14th Annual Colloquium of Superannuation Researchers

July 2006

The University of New South Wales

Centre for Pensions and Superannuation

The shape of things to come: the impact of choice & APRA licensing

Ross Clare, Principal Researcher

ASFA Research Centre

Association of Superannuation Funds of Australia
www.superannuation.asn.au

Federal Secretariat

Level 19
Piccadilly Tower
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001
Tel: (02) 9264 9300
Fax: (02) 9264 8824

The Association of Superannuation Funds of Australia Limited ABN 29 002 786 290 ACN 002 786 290
ASFA Website: www.superannuation.asn.au

1. Introduction

2005 and 2006 have been watershed years for many superannuation funds, given the dual challenges of the “choice of fund”, which commenced on 1 July 2005, and APRA’s new “Superannuation Licensing” regime, which after a two year implementation period culminated in all trustees and funds operating after 1 July 2006 required to be APRA licensed (other than Self Managed Superannuation Funds, which are supervised by the Australian Taxation Office, and Exempt Public Sector Funds, which answer to their respective government employer sponsors). As a result of these and other developments a large number of funds, particularly small to medium sized corporate funds, have decided to shut up shop, transferring members and funds under investment to other superannuation funds.

However, these developments need to be seen in context. Too much can be read into a reduction in the number of superannuation funds, especially given that most of the exiting funds are quite small. It would be inaccurate to say that a fall in the number of corner stores has brought about a fundamental change over the last few years in the structure of the retail grocery market in Australia, just as it would be inaccurate to say there has been substantial entry of new players to the retail grocery market brought about by the opening of 24 hour convenience stores. Consideration has to be given to the size and role of exiting and entering players in the market.

APRA licensing and choice of fund also have not been the only factors at work. The number of APRA supervised superannuation funds has steadily (some would say rapidly) declined over the last decade or so, well before choice of fund became a reality, and well before the notion of APRA licensing of trustees was even canvassed.

Some of the decline in recorded numbers of funds has come from APRA (and its predecessor the Insurance and Superannuation Commission (ISC)) better counting the number of funds being supervised. One might think that for a regulatory body knowing how many funds it was supervising would be a fairly no-brain matter, but for a number of years the ISC struggled to count the funds it supervised. There are even suggestions that some of the figures for the number of funds in ISC published statistics were derived from extrapolation of estimated trends in numbers from some fairly inexact baseline figures. This is a procedure all too familiar to researchers, but is not normally associated with official statistic gathering.

However, to be fair to the regulator (or more accurately its largely forgotten predecessor) it was never that easy to count the funds, particularly the subset of very small corporate funds with erratic reporting habits. The ISC had (in a purely metaphysical sense) a very large bottom drawer full of files on funds that were active and not reporting, or which had been active but were now defunct, or which had never really got into action in the first place.

Some trustees of small corporate funds were more frightened of the Australian Taxation Office (who they knew and had dealings with, sometimes unpleasant) than the ISC (which did not always have much contact with small funds). This subset of trustees put in tax returns, but not the regulatory returns required by the ISC. Some trustees were even naughtier, and failed to provide returns to either organisation despite receiving contributions and holding investments. The regulator also had to contend with funds discarded by the ATO, as funds which became non-complying as Self Managed Superannuation Funds through having too many members or some other defect defaulted to being funds within APRA supervision. Such funds did not have a good compliance record in regard to their new friends at APRA either. In 2004-05 APRA had 47 new corporate funds come onto its books, the largest number of entrants for any fund category. It is likely that a fair proportion of these were funds transferring involuntarily between regulators. From 1 July 2006 these departures from ATO supervision are likely to be unable to operate at all unless the trustee gets an APRA licence, or the fund becomes the responsibility of an APRA licensed trustee.

In other cases trustees failed to depart from APRA supervision in that trustees did not notify the regulator when a fund was in effect closed, leaving not even a forwarding address. Some funds existed in name only, the creation of an enthusiastic accountant at end of tax year, but never really in operation. Over time and as a result of concerted action by the regulator in its aptly named *Lost and Lazy Project*, this list of lost, forgotten and neglected funds decreased substantially. The setting in legislation of more substantive penalties for not reporting helped, but actually following up on non-reporting helped even more.

At times this process required some creative legal fictions to be applied in the winding up of apparently inactive or non-compliant funds through use of gazette notices and the like, as it is difficult to have a dialogue with a trustee aimed at achieving an orderly windup when the regulator mail comes back marked “return to sender”. While licensing of superannuation entities has been driven by a number of factors, no doubt the desire by the regulator to avoid these sort of things ever happening again had something to do with its adoption. Such pragmatic concerns

actually can make more sense than some of the claimed benefits of licensing regime. For instance, Commercial Nominees was licensed by APRA in that it was an Approved Trustee supposedly meeting the onerous requirements set by APRA for such an entity, certainly it was not some blow-in entity they new nothing about.

