

KPMG-ACFS MONOGRAPH

Superannuation trends and implications

November 2011



Foreword

The Australian Centre for Financial Studies (ACFS) and KPMG are pleased to publish the ACFS-KPMG Monograph Superannuation trends and implications.

This monograph is an outcome of the research partnership between ACFS and KPMG and is central to the mission of both firms. It broadly covers the period from 2000 to 2011. During this period, which includes the Global Financial Crisis, the characteristics of the superannuation industry in Australia changed significantly. It was also a time when significant demographic trends intensified.

In contrast to earlier periods characterised by consistently strong growth of superannuation institutions, the extraordinary growth of the self-managed super fund segment since the beginning of this millennium and an ageing Australian population mean that, many superannuation institutions are now facing increased rollovers to self-managed superannuation funds, increased benefit payments (both lump sums and pensions) at the same time as their contribution inflows slow. The long-term future for such funds is problematic. Our analysis also suggests many funds are struggling to reduce member costs.

Superannuation institutions that fail to adapt and respond to the changing landscape face the prospect of negative funds flow, diminishing assets and terminal decline.

ACFS and KPMG gratefully acknowledges participants who so obligingly contributed their time and thoughts to this monograph. A special acknowledgement goes to Superannuation Sector Manager, John Batzaxis who provided research assistance.



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About ACFS

ACFS is a not-for-profit consortium of Monash University, RMIT University, the University of Melbourne and Finsia (Financial Services Institute of Australasia). ACFS was established in 2005 with seed funding from the Victorian Government, but now generates much of its support through corporate partnerships.

ACFS specialises in leading edge finance and investment research, aiming to boost the global credentials of Australia's finance industry, bridge the gap between research and industry, and support Australia as an international centre for finance practice, research and education. ACFS facilitates industry-relevant and rigorous research and consulting, thought leadership and independent commentary. Drawing on expertise from academia, industry and government, the Centre promotes excellence in financial services. Visit australiancentre.com.au for more information.

About KPMG

KPMG is one of the leading providers of audit, tax and advisory services. We proactively assist clients to respond to business challenges with a global perspective and local knowledge that spans industry sectors. Our high-performing people mobilise around our clients, using our expertise and insight to cut through complexity. We deliver informed perspectives and practical advice that our clients and stakeholders value.

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Contents

Executive summary	2
1. Introduction	5
2. Segmentation	8
3. Membership demographics	12
4. Consolidation and scale	15
Conclusion	18



Executive summary

The Australian superannuation industry is a vital component of the Australian financial sector and the Australian economy. At around 20 percent, the Australian superannuation industry's share of total financial institution assets is second only to that of the banks. Superannuation assets are equivalent to approximately 85 percent of the Australian share market capitalisation and 90 percent of Australia's annual GDP, significantly higher than the OECD weighted average. Assets in the Australian superannuation system have more than doubled since June 2000, increasing from approximately \$480 billion to \$1.3 trillion as at June 2011. During this period of significant growth, some of the characteristics of the superannuation industry also changed significantly.

During the period from June 2000 to June 2011, the industry funds segment and the small funds segment, which is comprised predominantly self-managed super funds (SMSF) were the fastest growing, increasing in size by approximately 410 and 461 percent respectively (measured by the change in nominal assets). The retail fund and public sector fund segments grew by 177 and 100 percent respectively over the same period, while the corporate fund segment contracted by 11 percent. The self-managed super funds segment now has the highest average balance per member account, more than five times higher than the corporate fund segment which is in second place in terms of average balance per member.

Consolidation of superannuation institutions in Australia has continued, albeit juxtaposed with continuing growth in the numbers of small funds. Consequently the average size of superannuation institutions (i.e. funds excluding self-managed super funds) has increased significantly, reaching approximately \$2.3 billion at June 2011.

Achieving greater scale is widely held to be one aspect of generating better outcomes (measured by lower total costs) for superannuation fund members. In practice, the phenomenal growth in the average size of superannuation institutions in recent years has yielded varied results in terms of lowering total costs per member. There is evidence from recent historical experience on the relationships between returns, costs and institution size suggesting that performance per dollar of assets increases with size, which supports the

argument for mergers between superannuation institutions in order to optimise outcomes for members. However, analysis of data published by the Australian Prudential Regulation Authority (APRA) in their Annual Superannuation Bulletin and Quarterly Superannuation Performance Reports suggests that greater scale has not consistently resulted in reduced total costs per member.

In line with overall demographic trends, superannuation membership in Australia is ageing. This means the proportion of fund members drawing an income stream from their superannuation is increasing and the proportion in the accumulation phase is falling. One of the obvious consequences of the rapid growth in the number of pension members is the related increase in the value of pension payments, which increased by approximately 500 percent during the decade to June 2010 as measured by the change in nominal payments. Year on year increases in the value of pension payments were recorded in 9 of the 10 years to June 2010. Notably, the value of pension payments as a percentage of total benefit payments has also increased significantly, from approximately 20 percent in 2000 to approximately 50 percent of total superannuation payments in 2011.

Over the past decade, the tax advantages associated with superannuation and the compulsory nature of the Superannuation Guarantee have underpinned the growth of assets in the Australian superannuation industry with continued inflows of contributions, offsetting some of the decline in the value of assets following the onset of the Global Financial Crisis (GFC) in 2007. This trend is expected to continue and growth of total superannuation assets may accelerate further if, as proposed, the rate of the Superannuation Guarantee increases from 9 to 12 percent. However, the extraordinary growth of the self-managed super fund segment, and an ageing Australian population, present a range of challenges for Australian superannuation institutions.

For example, the growth experienced by the self-managed super fund segment in the period from June 2000 to June 2011 has limited the growth of assets within superannuation institutions during the same period and, to some degree, will continue to limit asset growth within superannuation institutions. Members of superannuation institutions have not only transferred a disproportionately high per member value of benefits to self-managed super funds reflected in significantly higher member average balances in self-managed super funds, they have also redirected contributions to self-managed funds.

