



## GATEWAY INSIGHTS

December 2010

### # 22 The Australian Superannuation Market

#### A Gateway guide for new market entrants

##### **Introduction**

Superannuation accounts for in excess of 60% of all funds inflows in Australia. Australians have over a trillion dollars in Superannuation savings. For fund managers, both offshore and onshore it is the ability to tap into this huge pool of money that can substantially make or break a business. We are always asked how to access this pool, how it works and what it all means. We have put together in this Insight an overview, or recap for some, about how the Australian superannuation market works and why it remains so important.

In 1992 the Government mandated a compulsory superannuation contribution of 9% of annual wages. This has seen the Australian superannuation pool grow exponentially to current figures. The current superannuation system in Australia is complex and not always user-friendly, yet it is a system in which virtually everyone participates. Given that the Federal Government has also announced an increase in compulsory employer superannuation from 9% to 12% by 1 July 2019, the need to understand superannuation has become even more imperative.

##### **What are the different types of Superannuation Funds?**

Australian Superannuation Funds can generally be divided into five main segments: corporate, public sector, industry, retail and small funds.

Corporate funds are funds operated for the benefit of employees of a particular company or

Corporate group. As at March 2010 Corporate Funds accounted for 18% of Superannuation monies. Examples of Corporate super funds are Qantas Superannuation Fund and Telstra Super.

Industry funds are funds formed to provide access to superannuation for employees working in the same industry, although an increasing number of industry funds are now open to the public (18% of Superannuation monies). HESTA (for Hospital employees); CBus (for building industry employees) and MediaSuper (for employees in the Media) are three examples of Industry Funds.

Public Sector funds are funds that provide benefits for government employees, or are schemes established by a Commonwealth, State or Territory law (14% of superannuation monies).

Retail funds offer superannuation products on a commercial basis and their trustees are typically a part of a larger financial conglomerate (27% of superannuation monies).

Small funds are those with less than five members. Almost all small funds are Self Managed Superannuation Funds (SMSF's). This sector accounts for 32% of superannuation monies.

### **How are the assets held?**

Superannuation has become a significant financial asset for many Australians. In August 2009, 88% of all employees had superannuation contributions paid into a superannuation scheme on their behalf by their employer. Most superannuation in Australia is provided through a trust structure where trustees hold the superannuation assets on trust on behalf of members and owe a fiduciary duty to those members. Trustees have a duty to act in the best interest of members while managing the superannuation savings in their care. Legislation includes measures which set out the basic duties and responsibilities of trustees and ensures that they have adequate powers to carry out these responsibilities.

An alternative to trustee-controlled superannuation funds was introduced in June 1997 by the Retirement Savings Accounts Act 1997. Retirement savings accounts (RSAs) are able to be offered by banks, credit unions, building societies and life offices outside a trust structure.

Retirement savings accounts were intended as a low cost, capital protected, alternative to superannuation accounts for small balances that could be rolled over into traditional funds after savings had been built up. RSAs could also serve retirees with little risk appetite, seeking cash investments.

### **Taxation of Superannuation**

Superannuation has always been a preferentially taxed savings vehicle.

From 1 July 1988, a 15 % tax was applied to all employer contributions and deductible member contributions received by superannuation funds, while the tax on end benefits was correspondingly reduced. A 15 % tax also applied to the investment income of superannuation

funds derived from 1 July 1988. The tax on investment earnings can be offset by the allowance of full imputation credits for franked dividends received from Australian companies and credits for dividend and interest withholding tax on income received from foreign sources (the latter quarantined to foreign income).

### **The gatekeepers**

To manage superannuation successfully in Australia fund managers need to deal with a range of gatekeepers and regulatory authorities:

- Regulatory Authorities
  - ASIC – Prudential regulation of Superannuation Funds, Insurance and deposit taking institutions
  - APRA – Market integrity, Consumer Protection, Corporations

Managers must have at a minimum a wholesale registered fund to approach large superannuation funds.

- Asset Consultants/Research Houses
  - Provide independent, objective assessment of product viability
  - Required as evidence that adequate due diligence has been undertaken
  - All operate differently providing significant hurdles for new entrants

Approval by independent Asset Consultant/Research House is mostly required.