2. Developments in the number of funds prior to licensing (and choice)

There have been both apparent and real developments in the number of superannuation funds. One result of the tidying up by APRA of its records is that history is not what it used to be, with current published historical series on the numbers of funds somewhat different from contemporary accounts of fund numbers. For instance, the June 2005 (issued April 2006) *APRA Annual Superannuation Bulletin* indicated that as at June 1998 there were 3,898 corporate funds, 172 industry funds, 76 public sector funds, and 328 retail funds. In contrast the ISC figures for June 1998 published shortly after that date were substantially different, with 4,259 corporate funds, 108 industry funds, 62 public sector funds, and 363 retail funds. These differences are more than what can usually be expected when an agency conducts or is able to conduct a supposedly full enumeration survey of entities.

Reclassification of funds to fund types has also taken place by APRA, as self identification of fund type by trustees was not always accurate or even consistent over time. The good news is that more consistent and comprehensive counts are now more or less assured, as APRA licensing does not really permit a trustee to go missing in action or inaction, and the classification of fund type issue also appears to have been settled. Having far fewer funds to count also makes the job much easier.

On a number of occasions senior officials of APRA have indicated that it is a myth that there is an overt or covert attempt to force the closure of small funds or consolidation of funds[1]. However, even if this is not an intention, it certainly has been the outcome. It also seemed to be something contemplated and most likely desired by the senior APRA official back in 2001 who

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1 Ramani (S.G.) Venkatramani, *Superannuation Safety,* IFSA Conference, August 2004; Tony Randle, *Licensing – A Post War Reconstruction,* CMSF Conference April 2006; Ross Jones, address to Women in Superannuation Luncheon, Sydney, 6 July 2006.

indicated not entirely accurately (in a number of aspects) that there were then more than 3,000 corporate superannuation funds with assets of less than $1 million with many funds (and members) at potential risk.

To be fair to this APRA official, some of the very small funds were a bit of a worry. There have been suggestions that some small corporate funds were originally set up as a sort of unofficial tontine, where the owner/manager of the company was angling to take the greatest share of the fund assets after the departure of assorted unfortunate employees. The owner manager also had considerable control over the departure of the staff even in pre Work Choices times. Some such funds also dabbled in or even specialised in related party transactions, which seldom benefited non-related parties or tax revenue.

However, even before APRA licensing such behaviours were being dealt with by the regulators, and a number of funds closed down of their own accord or as a result of regulator enforcement action. In some cases, funds continued in existence, but with new trustees. For instance, the Tunstall Bond Superannuation Fund and the Wall and Ceiling Superannuation Fund were two relatively small funds where the courts found that related party transactions at non-market prices disadvantaged members of the funds, with various trustee directors of the funds being disqualified for their efforts with some even facing criminal prosecution. The reduction in diversity in the sector from the members of such funds being transferred to better run superannuation funds certainly is not a loss for the sector. The introduction of vesting requirements as part of the compulsory superannuation regime also reduced the opportunities in small corporate funds for owner managers to take a disproportionate share of benefits.

There have been also other more legitimate factors driving a massive decrease in the number of superannuation funds. These factors have varied both between sectors and over time.

2.1 Retail funds

Between June 1998 and June 2005 there was a substantial decrease in the number of retail superannuation funds, by about a third, from 328 to 226. A large part of this reduction appears to have been in smaller retail funds, with much of the reduction happening in the late 1990s and around the turn of the century (which is not as long ago as it sounds).

In recent years the decline in retail funds has been less marked, especially amongst larger funds. Between September 2004 and March 2006 the number of retail funds with assets over $50 million fell by not very much, from 133 to 126. Over some parts of the period the number of retail funds with assets over $50 million actually grew, no doubt helped by growth in fund membership numbers and investment returns.

In the retail sector the factors leading to consolidation have included a decline in the number of life insurance companies, with a series of takeovers of smaller players. As well, older style life insurance savings products, including products where most of the wealth creation was for the persons selling them, fell out of fashion, and became not infrequently unwanted and unloved legacy products. A number of providers have sought to close such products and transfer members to more modern products and associated funds.

Modern product design for retail superannuation products also has supported the use of a one trustee and one fund structure to support a multiplicity of product lines, including badged products marketed by third parties. For example, the Universal Super Scheme is one of the largest superannuation funds in the country, but it is much better known by the names of various financial products offered by MLC and the National Bank than by the formal fund name itself. However, a number of retail players persist with multiple funds. Sometimes they have specific funds catering for different markets (such as one fund for personal super and one for group employer arrangements) and sometimes a retail provider will have different funds with differing asset allocations.