In combination with an ageing population, which will result in increasing numbers of pension members for at least the next decade and the related increase in pension payments, superannuation institutions with unfavourable demographics, and that fail to adapt and respond, face the prospect of negative funds flow, diminishing assets and terminal decline. As their assets diminish in a competitive environment, higher total costs per member will increase the propensity for members to transfer their benefits to either self-managed super funds which are perceived by some to be a low cost alternative to superannuation institutions, or to larger more operationally efficient and therefore, lower cost institutions, thereby perpetuating a vicious cycle of decline.

Over the coming decade, the ability of a superannuation institution to adapt to an ageing population and respond to the challenges presented by the growth of the self-managed super funds segment will be vital for its continued success and growth. With 86 percent of respondents to the 2008 ATO New Trustee Questionnaire indicating that gaining control of their money was their most powerful motivation for starting a self-managed super fund, and a third of the same trustees stating that saving on fees was another reason for establishing a self-managed fund, superannuation institutions must offer 'Choice' (i.e. greater control) and become more cost competitive if they are to attract and retain the assets and contributions of members.

Under the proposed MySuper regime, where the cost of providing 'Choice' features and benefits cannot be cross-subsidised and paid for by disengaged default MySuper members, one of the few options remaining for superannuation institutions with diminishing assets will be to attempt to attract and retain assets and contributions by reducing operating costs per member to enable both MySuper and 'choice' to be offered to members at lower price points. This may be achieved either through an increased focus on operational efficiency, or by merging with larger, more operationally efficient superannuation institutions with more favourable member demographics.

Issues for superannuation institutions

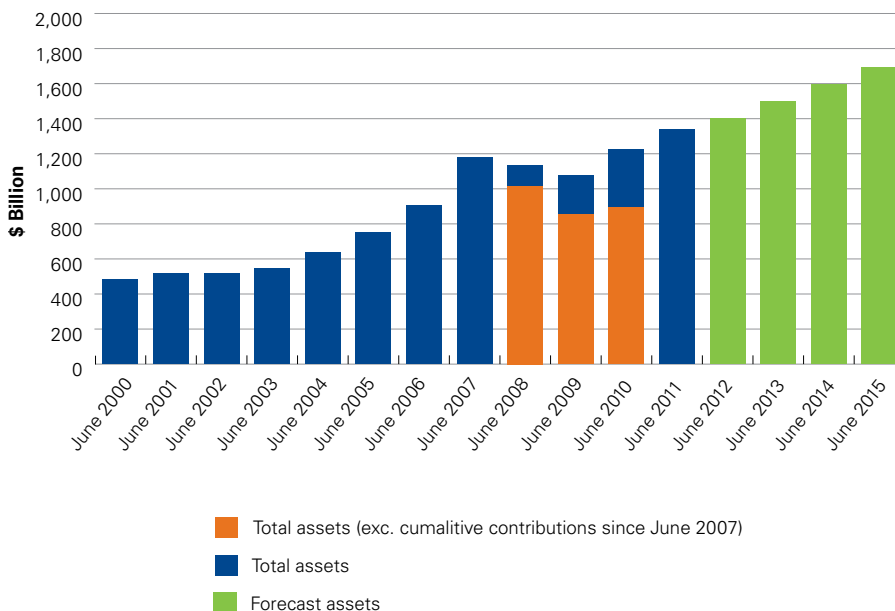
Superannuation institutions need to review their strategy and plans to grow their assets and members over the coming decade, taking into consideration the ageing population, size and continued growth of the self-managed super fund segment, the growth in average size of competitor institutions and impact of the upcoming Stronger Super reforms. Specifically, superannuation institutions should:

- Review the competitiveness of their offering, particularly with regard to fees and costs which are one of the reasons cited for establishing a self-managed fund and one of the few points of differentiation for superannuation institutions which intend to offer a MySuper product under the proposed Stronger Super reforms. Recognising that superannuation is a highly outsourced industry, this review may involve benchmarking outsourced service providers such as administrators and custodians. Superannuation institutions can also use techniques such as activity based costing, process mapping, benchmarking and diagnostic testing to quantify the cost and value of their services and benefits they provide to members, with the objective of reducing waste, improving productivity and maximising the value derived by members.
- Consider alternatives to organic growth, such as merging with another superannuation institution with complimentary member demographics and strategic or operational synergies. For superannuation institutions, reaching agreement to merge is a challenge in itself because of the trust structure in superannuation which creates a somewhat unique relationship between the regulated entity and members. Superannuation institutions considering a merger as part of their growth strategy need to carefully consider their particular circumstances, the relevant risks associated with merging, the material benefits to members that may be realised by merging and the unique challenges faced by superannuation institutions which, if not addressed early, can cause a proposed merger to fail.
- Formulate a strategy and transition plan specifically in relation to the upcoming Stronger Super reforms. In particular, superannuation institutions need to consider aspects of the reforms such as auto-consolidation which has the potential to significantly impact the assets under management of superannuation institutions which have a large number of inactive members. Consideration also needs to be given to how the competitive landscape may change in the superannuation industry due to the Stronger Super reforms.

1. Introduction: Overview of super institutions and their role in the economy

During the period from June 2000 to June 2011, assets in the Australian superannuation industry more than doubled, increasing from approximately \$480 billion to approximately \$1.3 trillion. Figure 1 illustrates how assets in the Australian superannuation industry have grown.

Figure 1: Total superannuation assets



Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 9
 APRA Statistics - Quarterly Superannuation Performance June 2011 KeyStats
 APRA Statistics - Annual Superannuation Bulletin June 2010 Table 7

The tax advantages associated with superannuation and the compulsory nature of the Superannuation Guarantee have underpinned the growth of assets in the superannuation industry. Continued inflows of contributions have offset some of the decline in the value of assets following the onset of the GFC in 2007. As depicted in Figure 1, without the strong contribution flows recorded in the 3 years to June 2010 (approximately \$330 billion), the total value of superannuation assets would have been approximately \$900 billion at June 2010 instead of \$1.2 trillion and, arguably, total superannuation assets would be much lower today.

