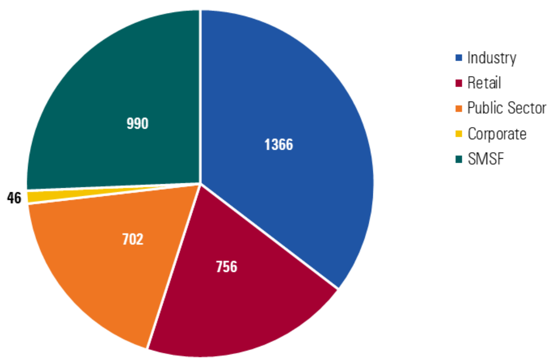
Buoyed by rising employer contributions and concessional tax treatment, sector assets have soared from A$150 billion in 1992 to almost A$4 trillion by mid-2024; some forecasts predict this could rise to A$9 trillion by 2040. The super sector is now among the five largest pension pools in the world—an impressive feat given that Australia's population is outside the top 50 countries globally. Super assets exceed Australia's annual gross domestic product by around 40%, represent one fifth of household wealth, and account for 80% of the local managed fund industry's assets. In short, the sector matters a lot—to households and the Australian economy as a whole.

The super industry can be split into two main fund types: regulated funds and self-managed super funds, or SMSFs. A third category, exempt public sector funds, represents a much smaller segment.

Regulated funds are overseen by the Australian Prudential Regulatory Authority, or APRA. There are over 60 licensees with a combined A$2.7 trillion in assets—around 70% of sector assets— managing the super of over 90% of the population with superannuation balances. They can be split further into:

- Profit-to-member funds, representing the majority of APRA-regulated funds, which do not seek to generate a profit to shareholders. They can be divided into:
    - Industry funds: the largest segment by assets, many industry funds trace their roots to trade unions and/or employer groups affiliated within certain industries.
    - Employer-sponsored funds, or corporate funds: Established by employers and exclusively open to their workers and families.
    - Public-sector funds: run by government entities and only open to public sector workers.
- For-profit funds, also known as retail funds, which aim to generate profits to shareholders. Often managed by financial institutions, they offer an extensive menu of investment choices via platforms.

Exhibit 1 Superannuation Segments by Size (A$ billion)



Source: APRA. Data as of June 30, 2024.

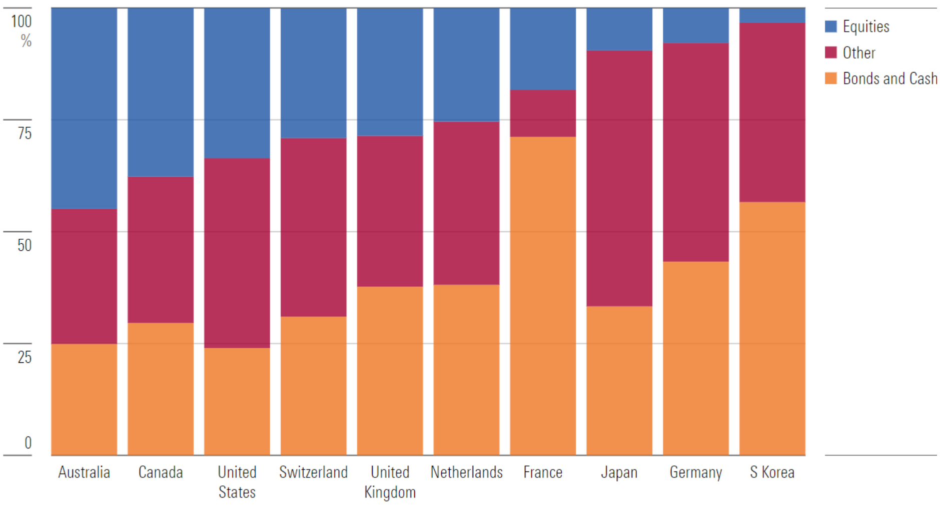
SMSFs are regulated by the Australian Tax Office, or ATO, and represent around one quarter of sector assets. These funds are managed by individuals for themselves and up to five other members. The individual makes the investment decisions and bears responsibility for regulatory compliance. Given their typically small size and the discretion afforded to SMSF trustees in managing their super, they are not the focus of this paper, which takes a closer look at the APRA-regulated sector.

Industry Features

Defined-Contribution Plans Skew Asset Allocation

In the context of pension systems globally, the Australian super industry stands out due to the greater prevalence of defined-contribution plans compared with defined-benefit plans. A key characteristic of defined-contribution schemes is that they do not pay a fixed pension amount upon retirement and can accordingly exhibit a more aggressive asset-allocation mix than defined-benefit schemes. For example, the proportion of listed equity investments in Australian super funds is over 50% higher than those in UK pension plans. Additionally, the longer-term investment horizon and member liquidity profile has allowed super funds to be pioneers in unlisted asset classes such as property and infrastructure.

Exhibit 2 Asset Allocation of Pension Plans (%) by Country



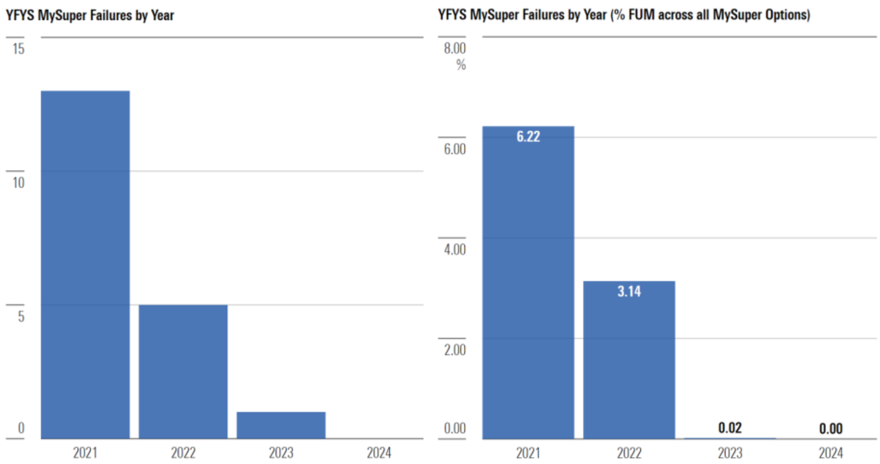
Source: OECD Pension Statistics. Data as of Dec. 31, 2022, or latest year available.

An Active Regulator

In 2021, the Your Future, Your Super—or YFYS—reform package emerged as the most significant among a new suite of regulations. Initially, it introduced an annual performance test for default "MySuper" investment options within each fund. In 2023, this test was extended to cover all "Trustee-Directed Products," or TDPs, capturing the full spectrum of multi-asset investment choices available to members.

The YFYS performance test operates simply: It compares an investment option's historical performance against the weighted average performance of legislated, class-specific indexes. Calculations incorporate investment fees and administration costs. Funds fail the test if their performance falls below the weighted benchmark by more than 0.50% per year over the past decade. In such cases, funds must notify members and take steps to rectify underperformance. A second consecutive failure prompts closure to new members. Notably, failing the YFYS test has often proven fatal, leading to numerous mergers with other funds. Of the 14 funds that failed the performance test since 2021, 12 have closed or merged, and one remains operational but closed to new members. Though the test is relatively new, there is a sharp downward trend in MySuper options failing it—both by number of options and assets within the options; by 2024, all 57 remaining MySuper options passed the test.

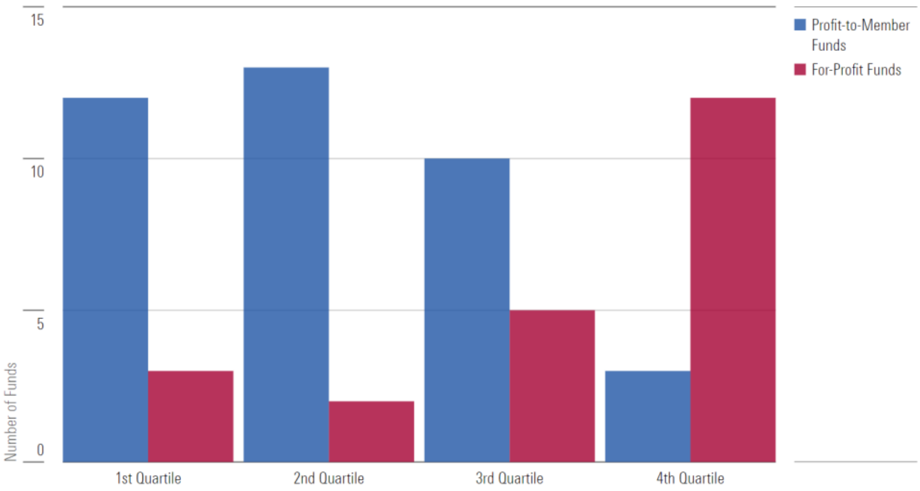
Exhibit 3 YFYS MySuper Failures by Year (Number of Funds and % Assets of all MySuper Options)



Source: APRA. Data as of June 30, 2024.

The test's incorporation of fees has tended to score profit-to-member funds higher than for-profit retail funds—the lowest quartile funds in 2023 reported results that were largely for-profit funds. That said, this hasn't been catastrophic; of the 60 MySuper options evaluated that year, just one failed the test.