- Platforms
  - Utilised by vast majority of retail investors
  - Puts extra pressure on fees and charges
  - Being approved by Asset Consultants or Research Houses does not guarantee inclusion on Platform Menus

### **Future developments in Superannuation**

As recognition of the potential growth and significance of the Superannuation industry, the government commissioned the Cooper Review to review the superannuation system in Australia. This 18 month review delivered its findings in July 2010. Key assumptions used in the review included:

- In real terms, total superannuation assets are assumed to grow at an annual average of about 4.3 % from around \$1.08T in 2009 to about \$3.2T in 2035. Small funds, including SMSFs and small APRA funds, will grow to slightly more than a third of total superannuation assets.
- The number of superannuation funds is expected to continue to decline as funds consolidate, the big are likely to get bigger.
- The number of industry funds and retail funds will continue to decline at the same average rate (around 7 % per annum) as they have since 1996.
- The number of public sector funds will decline at 2 % per annum, the average rate experienced since 1996.
- The number of corporate funds has declined, on average, by 20 % each year from 1996 to 2009. It is projected this rate of decline will gradually slow.

## **MySuper**

The report recommended the introduction of a new architecture model for Super which has at its core MySuper. The MySuper component of the model aims to provide a simple, cost effective product with a single, diversified portfolio of investments for the vast majority of Australian workers (roughly 80 % of members) who are in the default option in their current fund.

MySuper is designed with two large groups of members in mind: those who take no real interest in their super, and those who choose to be in a large, low-cost and well-managed product where the investment strategy is designed and implemented by the trustee.

MySuper would have a number of features designed solely with the member in mind:

- specific trustee duties designed to deliver lower cost outcomes for members;
- increased transparency leading to better comparability, especially of costs and long-term net performance;
- provision of intra-fund advice;
- simpler communications;
- and an embedded retirement product.

It has been designed to sit within the existing superannuation structures and is based on existing widely offered and well understood default investment options.

The aim of MySuper is to lower overall costs for members while supporting and encouraging a competitive market-based, private sector infrastructure for superannuation. The objective of the Cooper Review's findings is to make Superannuation better value for money and MySuper is designed with this in mind. While the Panel has not recommended a cap on fees, there were recommendations to change legislation and regulation to make fees more transparent and to assist members to compare fees across the industry. These measures, along with sharper duties on trustees, are designed to see better management of overall costs.

### **Benefits and impacts of MySuper**

- scale and efficiency gains mean increasing members' net wealth;
- prohibiting adviser commissions on insurance
- removing trailing commissions on advice and limiting performance-based investment management fees;
- requiring trustees to manage investments for after-tax returns and to align investment management arrangements with member interests
- giving trustees a duty to consider longevity risk and inflation risk in relation members in retirement phase;
- removing barriers in the tax legislation and SIS Act to fund consolidation so that scale can be more easily achieved; and
- requiring trustees to have not only an investment strategy, but also an insurance strategy so that costs in both areas are actively considered and managed by the trustee

On August 1, 2010 the Federal Government announced that it would implement the MySuper scheme in July 2013 in conjunction with the introduction of new standards that funds would need to be compliant with in order to offer MySuper. These would include no entry fees, limited exit fees, quality standards and a requirement that investment options be easy to understand.

### **Summary**

The Australian Superannuation industry provides a large and very attractive pool of funds for potential new entrants into the Australian financial markets. The structure of Superannuation is somewhat complex and currently subject to change ahead of the introduction of MySuper. For any entrant commencing a Funds Management operation which targets the Australian market we would recommend beginning with a thorough market entry study and competitor analysis to ensure your product is pitched to win the inflows of the future.

## End Notes

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<sup>i</sup> Super System Review Final Report ([www.SuperSystemReview.gov.au](http://www.SuperSystemReview.gov.au))

Super System Review Appendices

APRA Insight No 2 2007 “A recent history of Superannuation in Australia”

Various Press Articles

### About Gateway

Gateway Financial Marketing (Gateway) was established in February 2004 by Amanda Rethus and Edwina Best for the purpose of offering fund managers, other product providers and international new entrants, expert advice, services and assistance in negotiating entry into the Australian Retail Financial Services market. Use of Gateway’s services provides the opportunity for clients to overcome the hurdles that can often confront fund managers when transitioning from institutional to retail and hence improve participation in retail funds flow. Prior to Gateway, Amanda and Edwina spent over 30 years combined with major institutions in the Retail Financial Services market.

### Our qualifications

Amanda has over 20 years experience in the Financial Services industry and was formerly a Divisional Director in the Financial Services Group of Macquarie. Amanda managed investment portfolios for over 10 years, and has spent in excess of 10 years introducing investment products to the Australian Retail market.

Edwina has a Bachelor of Business from UTS majoring in Marketing and International Business. She has over 12 years experience in the financial services market, concentrating in relationship management, product management and marketing. They both have extensive contacts in the retail financial services market especially with key decision makers.

If you would like to confidentially discuss your current approach to the retail market or have any questions on the above please do not hesitate to contact us on – Edwina 0404 046 179 or Amanda or 0414 658 323.