Superannuation institutions are an increasingly important component of the Australian financial sector. The share of total financial institution assets of the Australian superannuation industry is one of the largest by size, growing substantially over the last decade, primarily at the expense of registered financial corporations, life offices and managed funds, as shown in Table 1. Notably, despite the financial market turmoil following the onset of the GFC in 2007, superannuation institutions' share of financial institution assets continued to increase (with the value increasing from \$833.2 billion in December 2007 to \$946.5 billion in December 2010¹).

¹ These figures exclude self managed superannuation funds.

Table 1: Share of total financial institution assets

% of total	ADIs	RFCs	Life offices	Superannuation	Managed funds	General insurance	Securitisation vehicles
Dec-1999	46%	8%	10%	16%	9%	4%	3%
Dec-2005	49%	5%	6%	18%	9%	3%	6%
Dec-2007	51%	5%	5%	19%	8%	3%	6%
Dec-2010	59%	4%	4%	20%	6%	3%	3%

Source: Reserve Bank of Australia Bulletin – June Quarter 2011, Table B3

During 2010, a significant proportion of household savings flowed into superannuation at the expense of other savings vehicles such as bank deposits. In that regard it is worth noting that the large and growing Authorised Deposit-taking Institutions (ADI) share of total financial institution assets in Table 1 partly reflects the large reliance of banks on wholesale and offshore financing to fund those assets. The banks' share of domestic residents' investments is considerably less. Table 2 provides information on major household asset acquisition patterns in 2010. Superannuation institution balances are approximately double the holding of bank deposits, and the flow of household funds into both in 2010 was roughly similar.

Table 2: Household asset acquisition and holdings 2010^a

	March quarter (\$ Billion)		June quarter (\$ Billion)		Sept quarter (\$ Billion)		Dec quarter (\$ Billion)	
	Net flow	Value	Net flow	Value	Net flow	Value	Net flow	Value
Bank Deposits	12	527	2	529	26	554	14	568
Superannuation	18	1149	23	1107	14	1155	15	1195
Equities/Managed Funds	-4	306	-5	272	-9	278	-6	281
Unfunded (Govt) Super	3	205	4	220	2	222	2	224

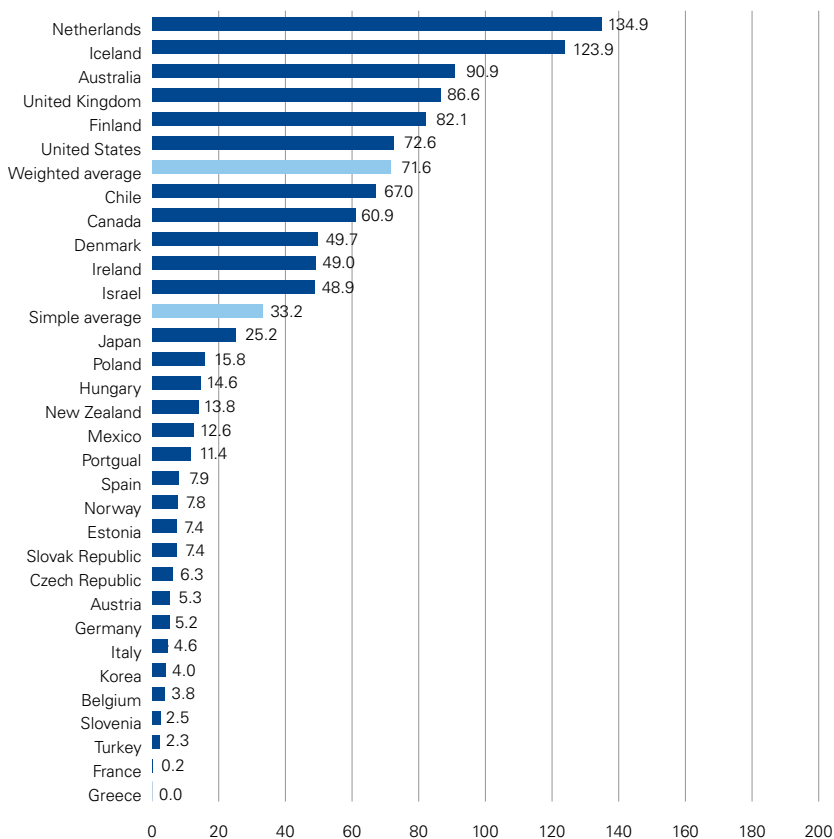
(a) The values at end of the quarter reflect both transactions (net flow) and valuation effects.

Source: ABS Cat. No 5232.0 Table 20, Dec 2010

By international comparison, Figure 2 illustrates the importance of the superannuation industry within the Australian economy. Superannuation fund assets are equivalent to approximately 90 percent of Australia's annual GDP, which is significantly higher than the Organisation for Economic Cooperation and Development (OECD) weighted average.



Figure 2: Fund assets as a percentage of GDP – selected OECD countries - 2010



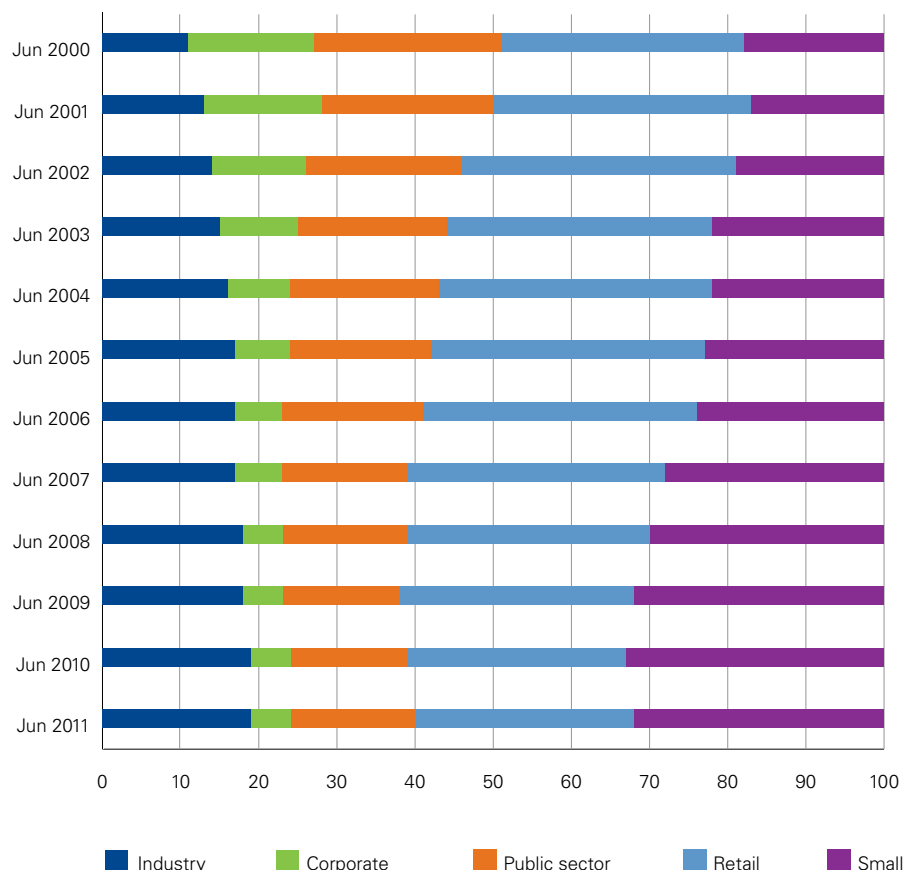
Source: *Pension Markets in Focus: July 2011, Issue 8 OECD 2011*