Exhibit 4 YFYS MySuper 2023 Performance Test Results — Profit-To-Member Versus For-Profit by Quartile

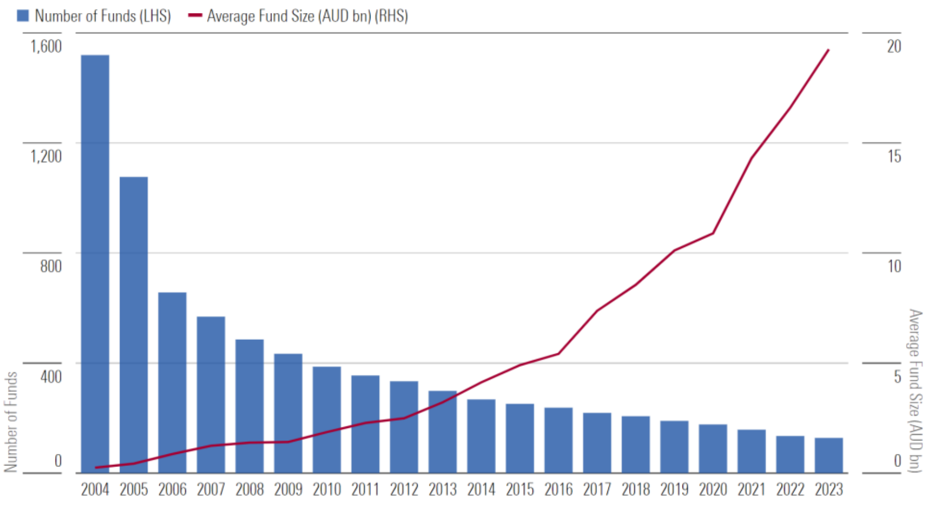


Source: Source: APRA. Data as of June 30, 2023.

Rapid Consolidation

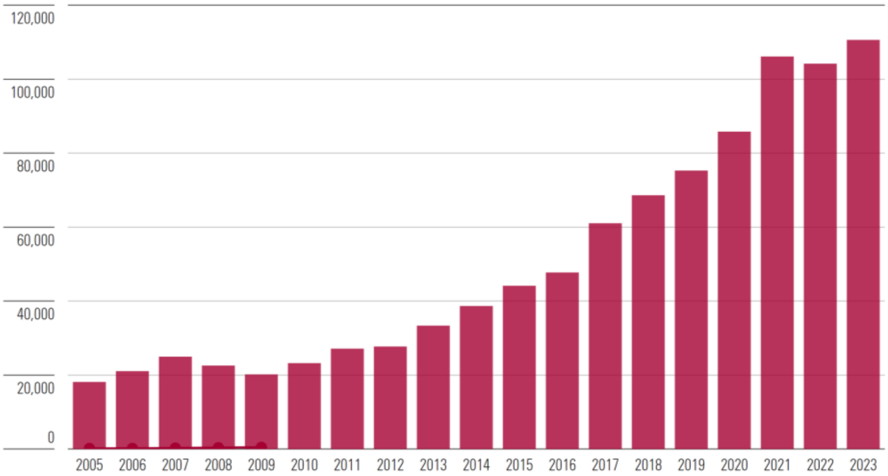
Growth in the sector over the past decade has been remarkable. Mandatory contributions, favorable tax treatment, and robust investment returns have fueled a doubling in sector size in the last decade alone. But here's the twist: Rather than a commensurate increase in new market entrants, regulatory pressures and a drive for economies of scale have led to a significant reduction in the number of APRA-regulated funds — a 93% fall between June 2004 to March 2024 to be exact. As a result, the average fund size has ballooned from a modest A$250 million to an impressive A$19 billion over the same period. Meanwhile, members now enjoy an average balance 7 times higher, and now in excess of A$100,000 — quite the personal finance success story.

Exhibit 5 Number of APRA-Regulated Funds and Average Fund Size



Source: APRA. Data as of June 30, 2023.

Exhibit 6 Average Superannuation Member Account Balance (A$)



Source: APRA. Data as of June 30, 2023.

APRA has helped encourage this consolidation effort. It has boldly labeled funds with less than A$30 billion in assets as "uncompetitive," and it has even hinted that the threshold might actually be closer to A$50 billion. Funds above this level are likely to find themselves better equipped to meet member needs, navigate the intricate regulatory landscape, and trim costs.

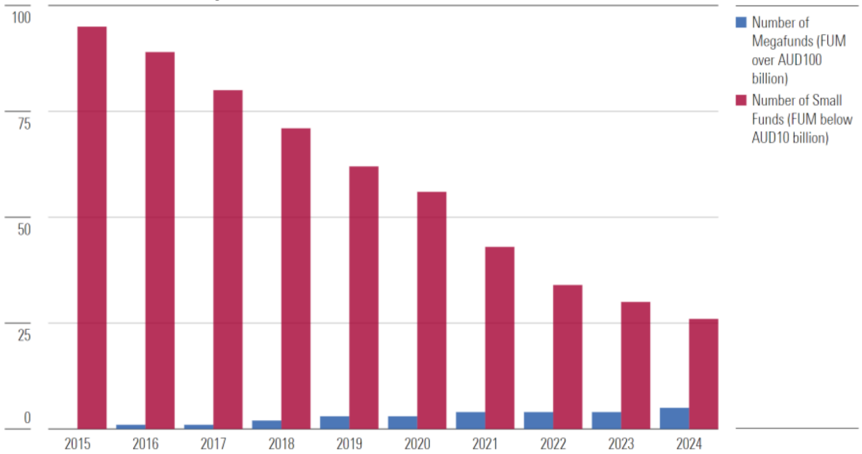
For a poorly performing small fund, the playbook may seem fairly simple: merge into a larger, better-performing fund and exit stage left. However, consolidation isn't the exclusive preserve of small funds. We've witnessed mergers among larger players, like Sunsuper and QSuper joining forces in 2022 to create the Australian Retirement Trust, or ART; and First State Super teaming up with VicSuper in 2020 to form Aware Super. However, much of the low-hanging fruit has already been plucked, and future mergers may chart new courses. A broader array of factors—member demographics, shared interests, and merger implementation costs (which can reach tens of millions of dollars)—will shape these strategic moves.

The Emergence of the "Megafund"

The raft of merger activity, strong performance, and high inflows has led to the rise of "megafunds." Managing over A$100 billion each, these behemoths wield substantial scale, allowing them to negotiate lower fees and operate with greater efficiency. Their ample financial resources also give them the financial clout to establish robust internal investment teams if they so wish, including for relatively complex and esoteric classes, such as private markets.

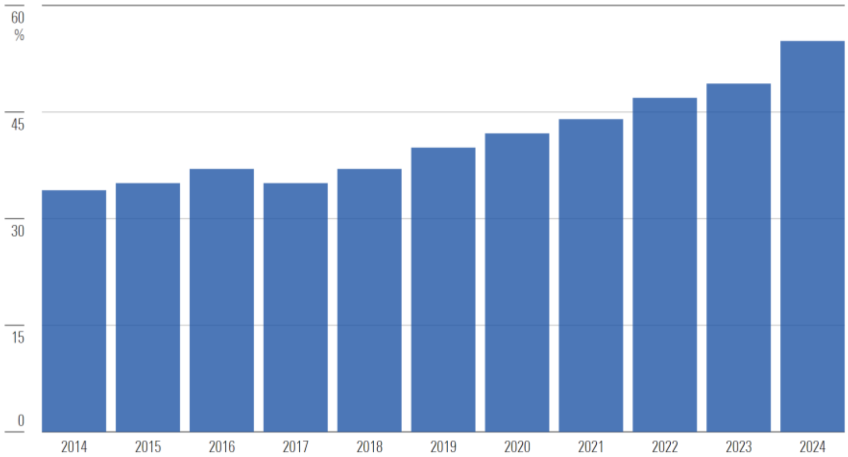
As of early 2024, we have five Australian megafunds, all industry funds: Australian Super, ART, Aware Super, UniSuper, and Hostplus. Three more industry funds—Cbus, Rest, and HESTA—are on the cusp of reaching this remarkable milestone. Collectively, these funds constitute a "big eight" within the industry fund segment, materially outpacing their peers in size. Not surprisingly, their market share continues to expand. A decade ago, they held roughly one third of the APRA-regulated market; today, they command over half of all assets. The two largest funds alone—AustralianSuper and ART—control nearly a quarter of the total assets. At the same time, the number of small funds continues to shrink, falling over 70% since 2015.

