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How super funds are adapting to new regulations and volatile markets

The retirement industry is being radically reshaped yet super funds remain resilient, according to Nadia Schiavon, head of Securities Services, Australia and New Zealand, J.P. Morgan.

Australia's $3.3 trillion superannuation industry is facing a myriad of changes, two of the largest are turbulent market conditions and a new wave of regulation. These factors are dramatically changing the retirement landscape with more than a dozen funds merging in recent times.

Headwinds have only become stronger since J.P. Morgan surveyed asset owners for its inaugural Future of Superannuation report report released earlier this year, yet the industry continues to show its resilience and ability to bolster the long-term retirement incomes of millions of Australians.

Investment returns under pressure

During our conversations with senior executives, funds cited their ability to generate strong investment returns as one of their biggest challenges – predictions which have quickly crystallised as inflation and interest rates have skyrocketed. The result was the average balanced fund lost 3.1 per cent in 2021-22 – the first negative year since the dark days of the Global Financial Crisis.

But funds are quickly adapting to this environment by re-aligning their portfolios and exploring innovative investment strategies.

Funds are internalising more of their investment activities rather than outsourcing to fund managers. Many started with relatively simple investments such as cash and passive equities but are now adding an increasing range of more complex assets such as unlisted property.

It is a strategy that can lower costs and provides greater control, although it relies on a strong control and governance culture to ensure performance remains strong. As funds continue to grow, they are also diversifying offshore, targeting assets such as private equity and infrastructure.

These new strategies will be crucial if funds are to meet their long-term return targets of outperforming inflation by 3-4 per cent.

Funds adapt to new regulations

It is not just the investment environment that is becoming more complex: a significant increase in regulations is reshaping the operational environment.

The proposed prudential standard (CPS 230) is just the latest. It will require funds to further lift their operational risk standards. It also serves as another reminder why funds we spoke to last year overwhelmingly said meeting new regulatory requirements is their biggest challenge.

Since then, the significant impact of the Your Future, Your Super (YFYS) reforms has continued with the regulator recently naming more funds that failed to meet its investment benchmark. The regulations are continuing to prompt mergers, which is increasing the scale of funds.

According to KPMG, the largest 13 funds now hold three-quarters of the industry's net assets (excluding SMSFs), with just eight mega-funds expected to be managing more than $125 billion in funds under management each by 2025. The benefits of this scale are already flowing through to members in the form of lower administration fees.

Yet these lower fees are covering more services as funds increasingly engage with their members.

The new Retirement Income Covenant places a legal requirement on funds to help members plan for their retirement income needs. It is also encouraging greater engagement through digital tools and advice as the government finalises its Quality of Advice review, which could potentially extend the reach of financial advice.

Big data turbocharges returns and streamlines operations

Meeting these challenges requires a deeper understanding of data, which can lead to new insights and solutions. Some larger funds have built their own data platforms to bring together administrator, custodian, and other data which can be used in multiple ways.

We are working closely with Australian asset owners overseeing almost $1 trillion in funds to provide an ever-widening range of investment data more quickly than at any time in history.

While data attached to major listed Australian companies such as miners and banks is readily available, it is more challenging when the asset is an unlisted telecommunications tower or a seaport in Europe.

This deeper understanding of their investments allows funds to remain nimble, despite a growing asset base.

Funds are also asking for more non-traditional data, such as ESG overlays, from a range of third-party providers. This allows them to assess issues such as climate impact or modern slavery risks – it will also help investors make decisions that align with their values under portfolio holdings disclosure legislation.

But big data is not just helping funds make better investment decisions, it is also helping them make smarter operational decisions. Manual processes are being automated, which is reducing errors and incrementally cutting costs, while also freeing up staff to focus on higher value adding activities in a tight labour market.

As asset owners look to use big data to better serve their members, it is becoming ever more challenging and costly in ensuring that their members personal data is protected as the growing threat to asset owners is cybercrime and financial crimes, particularly as there is more activity and significant money flows through the system in a more digital environment.

While the challenges facing the retirement industry continue to mount, asset owners are responding quickly. They have built strong experience navigating through multiple market cycles over the past three decades, which means Australians should remain confident that their retirement incomes remain in safe hands.

J.P. Morgan's inaugural 2022 Future of Superannuation report can be downloaded here.

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