Superannuation assets are also equivalent to approximately 85 percent of the Australian share market capitalisation. The growth of total assets in the superannuation industry and its increasing importance within the Australian economy is expected to continue, provided that any future tax reforms do not make superannuation less attractive as a retirement savings vehicle. Growth of total superannuation assets may accelerate further in the decade ahead if financial markets recover and if the rate of the Superannuation Guarantee is increased from 9 to 12 percent as proposed.

2. Segmentation

The Australian superannuation industry can be segmented into five categories of funds, industry, corporate, public sector, retail and small funds (predominantly self-managed super funds).

Figure 3: Assets by type of fund as a percentage of total superannuation assets

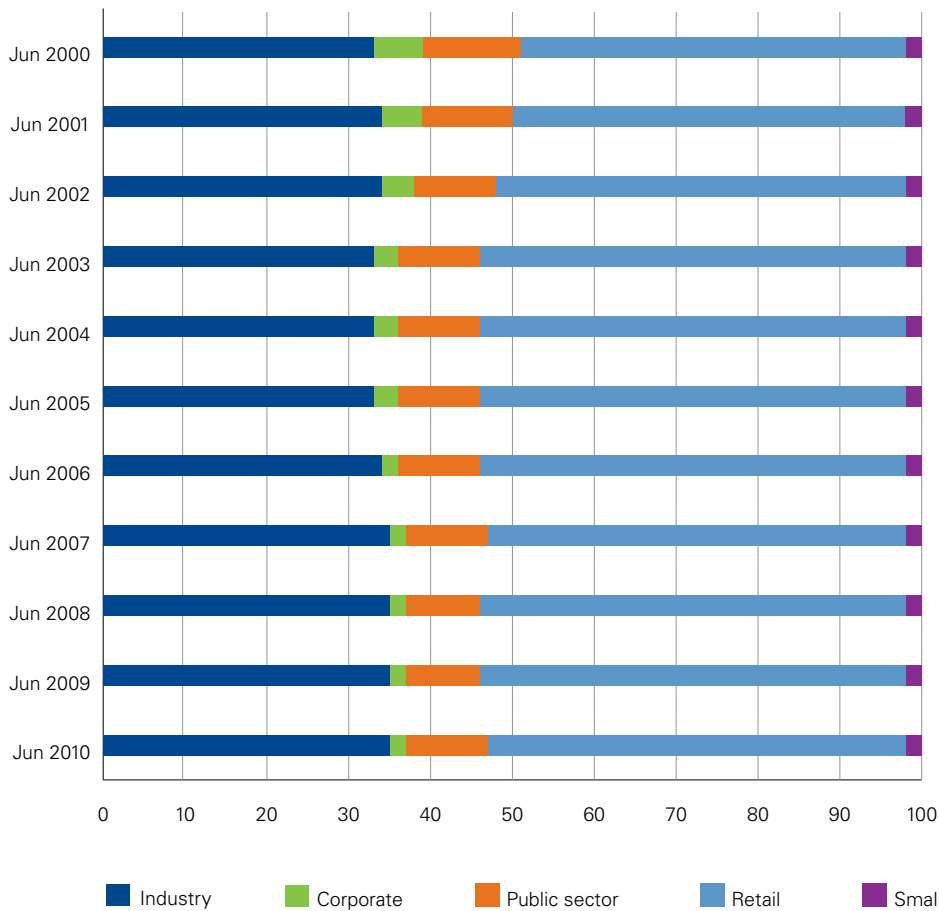


Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 9
APRA Statistics - Quarterly Superannuation Performance June 2011 KeyStats

Figure 3 illustrates how the distribution of assets by segment, as a percentage of total assets held within the Australian superannuation industry, has changed over time.

Measuring by either the change in nominal assets or as a percentage of total assets held by the superannuation industry, over the period from June 2000 to June 2011, the industry funds segment and small fund (predominantly self-managed super funds) segment were the fastest growing segments, expanding by approximately 410 and 461 percent respectively when measured by the change in nominal assets. The retail fund segment and public sector fund segment grew much more slowly over the same period, by only 177 and 100 percent respectively. In contrast, the corporate fund segment contracted by 11 percent.

Measuring by the distribution of members, Figure 4 shows that changes in the distribution of members across the five categories has not followed the same trend as changes in the distribution of assets. For example, the number of self-managed super fund members doubled over the decade to June 2010, whereas the assets in the self-managed super fund segment quadrupled.

Figure 4: Members by type of fund as a percentage of total members

Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 3

Table 3 indicates that self-managed super funds now have by far the highest average balance per member account compared to the other segments.