There also have been a number of entrants to the retail superannuation sector in recent years. These have included overseas headquartered financial organisations establishing a local presence, and new players such as VirginSuperannuation and MaxSuper pursuing specific market segments. The latter funds contract out most things other than promotion and marketing, and have even contracted out the trustee role to professional trustee organisations.

Choice of fund does not appear to have markedly changed the number of retail funds. Traditional retail funds have basically responded by using their already established product range, including group corporate arrangements. Direct marketing of retail products to employees following choice has not really happened with traditional retail providers.

Data from research company Nielsen Media indicates that retail funds, or more strictly speaking their associated promoters, spent in aggregate just over $10 million in the 12 months to May 2006 on advertising. The biggest retail spenders were the BT Financial Group, spending $1.8 million, Virgin Money with $1.7 million, and Colonial First State with $1.5 million.

VirginSuperannuation and MaxSuper would be the main examples of entrants at least partially motivated by the introduction of choice. Both VirginSuper and MaxSuper promote themselves on the basis of having a low, asset based fee. Relying on an asset based fee of a modest amount is a reasonably challenging business model if you are a for profit provider, as the margins are not large, and distribution depends on strength of brand and direct marketing. Unlike other retail superannuation products these new promoters of superannuation products make little or no use of financial planners in distribution (as no commissions are paid), and they generally are not used for any large scale corporate superannuation plans. They also do not have the benefit of being specified in any award or group industrial agreements. There is also something of a youth orientation in their marketing, which while potentially valuable in the long-term is not necessarily of assistance in attracting members with large balances in their run-up to retirement.

That said, these new funds have been effective in developing their brands, and are starting to turn up as destination funds on the lists of clearing houses and in surveys of the population. However, they do not seem to be yet at the point where they are generating a profit for their promoters, and the experience of these funds is not encouraging other new players to enter the market. Substantial assets under management would be needed to generate revenues to cover the cost of advertising and other expenses. For instance, if the promoter of such a fund were achieving a return after assorted administration and other expenses of around 0.3% of assets under management, then they would need around $670 million of assets under management to support promotional expenditure of $2 million, and $6.7 billion to support promotional expenditure of $20 million. The margin available to the promoter could of course be less than 0.3% of assets, but there would be commissions on insurance premiums as well contributing to revenue of the promoter.

At this stage it would appear that both of these new entrants have assets under management well below these levels, but it is early days yet. However, the departure of the CEO of one of these funds and the subsequent adjustment of the fund's marketing approach suggests that choice of fund has not provided a bed of roses for new entrants in the retail sector.

2.2 Industry funds

The number of industry funds as recorded by APRA has bounced around a bit in recent years, with a significant part of the movement in numbers apparently due to reclassification of funds by APRA. There could also have been some ring-ins in the APRA estimated number of industry funds, as it does not seem altogether plausible that there were nearly 160 industry funds in 1999. It is possible (likely?) that a fair number of these were actually employer sponsored funds with multiple employer sponsors operating in a specific industry, rather than a fund with both employer and union sponsors. However, to be fair to APRA, there is no real hard and fast definition of an industry fund, as the government discovered in one of the early proposed versions of choice of fund when an industry fund was supposed to be included on the list of funds to be offered by employers.

Even the definition in the ASFA Dictionary of Superannuation is a bit vague in that it uses the terms "most" and "usually", terms not known for their precision. It defines an industry fund as:

> a multi-employer superannuation fund. Usually, an industry fund will cover a specific industry or range of industries, and such funds will accept contributions from any employers in those industries. Most industry funds were established in the mid to late 1980s, originally to accept award contributions. Most industry funds have trustees appointed by trade unions and employer associations.

However, being named in an award or having multiple employer sponsors does not really distinguish a fund from being a retail fund, or a multi-employer corporate fund. For instance, the Wall and Ceiling Fund referred to earlier in this paper might have been considered to be something of an outsider by more conventional industry funds despite or because of its coverage of a niche industry. Its governance arrangements also were different from the classic sort of industry fund.

The APRA numbers have 23 industry funds exiting the sector in 2004-05. Given that this went pretty much unnoticed at the time, they must have been pretty small funds and/or representing pretty small industries. Some industry like funds were set up by employer groups and others in order to provide an alternative to funds where unions were involved, often in retail or hospitality industries, and not infrequently in Queensland. However, some of these alternatives were pretty ordinary and some were actually criminal. For instance, the Beneflex Superannuation Plan and Employee Productivity Award Superannuation Fund (EPAS) were two such Queensland funds

where trustee directors were eventually jailed for their wrongdoing. However, importantly only a very small proportion of aggregate superannuation assets and members have been affected by such behaviours, compensation has been available to any members affected by theft or fraud within an APRA regulated fund, and appropriate successor fund arrangements have been put in place for members affected.

