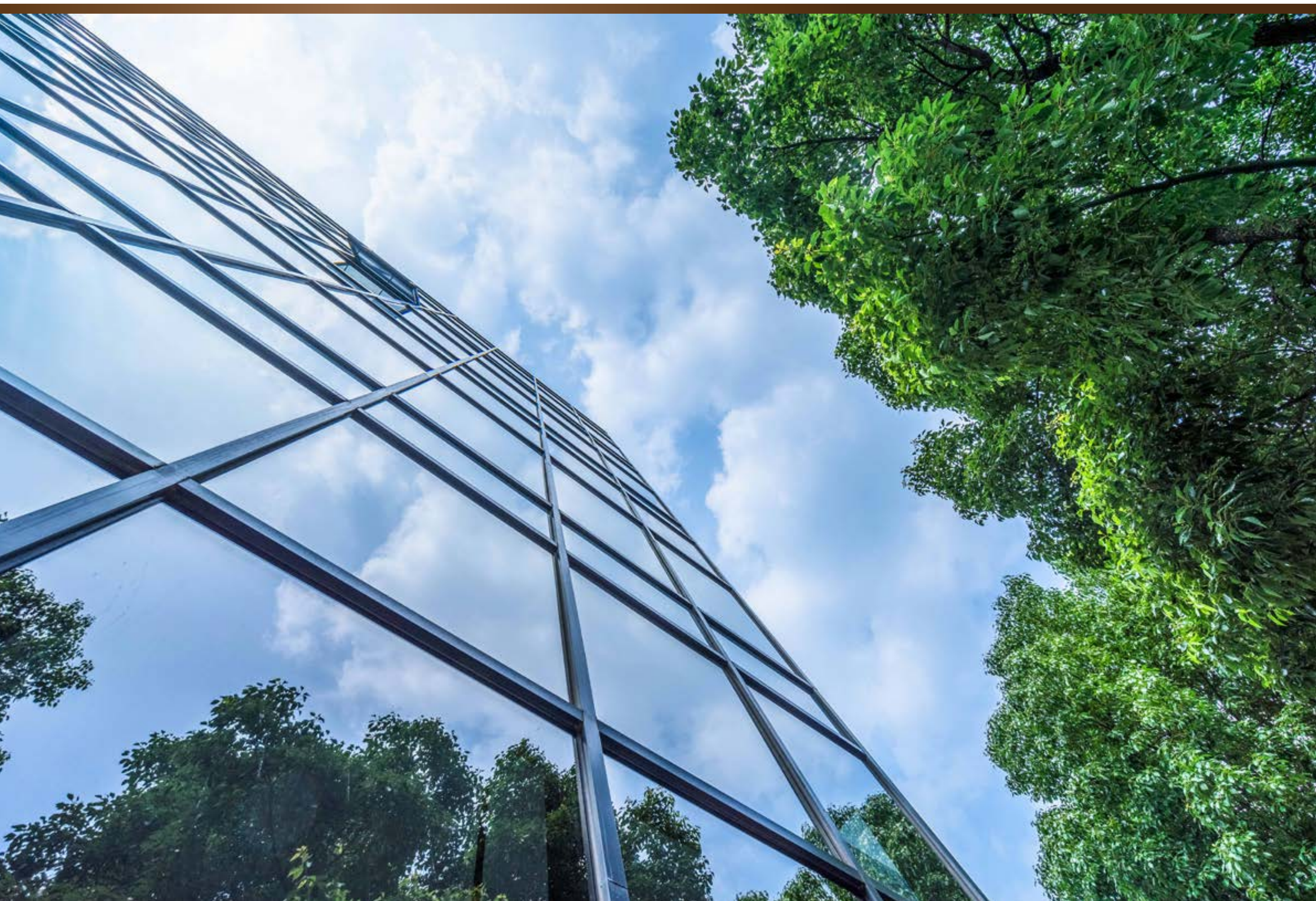
Why there's a future for big and small super funds



The benefits of scale are well-known but there's still a place for competitive niche funds, according to J.P. Morgan's Polly Nix, Platform Sales – Securities Services.

The size of the average super fund has never been larger, but it's not a result of surging inflows or rising markets.

New regulation has prompted record levels of merger activity that is only likely to quicken in the years ahead, according to industry executives surveyed in J.P. Morgan's inaugural Future of Superannuation report.