Table 3: Average account balance per member

	Corporate	Industry	Public sector	Retail	SMSF
Total assets (\$m)	\$56,625	\$226,188	\$172,853	\$339,473	\$384,037
Total member accounts ('000)	624	11,516	3,131	16,766	815
Average member account balance (\$)*	\$90,815	\$19,641	\$55,203	\$20,248	\$482,107

Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 11
ATO Self-Managed Super Fund Statistical Report - March 2011, Asset allocation tables 'Total assets (\$m)'

* Excluding Eligible Rollover Funds and Approved Deposit Funds, the average account balance for retail funds is \$31,498. The average account balance for Public Sector funds is based on the funded portion of their benefits only.

One explanation for the significant growth in self-managed super fund assets relative to the slower growth in total self-managed super members may be the influx of contributions in the year ending June 2007, when self-managed fund assets increased by approximately 50 percent compared to an increase of approximately 30 percent for superannuation institutions in response to the 'Simpler Super' reforms and the availability of a \$1 million transitional non-concessional contribution cap. Table 4 indicates that the share of total contributions received by self-managed super funds increased to 41.1 percent of total contributions in the year to June 2007. This is approximately double the share of total contributions received by self-managed funds in the years preceding and after 2007.

Table 4: Personal and employer contributions

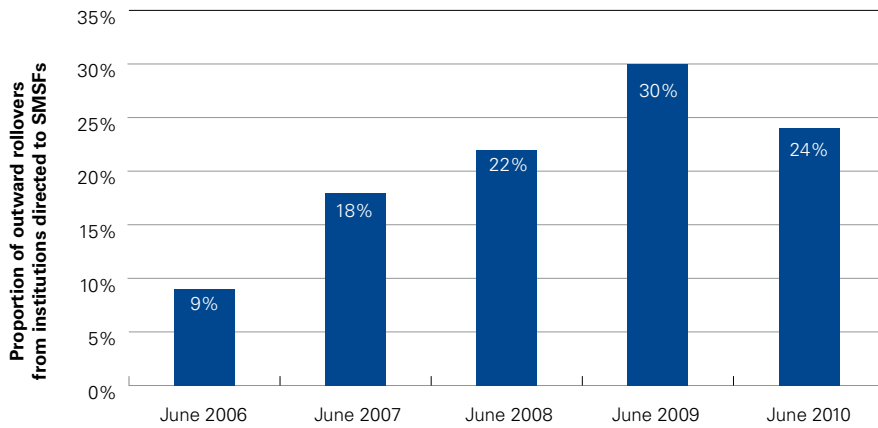
	June 2004		June 2007		June 2010	
	%	(\$ Billion)	%	(\$ Billion)	%	(\$ Billion)
Employer contributions						
Self-managed super funds	11.9	4.8	16.5	11.0	9.6	6.9
Institutions	88.1	35.4	83.5	55.8	90.4	65.1
Total employer contributions	100.00	40.2	100.00	66.8	100.00	72.0
Member / other contributions (\$ Billion)	%	(\$ Billion)	%	(\$ Billion)	%	(\$ Billion)
Self-managed super funds	35.3	7.1	58.0	56.2	42.3	15.1
Institutions	64.7	13.0	42.0	40.7	57.7	20.6
Total member / other contributions	100.00	20.1	100.00	96.9	100.00	35.7
Employer / member / other contributions	%	(\$ Billion)	%	(\$ Billion)	%	(\$ Billion)
Self-managed super funds	19.7	11.9	41.1	67.2	20.4	22.0
Institutions	80.3	48.4	58.9	96.5	79.6	85.7
Total contributions	100.00	60.3	100.00	163.7	100.00	107.7

Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 7
ATO Self-Managed Super Fund Statistical Report - June 2011, Flow of funds table (\$m)

While the growth of self-managed super fund assets can be attributed somewhat to the increased share of total contributions, the primary driver of growth is the disproportionately high value of assets per member that have been transferred (i.e. rollovers) from superannuation institutions to the self-managed super fund segment since 'choice of fund' was introduced in July 2005.

Figure 5 shows that inward rollovers to self-managed super funds increased from 9 percent of total outward rollovers from superannuation institutions in the year to June 2006, to 24 percent in the year to June 2010.

Figure 5: Rollovers from superannuation institutions to self-managed super funds



Source: APRA Statistics - Quarterly Superannuation Performance March 2010 Table 1b
ATO Self-Managed Super Fund Statistical Report - June 2011, Flow of funds table (\$m)

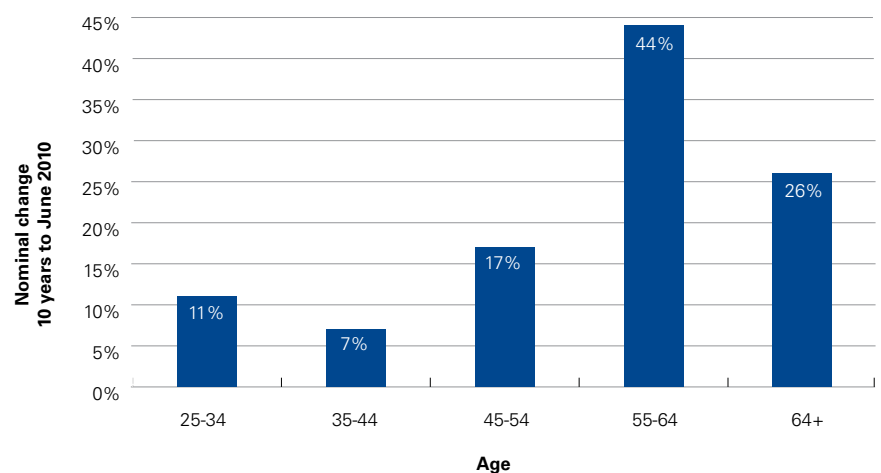
On average, in the 3 year period to June 2010, twenty-six cents of every dollar transferred out of a superannuation institution was directed to a self-managed super fund.

The Australian Tax Office, in its role as regulator of self-managed super funds, regularly conducts a survey of new self-managed super fund trustees. In 2008, 86 percent of respondents to the ATO *New Trustee Questionnaire* indicated that gaining control was their most powerful motivation for starting a self-managed super fund. More than half of the respondents also had a belief that their self-managed super fund could outperform their previous institutional superannuation fund while a third of the trustees included an effort to save on fees as another reason for establishing a self-managed super fund.