Exhibit 7 Number of Megafunds and Small Funds Over Time



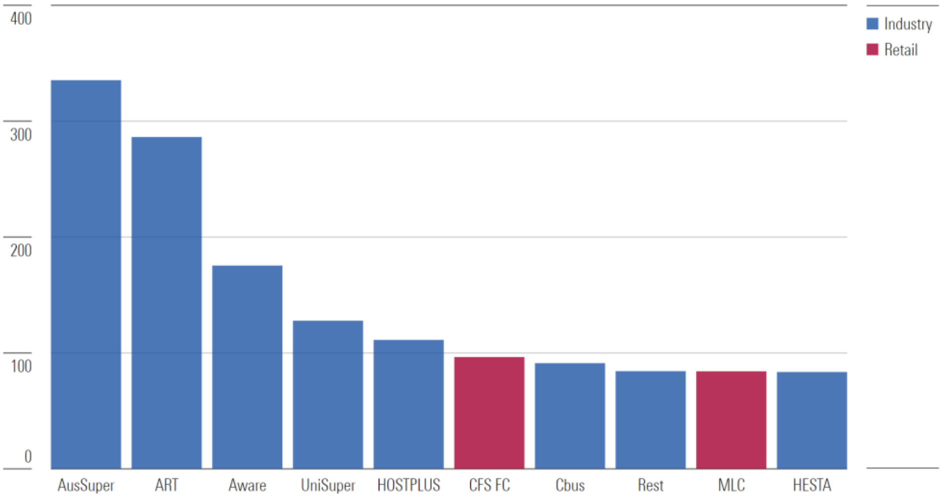
Source: APRA. Data as of June 30, 2023.

Exhibit 8 Market Share of the "Big Eight" Industry Funds*



Source: APRA. Data as of March 31, 2024.
* 2021 and earlier combines QSuper and Sunsuper (ART), and 2019 and earlier combines First State Super and VicSuper (Aware). Both were combined through a "merger of equals" rather than an absorption of a large fund by a small fund.

Exhibit 9 Largest Superannuation Funds (A$ billion)

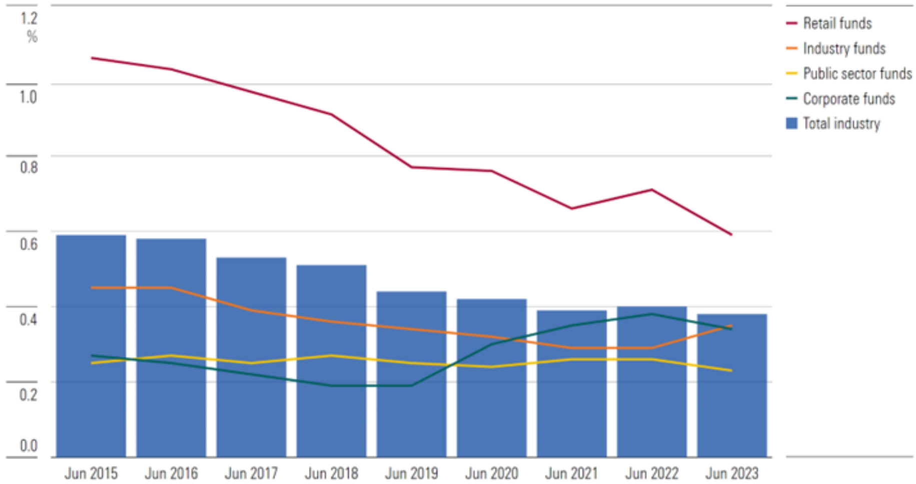


Source: APRA. Data as of March 31, 2024.

Fee Fallin'

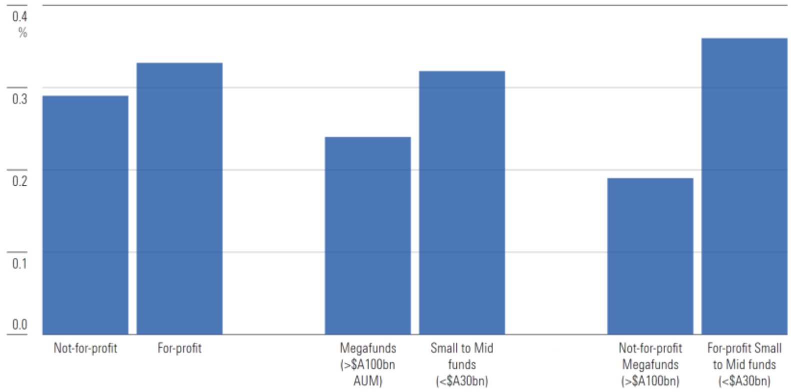
Increased size and efficiency have contributed to better fee outcomes for members. Since 2015, the percentage of fees paid (incorporating administrative, investment, and insurance costs) across the industry has fallen by more than 20 basis points, from 0.59% to 0.37%. When it comes to price, the impact of scale is evident: The administrative, advice fees, costs, and taxes, or RAFE, for MySuper options is typically around 50% higher for funds managing less than A$10 billion than for funds managing over A$30 billion.

Exhibit 10 Average Fees Paid—Total Industry



Source: APRA. Data as of June 30, 2023.

Exhibit 11 Average MySuper Option RAFE, 2022-23 Financial Year



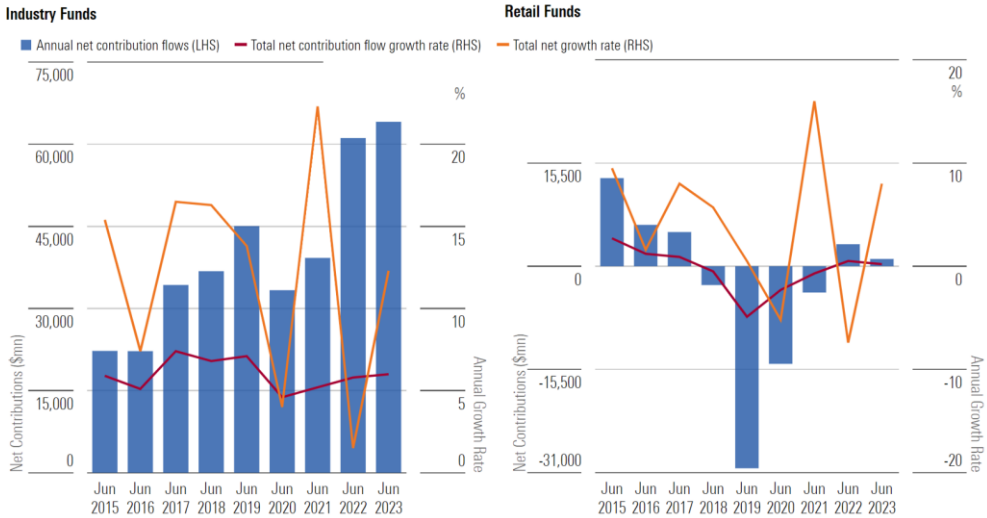
Source: APRA. Data as of June 30, 2023.

The Money Keeps Rolling In (For Some)

Net flows are a key factor for a fund's longer-term viability. They represent the sum of member contributions in, benefit payments out, and the net rollover of members switching between funds. A fund with consistent negative net flows will struggle to grow relative to the broader industry and may also face greater challenges managing liquidity risk.

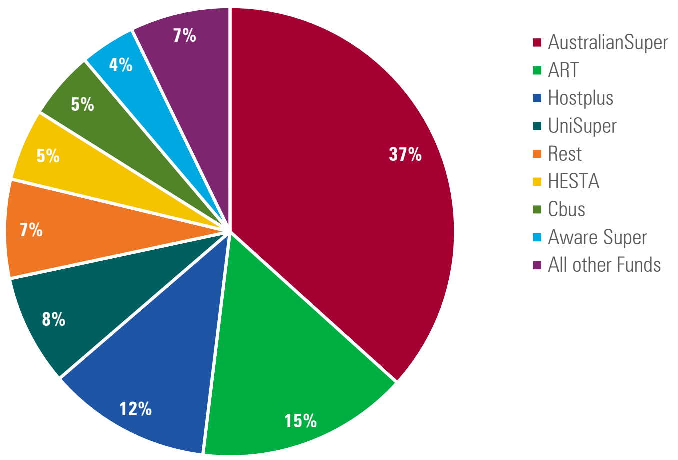
While net contributions have been consistently positive for the profit-to-member segment for some time, the picture for retail funds is somewhat more mixed; retail funds tend to have older member bases, with more members in the pension phase. Even among profit-to-member funds, not all funds are created equal; the "big eight" dominate net flows, having received nearly 93% of total superannuation net flows in the 2022-23 financial year. The largest fund, AustralianSuper, had net fund flows approaching an enormous A$20 billion in just one year—essentially, the fund is absorbing the equivalent of an entire medium-sized fund in net flows annually, all of which must be invested. It is evident that, longer term, large industry funds as a cohort are placed where they will continue to increase their market share of the industry.

Exhibit 12 Recipients of Net Flows June 2015-June 2023



Source: APRA. Data as of June 30, 2023.

Exhibit 13 Share of Net Inflows, 2022-23 Financial Year



Source: APRA. Data as of June 30, 2023.

The Current State of Play

Moving on from covered secular trends, we will now look at the super landscape as it stands today. We have gleaned insights via Morningstar's extensive database and from regulatory disclosures. Morningstar also undertook a recent survey of super funds. Ten funds participated in our survey: AustralianSuper, ART, Aware Super, UniSuper, Hostplus, Cbus, Rest, Vision Super, NGS Super, and Future Group. Together, they represent over 13 million members and around A$1.3 trillion in assets—nearly 60% of all member accounts and 50% of assets, respectively, within the APRA-regulated industry.

What's in a Name?

The majority of APRA-regulated super fund assets are in multisector strategies, albeit with a broad range of return objectives and risk appetite. A super fund member looking to pick a multisector option is likely to be faced with an investment menu using terms such as "balanced," "conservative," and "growth." However, there are currently no specific regulations on investment option labels; a super fund has ample freedom to pick a name it likes.