The industry regulator APRA has encouraged mergers because the benefits of scale are clear. Meanwhile, funds with less than $30 billion in assets are now finding themselves in the spotlight as being potentially uncompetitive against so-called mega-funds[1].

But rather than be squeezed out of the industry, these funds can find alternative ways to remain competitive.

The benefits of scale

Larger super funds have a well-known scale advantage which can bolster the products and services they offer members.

They have the leverage to negotiate lower fees with fund managers and service providers. A number of funds have linked recent member fee reductions to their growing size, such as Aware Super and Spirit Super.

Larger funds under management can open new investment opportunities, such as the ability to internalise asset management, which increases control and lowers manager fees.

> *AustralianSuper Group Executive Finance and Operations, Peter Curtis, says internalisation has saved the fund about $200 million in the last financial year and $750 million since it began the program in 2013[2].*

Mega-funds are also able to co-invest alongside specialist managers in asset classes such as private equity, lowering overall fees and increasing their insight into markets.

The final benefit of scale has received less mainstream media attention: it provides funds with the resources to adapt to rising regulatory obligations.

Almost two-thirds (64.2%) of respondents to the J.P. Morgan Future of Super report cited new regulation requirements as their biggest challenge over the next three years. Regulatory pressure was also cited as the third strongest reason for a fund to merge (53.6%), behind sustainability (58.9%) and increased scale (83.9%).

Bigger funds also face challenges

But the benefits of scale also come with their own challenges.

While larger funds can more easily internalise some asset management and undertake specialist investment strategies, their size can overwhelm niche asset classes, such as small caps.

It can even become challenging to take a meaningful position in Australian equities without buy-sell decisions moving the market. Smaller funds can easily move in and out of these asset classes.

Size alone is no guarantee of returns. The top super fund performers over the three years to February 2022 included a number of smaller funds, according to SuperRatings latest research.

While bigger funds attract natural economies of scale, Qantas Super Chief Executive Officer Michael Clancy told the Future of Superannuation report that size could make it harder to provide a more tailored member experience.

> *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," he said.*

[1]APRA Deputy Chair Helen Rowell - Speech to AIST Conference of Major Superannuation Funds | APRA. (2022, April 06). Retrieved from https://www.apra.gov.au/news-and-publications/apra-deputy-chair-helen-rowell-speech-to-aist-conference-of-major

[2]J.P. Morgan The Future of Superannuation - A new report for 2022. Retrieved from https://www.jpmorgan.com/solutions/cib/securities-services/future-of-superannuation-report

Qantas Super is an example of a smaller fund that remains particularly close to its members – it was able to understand and support its members when around 20,000 Qantas employees were stood down during the early days of the pandemic in 2020.

Other smaller funds that serve niche occupations can similarly argue they understand the unique needs of their members. For example, those who work in construction or mining industries may benefit from specialist group insurance cover given higher occupational risks.

Any merger must be carefully evaluated across factors such as fund culture, demographics, risk profiles, and investment strategy if it is to deliver member benefits.

Competition is not restricted by scale

There are many natural benefits of scale, but it is no guarantee that the best outcome will always be delivered to members.

The banking industry underwent consolidation decades ago and is now dominated by the 'big four' in Australia. Their scale allows them to offer high-level comprehensive services, yet smaller institutions such as overseas-owned banks, mutuals or new fintech-powered entrants tend to offer the cheapest consumer mortgages.

> *This isn't to say one offering is better than the other, but rather a truly competitive landscape includes a range of incumbents competing in different ways. Consumers reap the benefits.*

Smaller funds (and lenders) may not always have inherent scale, but they can find scalable solutions through other means.

"Technologically advanced funds like HESTA are going to draw most of their scale from the cloud and from data automation," HESTA Chief Operating Officer, Stephen Reilly, told the J.P. Morgan Future of Superannuation report.

> *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," Stephen Reilly said.*

The top three ways funds say they are increasing efficiency and innovation are data transformation (73.21%), automation (69.64%), and AI/Machine learning (21.43%), according to the survey.

While AI can deliver new insights, it is just as important to remove manual touch points across common tasks, freeing up staff to concentrate on higher value-adding activities.

Smaller funds that employ these strategies in an effective and targeted way deserve to retain a place in the industry.

Download a copy of the full report here. Polly Nix is a Senior Relationship Manager in Platform Sales - Securities Services, Australia and New Zealand at J.P. Morgan.

Polly Nix
Vice President
J.P. Morgan

J.P.Morgan

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