3. Membership demographics

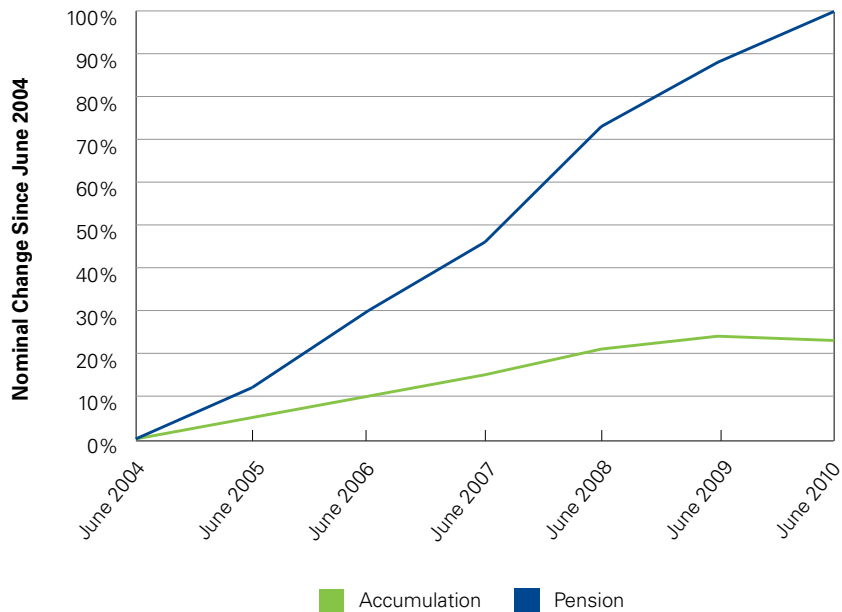
Similar to the general population, superannuation membership in Australia is ageing. Figure 6 shows that the estimated Australian resident population (i.e. number of individuals) who have reached preservation age (i.e. age 55 or above) increased by 70 percent during the decade to June 2010. At only 35 percent, the nominal increase in the estimated resident population aged 25 to 54 was much less over the same period.

Figure 6: Change in estimated resident population



Source: ABS 3201.0 - Population by Age and Sex, Australian States and Territories, June 2010

Specifically in relation to superannuation membership, Figure 7 illustrates that, for the top 200 Australian superannuation institutions (measured by assets under management), the number of members converting from the accumulation phase to the pension (i.e. income stream) phase has grown much faster than the annual growth in accumulation membership indicated by the steeper gradient of the pension line.

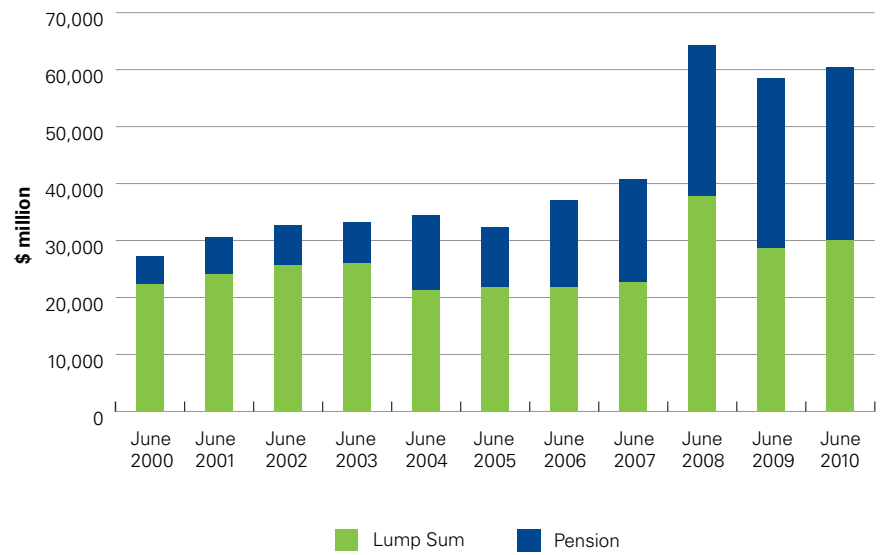
Figure 7: Accumulation vs pension membership growth

Source: APRA Statistics - Superannuation Fund-level Profiles and Financial Performance June 2010

Measuring the change in nominal membership, since June 2004 the number of pension members had doubled by June 2010 whereas the number of accumulation members increased by only 23 percent over the same period. More recently, since June 2009 the number of accumulation members has actually started to decline in the top 200 Australian superannuation institutions. Some of the increase in the number of pension members may be due to the popularity of transition to retirement pensions introduced in July 2005. However, reaching preservation age (currently age 55) is one of the conditions that must be satisfied to commence a transition to retirement pension. As such, the increase in the number of transition to retirement pension members is in itself also partly a function of the ageing population.

One of the obvious consequences of the rapid growth in the number of pension members is the related increase in pension payments in recent years as illustrated by Figure 8. The historical trend of increases in the value of pension payments is sustained throughout the decade, with a year on year increase recorded in 9 of the 10 years to June 2010. Notably, the value of pension payments as a proportion of total payments has also increased significantly, from approximately 20 percent in June 2000 to approximately half the total superannuation payments by June 2010.

Figure 8: Lump sum vs pension payments



Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 7

In recent times the combination of the growth in the number of pension members (and related increase in pension payments) and recent declines in the number of accumulation members (and related decrease in contributions), coupled with recent financial market turmoil, has challenged superannuation funds to reconsider their investment strategies and policies for managing liquidity and cash flow.

Over the medium to long term, the superannuation regulations structurally reinforce further growth of pension payments, with the superannuation pension drawdown relief reducing by 25 percent in 2011/12 and no further relief in 2012/13. Also, as the population ages, and more superannuation members enter their seventies and eighties, they will be required to draw a higher minimum percentage of their pension account balance as an income stream.



4. Consolidation and scale

There is a trend towards consolidation of superannuation institutions in Australia, albeit juxtaposed with continuing growth in the numbers of small funds (predominantly self-managed super funds) as shown in Table 5.