To ensure apples are indeed being compared with apples, Morningstar applies a framework using growth asset exposure bands to segment multisector strategies. This does mean that super fund multisector options with the same name may end up in different Morningstar categories. For example, "Balanced" super fund investment options are scattered across Morningstar's categories—in fact, most actually fall into the Growth category, though one "Balanced" investment option's growth asset exposure is so high that it ends up in our Aggressive category.

Exhibit 14 Superannuation Multisector Growth Exposure Bands and Labeling Conventions*

Superannuation Options		
Morningstar Category	Growth Assets Range	"Balanced" Labels in Each Category
Conservative	< 20%	0 / 8
Moderate	21% - 40%	5 / 99
Balanced	41% - 60%	30 / 115
Growth	61% - 80%	81 / 192
Aggressive	> 80%	1 / 109

*Accumulation strategies only.
Source: Morningstar Category Definitions as of June 26, 2024

Missing The Target

Superannuation fund multisector options tend to have inflation plus targets, and we have used APRA data to determine median Consumer Price Index plus targets for each Morningstar Superannuation Multisector category.

Regardless of category, it is evident that superannuation multisector options have struggled to meet CPI plus targets during the recent bout of elevated inflation. Performance over 2022—a year in which global bonds and equities uncharacteristically both recorded negative performance—was particularly detrimental.

Exhibit 15 Superannuation Multisector Category Average Return Versus CPI Plus Targets (%)*

Year	Multisector Balanced	Multisector Growth	Multisector Aggressive
2019	11.62	15.26	19.32
2020	2.58	2.92	3.44
2021	8.69	12.78	17.70
2022	-4.99	-5.81	-7.07
2023	8.43	9.96	12.38
YTD	3.69	4.93	6.72
CPI + Target^	CPI + 2.6%	CPI + 3.3%	CPI + 4%
3-year category average return	3.00	4.10	5.47
3-year CPI + Target Return	8.06	8.80	9.53
Over/Underperformance	-5.06	-4.70	-4.06
5-year category average return	4.02	5.47	7.36
5-year CPI + Target Return	6.57	7.30	8.03
Over/Underperformance	-2.55	-1.83	-0.67

Source: Morningstar Direct, data as of June 30, 2024. APRA, data as of March 31, 2024.
*Superannuation Category Peer Averages are calculated using Accumulation options only and exclude Pension and Transition-to-Retirement options.
^ Using the APRA product statistics as a guide, we have calculated approximate median CPI plus targets based on growth asset exposures, aligned to each Morningstar Superannuation Multisector Category.

Profit-To-Member Funds Go for Gold

Morningstar has extensive coverage of superannuation fund performance data, including over 500 multisector strategies. By far the highest number of strategies—nearly 200—fall within the Growth category. Looking at the best and worst performers in this cohort over three years reflects a trend consistent with other categories. Net of investment fees, the top performers tend to have a skew to profit-to-member strategies, while retail funds are more common among the poorest performers. For the best and worst performers across the other Morningstar categories, see the Appendix.

Exhibit 16 Three-Year Performance Net of Investment Fees—Super Multisector Growth Strategies

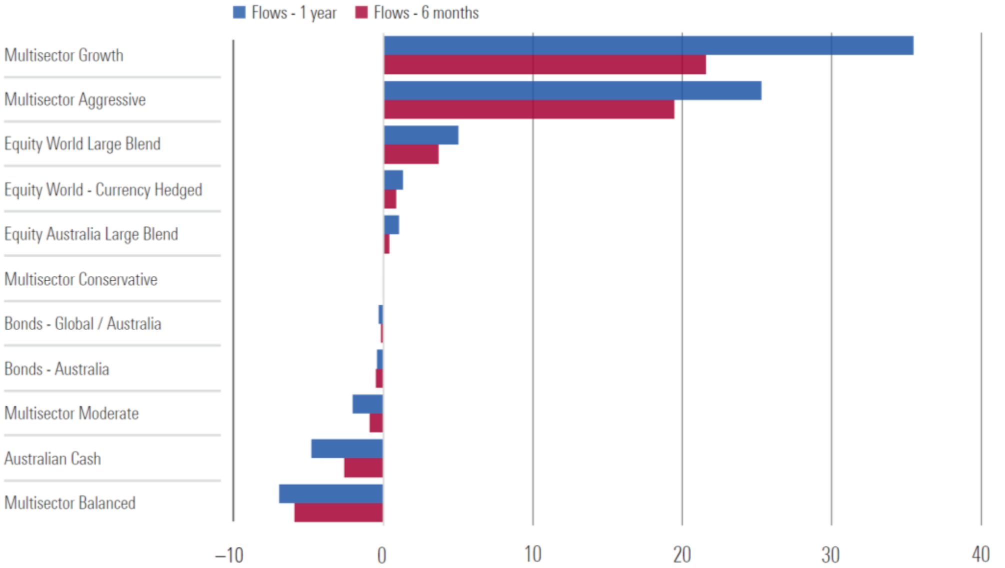
Multisector Growth	3-year return	3-year risk	3-year Sharpe	Excess Returns vs Index
AIA SPS - Growth	6.46	6.75	0.59	2.20
ART Balanced Sup	6.18	5.79	0.63	1.92
Aware Balanced Socially Conscious Sup	6.16	6.89	0.54	1.90
ART Lifecycle Balanced Sup	6.11	5.69	0.63	1.86
HOSTPLUS Indexed Balanced Super	5.93	8.94	0.41	1.68
Multisector Growth Category Average	4.10	7.16	0.25	-0.16
Morningstar Growth Category Benchmark	4.26	9.73	0.22	0.00
ART QSuper Balanced Sup	2.64	5.80	0.04	-1.62
AMP - FG - Multi-Manager Balanced	2.15	7.99	-0.01	-2.10
Zurich Sup - Managed Growth Fund	2.15	6.97	-0.03	-2.11
ART QSuper Socially Responsible Sup	0.08	5.56	-0.43	-4.18
CFS FC W PSup-Pendal Sustain Balanced	0.02	8.86	-0.25	-4.24

Source: Morningstar Direct. Data as of June 30, 2024.

Risk Is Back on the Menu

Over the six months and year to June 30, 2024, Growth and Aggressive strategies received strong net inflows at the expense of more defensive strategies. This partly reflects higher working age contributions into growth-oriented strategies. That said, net flows away from cash and bond single-sector options into equities reflects optimism of an economic "soft landing" scenario and easing monetary policy settings.

Exhibit 17 Superannuation Flows Over the 6-Month and 1-Year Periods Ended June 30, 2024



Source: Morningstar Direct. Data as of June 30, 2024.

Spoiled for Choice

As funds grow their member experience ecosystems, they continue to refine their menu of accumulation investment options. For example, some funds offer sustainability-themed offerings, and some allow members more scope to customize their investments. More options are not necessarily better; funds can and do rationalize their option list as they increase in size in an attempt to better fit member needs.

Exhibit 18 Accumulation Investment Options—Major Industry Funds

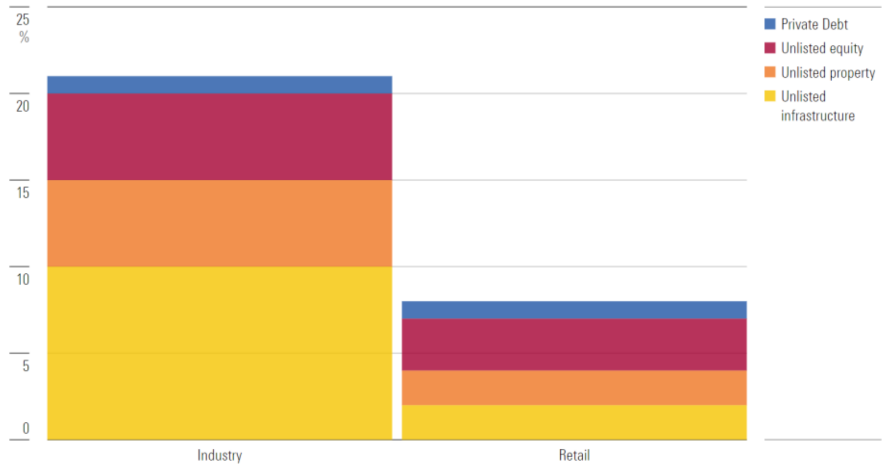
Industry Fund	Number of Accumulation Options	Total Fund Member Accounts	Total Fund Member Assets (AUD Billions)
AustralianSuper	10	3,408,700	335.3
ART	16	2,423,670	286.3
Aware Super	15	1,222,770	175.4
UniSuper	16	678,610	127.8
Hostplus	22	1,808,170	111.2
Cbus	11	928,560	91.2
Rest*	15	2,087,620	84.3
HESTA	10	1,069,760	83.6

Source: Superannuation Funds, APRA, data as of March 31, 2024.
*Rest will be reducing the number of investment options to nine from Sept. 30, 2024.