Table 5: Number of funds by type

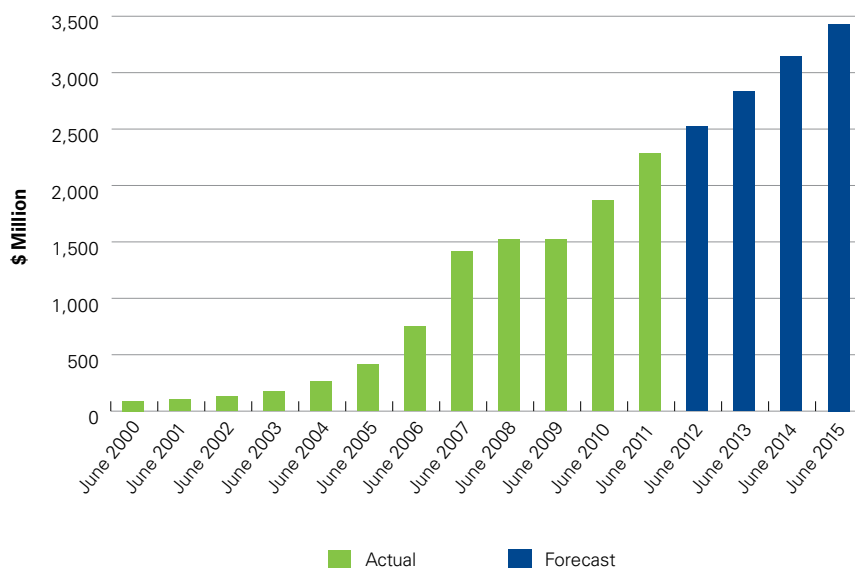
	Actual			Forecast
	June 2001	June 2006	June 2011	June 2015
Corporate	3,224	555	143	109
Industry	150	80	61	53
Public sector	81	45	39	37
Retail	293	192	143	120
SMSF	210,667	308,681	460,545	579,011

Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 1
APRA Statistics - Quarterly Superannuation Performance June 2011 KeyStats

As a consequence of the trend towards consolidation and the resilience of contributions into superannuation, the average size of superannuation institutions (i.e. funds excluding self-managed super funds) has increased significantly over time.

As shown in Figure 9, despite the financial market turmoil in recent years, the average size of superannuation institutions measured by assets, increased significantly during the period from 2000 to 2011, reaching \$2.3 billion funds under management by June 2011.

Figure 9: Superannuation fund average size



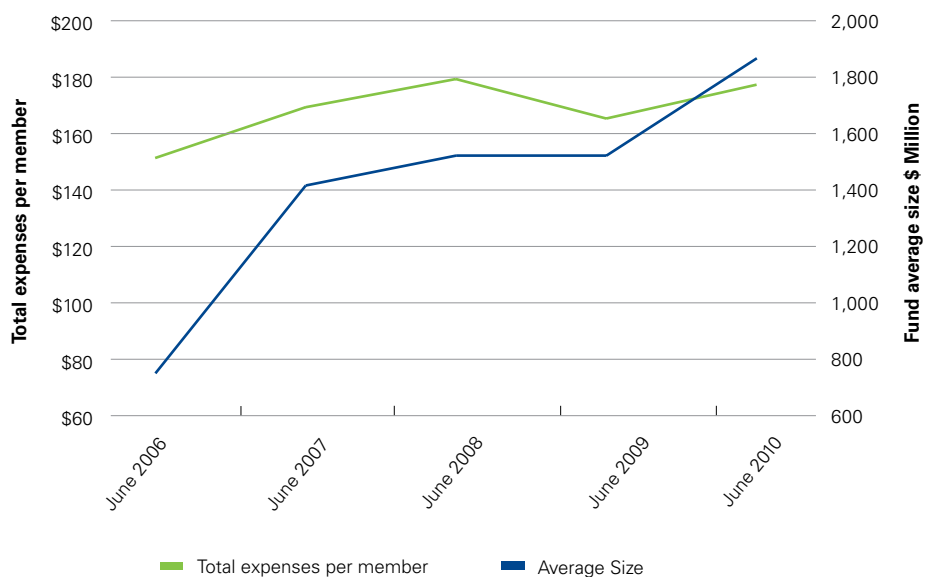
Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 1
APRA Statistics - Quarterly Superannuation Performance June 2011 KeyStats

Achieving greater scale is widely held to be one aspect of generating better outcomes (measured by lower total costs) for superannuation fund members. As superannuation funds increase in size (in terms of assets) trustees should be able to exploit economies of scale and thereby reduce total costs (i.e. operating and investment expenses) per member. However, the growth in the average size of superannuation funds has historically yielded varied results in terms of reducing total costs per member.

Figure 10 indicates that in the past 5 years the average size of superannuation entities and total costs per member both increased. Only in the year to June 2009 did total costs per member actually decrease, followed by a slight increase in the year to June 2010.

Neither the total costs per member nor fund average size in Figure 10 have been adjusted for inflation. However, given that annual inflation was subdued during the relevant period (approximately 3 percent p.a.), even after adjusting for inflation, total costs per member were at best flat over the period. By way of contrast, fund average size more than doubled over the same period.