Industry Funds and Unlisted Assets—A Dynamic Duo

It should come as no surprise that industry funds continue to maintain a materially higher allocation to unlisted assets than their retail fund counterparts. Indeed, direct property and infrastructure allocations have long been a staple of industry funds. Correspondingly, retail funds tend to have a higher allocation to listed equities, while allocations to cash and fixed income are broadly similar across the two types.

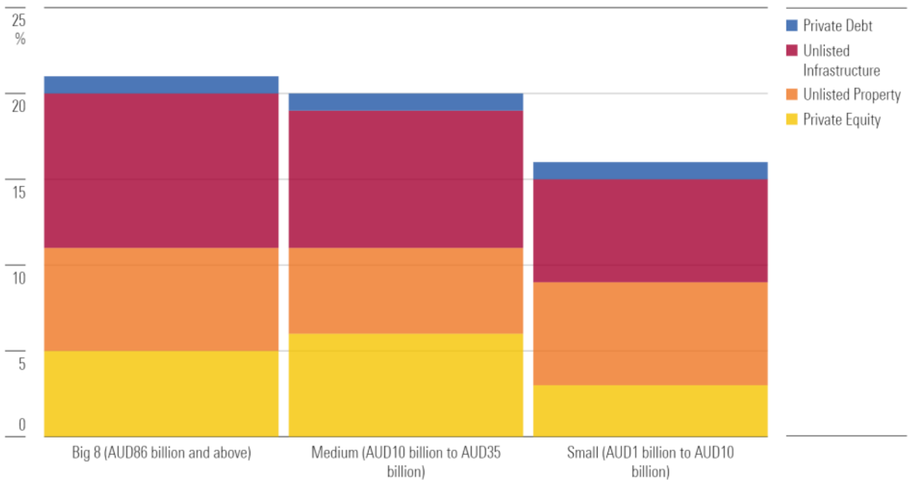
Exhibit 19 Allocation to Unlisted Asset Subclasses by Super Fund Type



Source: APRA. Data as of March 31, 2024.

The reason for this difference comes down to membership profiles; industry funds have historically had a stable membership base providing a steady, predictable steam of cash inflows. This in turn better facilitates allocations to less liquid assets without compromising liquidity risk for members reaching retirement or otherwise exiting the fund.

Exhibit 20 Allocation to Unlisted Asset Subclasses by Super Fund Size



Source: APRA. Data as of March 31, 2024.

When it comes to allocations by fund size, it is evident that larger industry funds tend to have higher unlisted asset allocations, with classes such as private equity and private credit gaining increased traction in recent years. High positive net flows and looming capacity constraints in some listed classes have provided a tailwind for large fund allocations across unlisted classes, with funds exploring cost-effective opportunities through co-investment and building out private asset investment teams.

While larger funds tend to have more appetite to allocate to unlisted assets, industry funds with the highest reported allocations to unlisted assets are drawn from across the size spectrum.

Exhibit 21 Top Five Unlisted Asset Allocations—Industry Funds

Total Unlisted		Unlisted Infrastructure		Unlisted Property		Private Equity	
Australian Food	42%	Prime Super	15%	MIESF	18%	Spirit Super	12%
MIESF	37%	MIESF	14%	Australian Food	18%	Australian Food	11%
NGS	29%	Cbus	12%	TelstraSuper	9%	Hostplus	10%
Hostplus	26%	AustralianSuper	12%	Cbus	9%	Qantas Super	10%
Spirit Super	25%	ART	10%	NESS	9%	NGS	9%
Median	**19%**	**Median**	**8%**	**Median**	**6%**	**Median**	**4%**

Source: APRA. Data as of March 31, 2024.

While not every unlisted asset is illiquid, there is a close nexus between unlisted assets and illiquidity. In our survey of funds, we asked funds about their allocations to illiquid assets. Among responses from the "big eight" industry funds, there has been a steady, moderate increase in average allocation to illiquid assets over the past five years, from 21% of total assets to 23%. That said, the current dispersion in illiquid allocations between funds—the lowest at 16% and the highest at 31%—suggests that there are divergent views on exposure to illiquid assets—even among large funds.

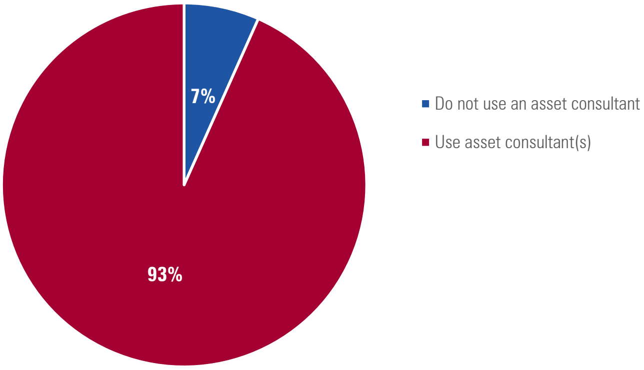
Insourcing Is Increasing, But Outsourced Consultants Remain Popular

As super funds continue increasing in size, the cost/benefit trade-off between using external investment managers and insourcing staff starts to move in favor of the latter. Many large profit-to-member funds manage at least some of their investment functions in-house. Among the large funds surveyed by Morningstar, the average team size has increased by around three quarters over the past five years. That said, insourcing is by no means the only way forward; a minority of large funds have instead opted to harness the skill of external managers and use their scale to negotiate lower fees.

For large funds that have chosen to insource, private assets have been a particular focus. Complex and nuanced, they require specialized resourcing. Indeed, the majority of the "big eight" have teams managing private equity, private debt, infrastructure, and/or property.

Another nascent trend among larger profit-to-member funds has been the establishment of offshore offices. While four large funds—AustralianSuper, ART, Aware, and Rest—have taken the plunge, only AustralianSuper has more than a handful of staff overseas. Indeed, with over 150 staff outside Australia, it is well ahead of the pack.

Exhibit 22 Asset Consultants Engaged—Profit-to-Member Funds



Source: Superannuation Funds, Morningstar Survey as of August 2024.

In a sector trending inexorably toward fewer, larger super funds with increased investment insourcing, reliance on external asset consultants may be expected to decline. So far, this trend has failed to materialize; the overwhelming majority of profit-to-member funds—over 90%, accounting for over A$1.4 trillion in assets—continue to engage external asset consultants.

The scope of a consultant's involvement can vary; for smaller funds, they may essentially be a "full service" outsourced investment team, whereas larger funds may engage them for certain steps of the process, such as capital market assumptions, manager selection, or as an external scrutineer of their investment recommendations.

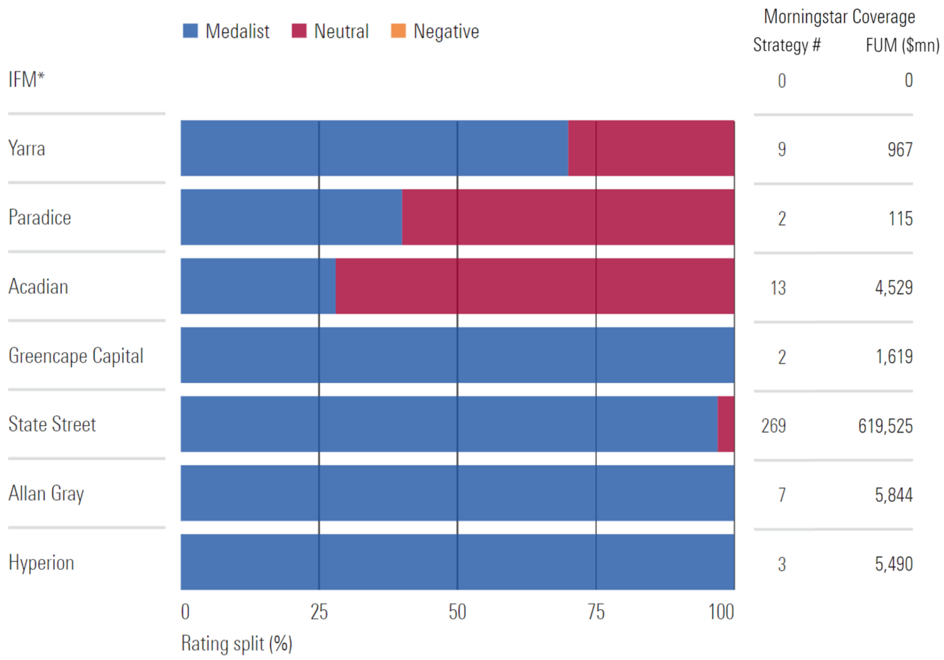
The consulting market is highly concentrated. Two firms—JANA and Frontier Advisors—are dominant. Of the approximately 30 profit-to-member funds that use asset consultants, around two thirds use one of the two (or, in the case of one fund, both). By funds under advice, they cover more than a remarkable 85% of the sector's asset consulting market.

Use of External Investment Managers

Despite increased insourcing, all APRA-regulated super funds utilize external investment managers. Through a combination of Morningstar survey responses and publicly reported information, we identified the most commonly used external investment managers for all funds exceeding A$20 billion in assets.

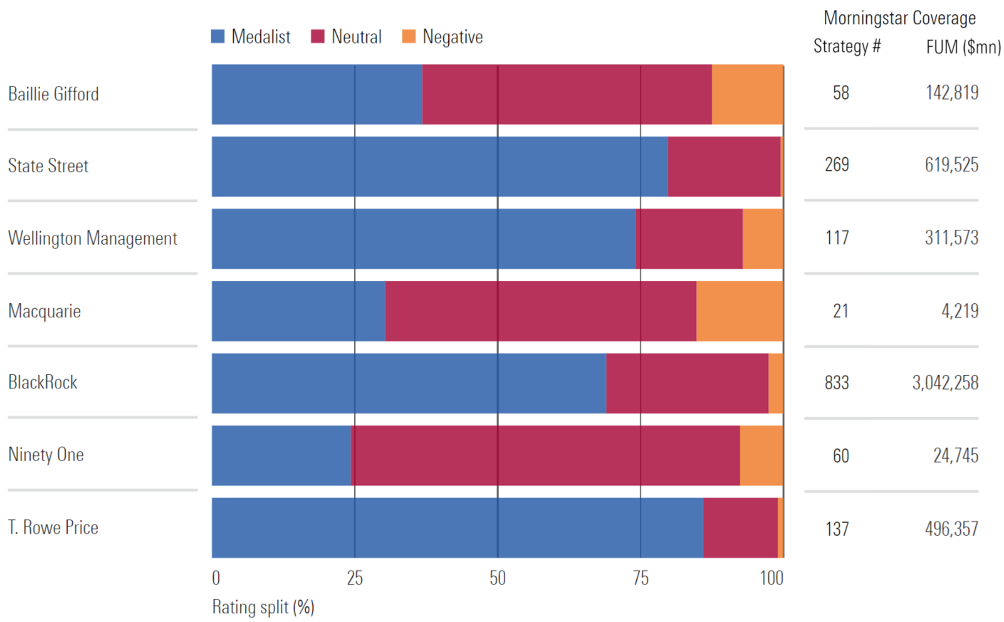
The most common managers for traditional public asset classes—Australian equities, international equities, and fixed income—are listed below. Harnessing our Manager Research resources globally, we can evaluate the split of Medalist Ratings across the strategies each manager offers within each asset class. Most equity and fixed-income managers popular with superannuation funds also tend to have a healthy proportion of their strategies earning Medalist Ratings. Meanwhile, strategies with negative ratings are low in number.

Exhibit 23 Most Commonly Used External Managers — Australian Equity (Rating by FUM)



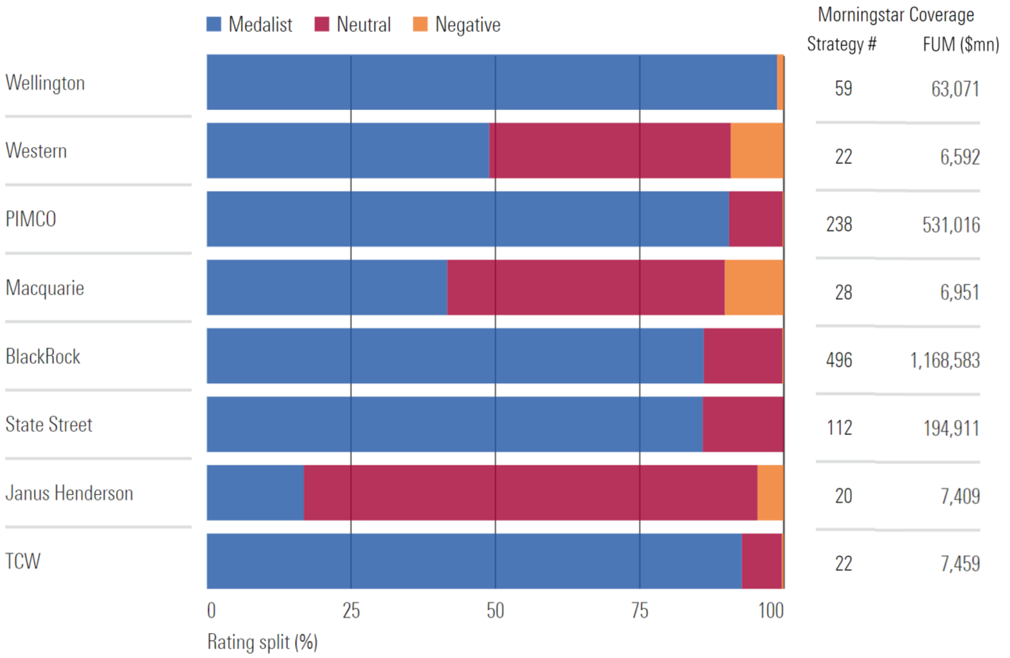
Source: Morningstar. Data as of Aug. 5, 2024.
*IFM Investors offers Australian equity strategies to institutional investors only, and accordingly its strategies are not covered by Morningstar.

Exhibit 24 Most Commonly Used External Managers — International Equity (Rating by FUM)



Source: Morningstar. Data as of Aug. 5, 2024.

Exhibit 25 Most Commonly Used External Managers — Fixed Income (Rating by FUM)

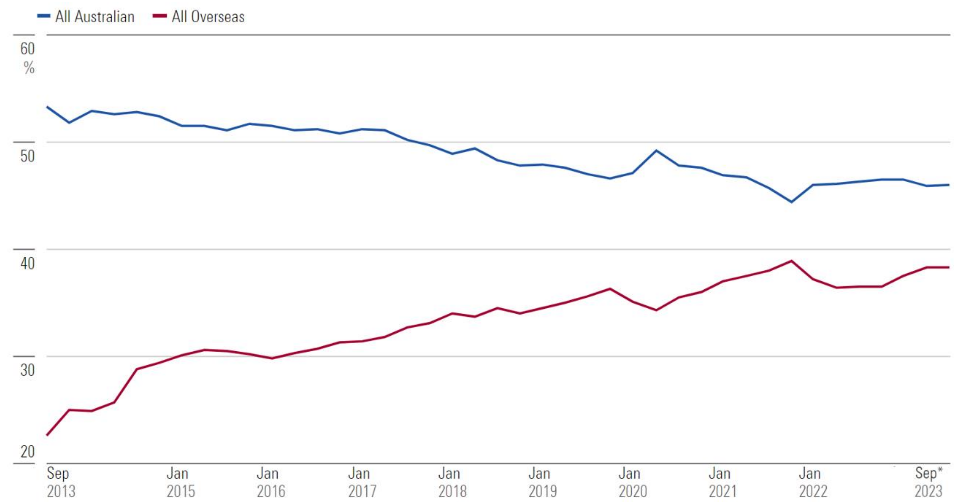


Source: Morningstar. Data as of Aug. 5, 2024.

Going Global

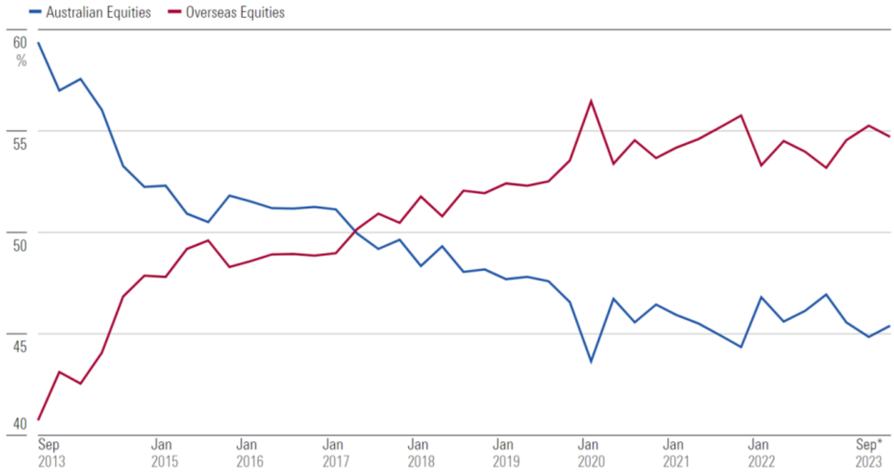
As the superannuation sector has increased in size and sophistication, the "home bias," or exposure to Australian assets, has eased over time across the industry. However, there is a wide dispersion on a fund-by-fund level and no clear trend by fund size. This is despite larger funds now dominating local asset classes (especially Australian equities), where they are likelier to face capacity constraints.

Exhibit 26 Australian Versus Overseas Exposure as a Percentage of Total Assets, All Super Funds



Source: APRA. Data as of March 31, 2024.

Exhibit 27 Australian Versus Overseas Exposure as a Percentage of Listed Equities, All Super Funds



Source: APRA. Data as of March 31, 2024.

Evaluating Funds: The Good, The Bad, and The Super

If there's one thing super members should glean from recent regulatory developments, it's that they should pay closer attention to their super. The YFYS reform package, Retirement Income Covenant, Quality of Advice legislation, and ASIC Report 779 all reflect a welcome trend of ensuring a super fund does a good job of looking after its members.

Back to the Future

Using a simple gauge of past performance and costs, the YFYS performance test sets a good baseline in evaluating a super investment option, especially in weeding out the worst performers. Past performance can show the prudence and repeatability of an investment process, and the resourcing and continuity of an investment team's implementation of the strategy. These are in turn useful predictors of future performance. Similarly, the incorporation of both administration and investment fees in the YFYS performance test also creates a clear link between price and future viability.