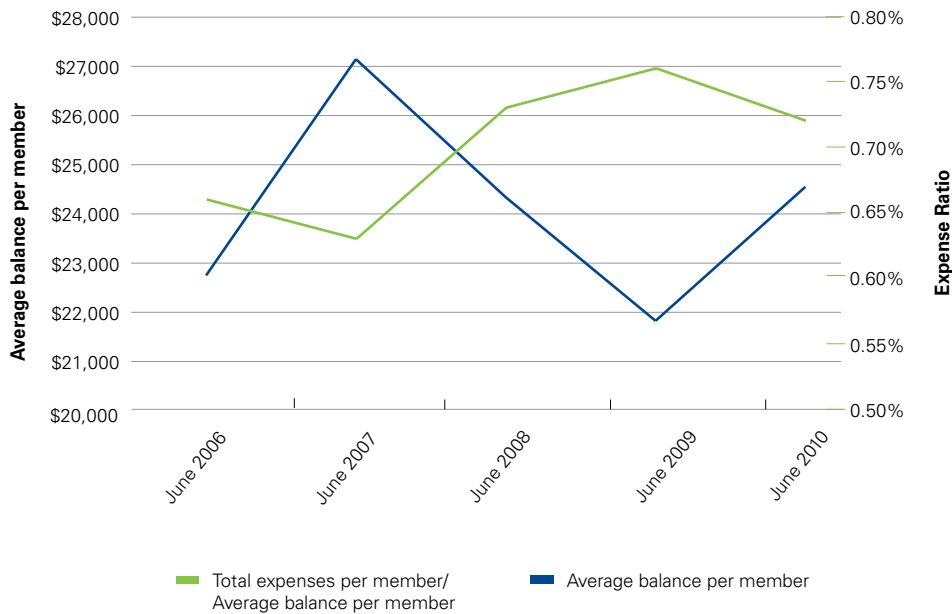
Figure 10: Total costs per member vs average size



Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 9
 APRA Statistics - Quarterly Superannuation Performance June 2011 KeyStats
 APRA Statistics - Annual Superannuation Bulletin June 2010 Table 1
 APRA Statistics - Quarterly Superannuation Performance June 2011 Table 1b
 APRA Statistics - Annual Superannuation Bulletin June 2010 Table 3

Consequently, there would appear to be some evidence from recent historical experience (i.e. the year to June 2009) to support the argument for mergers between superannuation funds in order to optimise outcomes for members. However, the inability for superannuation funds to reduce total costs per member over the 5 year period suggests that achieving greater scale does not necessarily result in an immediate reduction in total costs per member.

The inability of superannuation funds to reduce total costs per member in the five years to June 2010 cannot be explained through an increase in the average member balance (which, all else being equal, may increase the dollar value of asset based expenses per member). Figure 11 indicates that the average member balance fluctuated in the five years to June 2010 but did not increase significantly.

Figure 11: Average member balance & expenses

Source: APRA Statistics - Annual Superannuation Bulletin June 2010 Table 9
 APRA Statistics - Quarterly Superannuation Performance June 2011 KeyStats
 APRA Statistics - Annual Superannuation Bulletin June 2010 Table 1
 APRA Statistics - Quarterly Superannuation Performance June 2011 Table 1b
 APRA Statistics - Annual Superannuation Bulletin June 2010 Table 3

One reason for the inability to reduce total costs per member over the 5 year period to June 2010 is suggested by the inverse relationship between average member balances and expenses per average account size. Total expenses may be more closely related to total assets than to member numbers or assets per member, in which case economies of scale should ultimately translate into lower costs per member.

However, in the short term the absence of a relationship may be due partly to enhancements in the range and quality of services offered to members by superannuation institutions over the relevant period. These enhancements represent value to members, but the cost of these enhancements may have offset other scale related cost reductions. Additionally, the need to adapt to significant regulatory change during this period and the associated cost may have also offset other scale related cost reductions.

Another explanation may be that there is a time delay between consolidation occurring and the realisation of benefits from achieving greater scale. For example, the lower total costs per member achieved in the year to June 2009 may be due to the consolidation which occurred in the 2 preceding years when the fund average size almost doubled. Furthermore, to the extent that the superannuation industry is able to reduce 'lost' accounts or facilitate members consolidating multiple accounts, the reduction in the number of inoperative accounts also affects those average figures.

The upcoming 'Stronger Super' reforms, particularly MySuper (which effectively standardises default superannuation arrangements), will focus greater attention on the ability of funds to demonstrate a reduction in operating costs per member following a merger.

Conclusion

Despite financial market turmoil, the tax advantages associated with superannuation and the compulsory nature of the Superannuation Guarantee have underpinned the growth of the Australian superannuation industry. Continued contribution inflows have offset some of the decline in the value of assets following the onset of the GFC in 2007. Since June 2000, assets in the Australian superannuation industry more than doubled, increasing from approximately \$480 billion to \$1.3 trillion. This growth trend is expected to continue provided that any future tax reforms do not make superannuation less attractive as a retirement savings vehicle. Growth of total superannuation assets may accelerate further if financial markets recover and if the rate of the Superannuation Guarantee is increased from nine to 12 percent as proposed.

However, the growth of the self-managed super fund segment since June 2000 and the ageing Australian population present a range of challenges for Australian superannuation institutions in the decade ahead.

The disproportionately high value of assets per member that are typically transferred from superannuation institutions to self-managed funds in combination with increasing pension payments and fewer members in the accumulation phase pose a significant risk to superannuation institutions that fail to recognise, adapt and respond to these challenges. Compared to other institutions that respond adequately to these challenges and are therefore able to grow either organically or by merging, institutions that fail to respond will face cost disadvantages as their asset growth stalls and then begins to decline. In an increasingly competitive environment, this will weaken their ability to sustain and attract assets and contributions.

As their assets diminish, superannuation institutions operating costs per member will continue to increase, thereby perpetuating a vicious cycle, accelerating the transfer of benefits by members to self-managed super funds (which are perceived by some to be a low cost alternative to superannuation institutions), or larger more operationally efficient (and therefore, lower cost) superannuation institutions.

With 86 percent of respondents to the ATO New Trustee Questionnaire in 2008 indicating that gaining control was their most powerful motivation for starting a self-managed fund and a third of the trustees stating that an effort to save on fees was another reason for establishing a self-managed fund, superannuation institutions must offer 'choice' (i.e. greater control) and become more cost competitive if they are to continue to attract and retain members' assets and contributions.

However, under the proposed MySuper regime, where the cost of providing 'choice' features and benefits cannot be cross-subsidised and paid for by disengaged default MySuper members, one of the few options remaining for superannuation institutions with diminishing assets will be to attempt to attract and retain members' assets and contributions by becoming more cost competitive and reducing total costs per member. This will enable both MySuper and 'choice' to be offered to members at lower price points. This may be achieved, either through an increased focus on operational efficiency (i.e. intensifying resource use, removing operational waste and reconfiguring processes to generate value) or by merging with larger, more operationally efficient superannuation institutions with favourable member demographics.

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