That said, YFYS has limitations. Relying exclusively on past performance, it does not consider forward-looking investment merit. It also leaves out strategic asset-allocation choices and does not adjust for risk. It also fails to account for the tailoring of an investment strategy to the specific demographic traits of a member base (above all, age), nor does it consider that some investments may be made through a sustainability or faith-based lens where there are objectives other than just performance. And this is all before one considers the use of index benchmarks for investment strategies with absolute return performance objectives.

Members can take comfort in knowing that there are many other factors that can be harnessed to assess the investment merits of a super fund and the investment options it offers. The nuances of the APRA-regulated super ecosystem means that these can differ to a typical, nonsuper investment.

Playing the Long Game

As with any asset manager, the quality of a super fund's leadership, organizational structure, and governance all matter. However, given that members are participants in the super system from the commencement of work through to retirement, the long-term viability and strategic direction of a fund is of greater importance. There are other superannuation-specific factors that make the evaluation of a superannuation parent entity a key consideration.

Scale Is the Key to Survival

Compared with other types of investment entities, the regulatory landscape for super funds has an outsize impact on ongoing viability. APRA believes that funds below A$30 billion to A$50 billion are uncompetitive. Smaller funds tend to have higher fees and less scope to benefit from economies of scale—perhaps unsurprisingly, this makes it harder for a smaller fund's investment options to pass the fee-dependent YFYS performance test.

One pathway to greater size is through positive net flows—something at which most large industry funds excel. The recent introduction of compulsory "stapling" of member accounts is also likely to provide an additional tailwind for funds that tend to source new members from industries in which people start their working lives, such as in the hospitality and retail sectors.

Growing Pains Are Common

While positive net flows can help a fund build scale, by far the easiest trick in the book is to merge with another fund. Mergers may benefit members in the long run, but that doesn't mean they're perfect. They are often accompanied by restructuring and headcount reductions. The impact on team cohesion and staff morale is, understandably, suboptimal. In the case of mergers between similarly sized funds, the new parent will have to successfully establish a new culture that is unlikely to develop overnight.

Maintaining a consistent culture is also a challenge as a fund's investment team grows larger; the more staff, the harder it is to avoid silos, especially if staff are increasingly located in several countries (let alone different cities).

Old Habits Die Hard

Profit-to-member funds, especially industry funds, dominate the superannuation market. Their parent structure can be a big benefit, encouraging a culture of member stewardship without having to balance it with the interests of profit-seeking shareholders.

However, industry funds are by no means perfect. While many were established to cater to members in certain industries, the wave of super sector consolidation has seen larger funds' member bases evolve to represent a broader cross-section of society. This may not be the case for the composition of a fund's board; the directors are not appointed by members and may retain close links with industry-aligned trade unions and employer groups. This warrants scrutiny around governance; are board members best-suited to set and oversee a fund's strategic direction? What proportion of board members are independent? Do industry links skew asset-allocation decisions?

Investment options

There is no ideal menu of investment options offered by a fund, be it accumulation, transition to retirement, or pension phase. A number of funds offer lifecycle accumulation strategies, some funds enable members to customize their investment exposure, while some offer low-cost passive strategies. All of these offerings can have investment merit. What matters is that members have a choice between options that can effectively meet investment objectives without the fund bearing the administrative burden of too many options with overlapping risk and return objectives. An investment option should have sufficient funds and positive net flows to continue to be viable for offer; if not, the option risks closure even if a fund is otherwise successful.

The Superannuation Dream Team

The experience and quality of the CIO and investment team, adequate resourcing, and team culture are all obvious considerations for a super fund. This is especially so for the ever-expanding investment teams being brought in-house, especially among larger funds. However, unlike a typical asset manager, the remuneration structure for a super fund tends to offer less alignment overall; staff can receive performance-linked bonuses, but there is no equity stake on offer. Remuneration varies but is typically less than that of an asset-management firm, making staff retention a tougher ask.

While several larger funds continue to push for increased internalization, doing things yourself isn't always the best way forward; sometimes the experts need to be called in. While insourcing investment functions can reduce costs, a fund should have the fortitude to close down internal functions that struggle against external managers—especially when the fund's ability to negotiate ultralow fees improves the cost/benefit proposition in favor of the external manager.

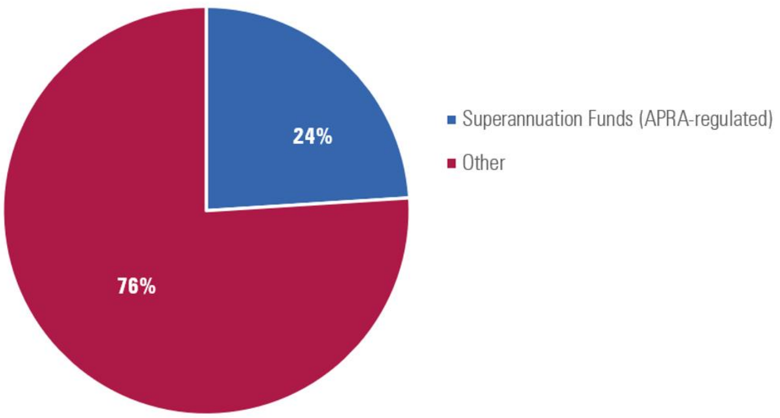
Profit-to-member funds have a well-known penchant for asset consultants, albeit to varying extents. For funds that use consultants extensively—especially smaller funds, where consultants sometimes constitute a de facto investment team—the quality of the consultant's staff matters, as do the associated issues of key-person risk and adequate resourcing. Asset consultants should be additive to a fund's investment process and consistent with the fund's investment philosophy; otherwise, the fund risks losing differentiation among peers, especially those advised by the same consultant.

More Money, More Problems?

The growth of super funds into ever larger entities can have a significant impact on the investment process. Larger funds benefit from economies of scale—larger mandate sizes beget lower negotiated investment manager fees, more cost-effective insourced investment functions, and more efficient access to private markets. It's no surprise that the benefits of greater scale have been flagged by the government and APRA as key drivers for consolidation within the sector.

That said, scale is a double-edged sword, and large funds can also face investment process challenges. For example, active listed equity strategies with stronger potential for outperformance also tend to have capacity constraints and are unlikely to be able to absorb more than a small proportion of a large fund's listed equity allocation.

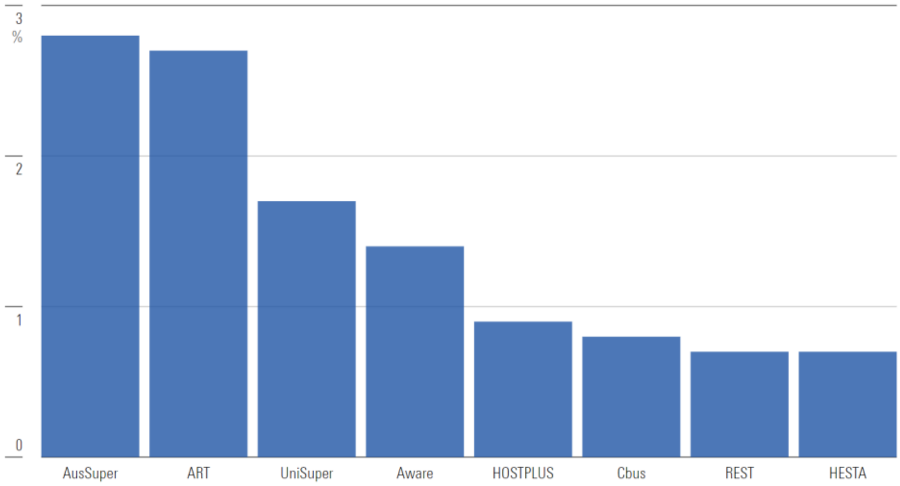
Exhibit 28 APRA-Regulated Super Funds % of ASX Held (March 2024)



Source: APRA, ASX. Data as of March 31, 2024.

The issue is especially clear when it comes to Australian listed equities (including listed infrastructure and listed property). Of the A$2.7 trillion market capitalization of the Australian Securities Exchange, as of March 31, 2024, A$646 billion, or 24%, was held by APRA-regulated superannuation funds; half of it by the "big eight" profit-to-member funds.

Exhibit 29 Percentage of ASX-Owned, Eight Largest APRA-Regulated Industry Super Funds



Source: APRA, ASX. Data as of March 31, 2024.

A megafund making an active tilt between stocks will find it difficult to transact at scale and in a timely manner without influencing the share price. This can impact asset allocation and style. A megafund may have no choice but to focus on passive, enhanced index or systematic strategies within certain listed asset classes. It may also have to limit its allocation to the class as a whole, even if its capital market assumptions and asset-allocation process recommend otherwise.

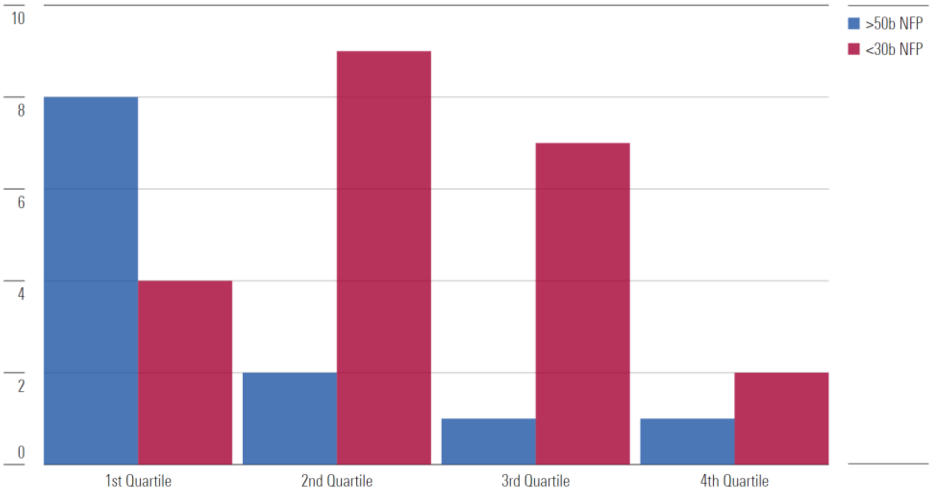
By contrast, some smaller funds have performed very well, both relative to YFYS benchmarks and peers. While having less scope to compete on fees, a small fund with talented staff and a strong investment process can be nimbler and invest in higher active return-generating strategies without the capacity concerns of larger funds.

Performance Testing—Size Matters

The key role fees play in the YFYS performance test presents a challenge for smaller funds less able to negotiate external manager fees and generate economies of scale. Looking at the latest performance test results published by APRA, the proof is in the pudding: profit-to-member funds above APRA's A$30 billion to A$50 billion "uncompetitive" threshold range are concentrated in the top quartile.

The data reflects the greater challenge smaller funds face in passing the YFYS test. They are unable to reduce fees by much, so to avoid failing the performance test they may have to rely on being overly cautious by allocating increasingly to passive, "benchmark-hugging" strategies with low tracking error that can compromise potential investment gains.

Exhibit 30 YFYS 2023 Performance Test Results—Profit-To-Member Funds in Each Quartile by Size



Source: APRA. Data as of June 30, 2023.

Additionally, the test's use of a limited menu of relatively broad-based indexes can lead to an investment process that discourages allocations outside these benchmarks, even if the strategy is otherwise attractive from a portfolio construction perspective.

What's It Worth to You?

A fund's approach to managing private assets—such as the frequency of valuations and the approval process for revaluations (including the robustness of debate)—warrants attention. APRA's recent Prudential Standard SPS530 reflects the growing regulatory drive for improved transparency from super funds in this regard.

Members should be cognizant of the impact of private assets on their fund's liquidity profile. High exposure to private assets, which are typically illiquid, can cause problems in stressed market conditions, or if changes in regulations permit members to access funds preretirement (as was the case at the height of the pandemic). Fund liquidity is increasingly important for larger funds facing capacity constraints in some liquid asset classes. A higher allocation to private assets beckons, but is the risk around liquidity and valuations well-managed?

Age Is Not Just a Number

The demographic profile of a super fund can impact its approach to portfolio construction and liquidity management. Funds with a skew to older members are likely to experience increased outflows as retiring members either drawdown their balances or change funds—and funds need to be confident they can manage liquidity given the outflows.

The differences between fund member bases can be stark; despite the broad market reach of the "Big Eight" profit-to-member funds—six of which have over 1 million members—their median ages differ significantly. For example, Rest and Hostplus, which target new memberships in the retail and hospitality industries, respectively, have a much younger member base and lower median account balance than peers.

Exhibit 31 Median Balance and Median Age of the "Big Eight" Industry Funds

	Median Balance (AUD)	Median Age
Aware Super	73,001	48
Unisuper	62,562	44
Cbus Super	39,422	40
ART	35,531	40
HESTA	32,641	42
AustralianSuper	27,332	40
Hostplus	16,764	34
Rest	14,151	29

Source: APRA. Data as of March 31, 2024.

The End Game

For the past two decades, super funds have grown larger in size and fewer in number. We know that APRA continues to encourage consolidation. We also know that megafunds are expected to continue growing in size; the largest, AustralianSuper, has previously flagged its target of reaching A$1 trillion in assets in the next decade or so.

But the big question remains: What does the future of the landscape look like once the dust inevitably settles on merger activity in the sector? Will a dozen or so megafunds survive? Or will we see a landscape more akin to the banking sector, with a few supersized funds coexisting with a few plucky, determined small funds that found their niche? Could the sector even eventually end up consolidating into one or two giant funds rivaling the world's large sovereign wealth funds? The answer, at this stage, is unclear.

Regardless of how the sector eventually looks, members are in a good position. Their interests are increasingly front and center for regulators. Improving member outcomes are a key area of focus, be it through cutting fees or encouraging increased super fund sophistication through upsizing. Nonetheless, sector consolidation and improved regulations are unlikely to be a cure-all panacea for issues within the sector. Indeed, new potential concerns with large funds are emerging. Ultimately, there is unlikely to be a one-size-fits-all solution when it comes to super funds, and it is imperative that members be discerning in evaluating a fund in the future.

Appendix

Three-Year Performance: Superannuation Multisector Investment Options

Exhibit 32 Three-Year Performance: Superannuation Multisector Conservative Investment Options

Multisector Conservative	3-year return	3-year risk	3-year Sharpe	Excess Returns vs Index
OnePath OA FR PS-Pendal Mly Inc Pl	1.96	3.22	-0.19	1.96
CFS FC W PSup-Pendal Monthly Income Plus	1.42	3.35	-0.34	1.42
Brighter Super Secure Super	1.33	3.43	-0.36	1.33
Multsector Conservative Category Average	1.09	4.01	-0.36	1.09
Morningstar Conservative Category Benchmark	-0.12	5.14	-0.51	-0.12
OnePath Life DIY Super-Capital Stable	-1.13	4.43	-0.84	-1.13

Source: Morningstar Direct as of June 30, 2024.

Exhibit 33 Three-Year Performance: Superannuation Multisector Moderate Investment Options

Multisector Moderate	3-year return	3-year risk	3-year Sharpe	Excess Returns vs Index
Spirit Conservative Super	3.51	3.28	0.29	2.56
UniSuper Conservative Super	3.36	2.81	0.28	2.40
ART Conservative Sup	3.23	3.03	0.23	2.27
HESTA Conservative Super	3.20	3.61	0.19	2.25
Care Capital Stable Sup	3.17	3.26	0.20	2.22
Multisector Moderate Category Average	1.77	4.25	-0.17	0.82
Morningstar Moderate Category Benchmark	0.95	6.54	-0.22	0.00
AMP - RB - Secure	0.67	4.90	-0.37	-0.29
AMP - FG - Secure	0.59	4.88	-0.39	-0.37
Zurich Sup - Capital Stable Fund	0.30	3.66	-0.62	-0.66
Australian Ethical Conservative Sup	0.18	4.75	-0.49	-0.77
AMP - FG - Multi-Manager Secure	-0.14	4.96	-0.53	-1.09

Source: Morningstar Direct as of June 30, 2024.

Exhibit 34 Three-Year Performance: Superannuation Multisector Balanced Investment Options

Multisector Balanced	3-year return	3-year risk	3-year Sharpe	Excess Returns vs Index
HOSTPLUS Conservative Balanced Super	5.73	5.55	0.58	3.22
Prime Income Focused Super	5.04	3.87	0.64	2.54
MINE Conservative Balanced Super	4.84	6.08	0.39	2.34
ART Retirement Sup	4.74	4.34	0.51	2.23
UniSuper Conservative Balanced Super	4.46	4.33	0.44	1.96
Multisector Balanced Category Average	2.71	5.48	0.05	0.21
Morningstar Balanced Category Benchmark	2.50	8.09	0.03	0.00
CFS FC W PSup-CFS Moderate	2.43	6.92	0.01	-0.08
CFS FC W PSup-CFS Diversified	2.14	6.10	-0.04	-0.36
AustralianSuper Stable Sup	1.82	3.32	-0.22	-0.68
AMP MF RO-AMP Moderate Growth	1.62	6.38	-0.12	-0.88
Zurich Sup - Balanced Fund	1.04	5.50	-0.25	-1.46

Source: Morningstar Direct as of June 30, 2024.

Exhibit 35 Three-Year Performance: Superannuation Multisector Aggressive Investment Options

Multisector Aggressive	3-year return	3-year risk	3-year Sharpe	Excess Returns vs Index
MINE High Growth Super	8.09	10.56	0.55	1.97
REST Shares Super	8.05	9.72	0.59	1.93
ART Growth Sup	7.60	6.65	0.76	1.49
REI Growth Sup	7.37	10.08	0.51	1.25
HESTA High Growth Super	7.26	7.33	0.65	1.15
Morningstar Aggressive Category Benchmark	6.11	11.23	0.36	0.00
Multisector Aggressive Category Average	5.50	8.39	0.38	-0.62
NGS Super High Growth Sup	4.36	6.05	0.32	-1.76
CBUS Growth (MySuper) Sup	4.34	5.94	0.32	-1.78
Australian Ethical Growth Sup	4.21	8.36	0.23	-1.91
AustralianSuper Socially Aware Sup	4.03	6.20	0.26	-2.08
ART QSuper Aggressive Sup	2.79	7.11	0.06	-3.32

Source: Morningstar Direct as of June 30, 2024.

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