Over time any claimed rationale for these alternatives to industry funds tended to diminish, and as well some of the small multi-employer funds were not very competitive in terms of fees and returns. The criminal prosecutions of the principals of some of these alternative funds also had an impact on any claimed advantages concerning governance.

Further, these type of funds not infrequently advertised that they charged only one low fee, but this was true only to the extent that the fee referred to was the only low fee amongst the several charged by the fund. Higher fees were especially the case when certain employer sponsors or associated entities were capturing part of the benefits from the operation of such funds. Fortunately, these sort of funds tended to be wound up, rather than merging with other industry funds.

In the lead-up to APRA licensing there were supposedly about 85 to 90 industry funds. The number of industry funds with assets over $50 million kept pretty constant at around the 70 mark, with the few exits from the sector counterbalanced by some funds growing and getting over the $50 million level.

Examples did exist of traditional industry funds amalgamating, but there were relatively few cases despite a number of funds thinking hard about it. One example where it did happen was the amalgamation of the Bus and Coach Superannuation Fund with Tasplan, a Tasmanian multi-industry fund. Getting a good fit between industry funds is not always easy given personalities and politics of various participants and fund sponsors.

In some ways it is easier to get agreement with a fund in a different industry or State, or with a multi-industry fund, than with a fund operating in a similar industry, or a fund in the same industry in another part of Australia. As with most things, the less baggage the better when embarking on a journey. (I must remember to point that out to my wife as we pack for our overseas trip next month).

For instance, Anglican Super Australia found the Australian Retirement Fund (as it then was) a better fit than other Church funds or even other Anglican funds (which might not come as a surprise to anyone with exposure to diocesan politics), while FinSuper merged with STA (which had its heritage in the manufacturing sector) rather than a fund focussing on the financial sector or office workers. That ARF and STA merged prior to 1 July 2006 was in no way a foregone conclusion, although that merger was assisted by a great deal of commonality between the two organisations, including common directors and employer and union sponsors.

Greater promotion of existing funds has been a more common response than merger of funds. For instance, industry funds spent $20.9 million on advertising in the 12 months to May 2006, with around half of that spent in June and July last year, when choice of fund legislation came into effect. One of the consequences of the introduction of choice was this increased marketing activity by industry funds. This involved an initial flurry with less intense but continuing advertising and marketing activity following. Advertising has been directed at building the brand awareness of industry funds both collectively and individually, so as to better retain and attract members.

There has not been much evidence of industry funds amalgamating so as to better respond to the challenges imposed by the choice regime, as most industry funds appear to have been doing fine in this environment. Advertising and other promotional activity no doubt assisted funds in achieving this, but even funds that did not advertise have been able to retain and attract members following the introduction of legislated choice of fund.

2.3 Public Sector Funds

The number of public sector funds as recorded by APRA declined substantially between June 1999 and June 2005, dropping by about 50% from 82 to 43. However, the number of exempt public sector schemes, basically the mostly unfunded schemes for State and local government employees under State legislation, remained relatively constant at around 19 over the entire period.

The number of public sector funds with assets over $50 million has been largely unchanged since September 2004, sitting at 36 for almost all this period. The great bulk of public sector funds are large funds, with only 7 out of the 43 funds in June 2005 having assets of less than $50 million.

It is likely that at least part of the reduction in the number of public sector schemes has come from privatisation of various government business enterprises, including in areas such as electricity generation and distribution. However, the stock of government business enterprises with their own superannuation fund and a capacity to be privatised is now also pretty much diminished.

There also have been moves for some public sector superannuation schemes catering for specific occupational groups, including police and assorted types of emergency service workers, to be rolled into more generic public sector superannuation arrangements. However, the special characteristics and special sensitivities of some such workers has limited the pace and extent of such developments. Closing down a major public sector fund is usually not an option, as almost all of them have substantial unfunded liabilities, with a number also having substantial numbers of life pensioners. However, the modern fashion is to close the defined benefit schemes to new members, and have more or less funded arrangements for those in the accumulation division of the public sector fund concerned.

2.4 Corporate funds

The number of corporate funds as recorded by APRA has shown the largest decrease of any fund type. APRA claims that there were some 3,898 corporate funds in June 1998, with this falling to 963 in June 2005. However, the drop in the number of corporate funds with assets over $50 million has been less marked. While the total number of corporate funds fell from 1,394 in June 2004 to 963 a year later, the fall in funds with assets over $50 million was only from 136 to 116.

As Table 1 suggests, most of the contraction in numbers has been in the “rats and mice” of the superannuation sector. Up until 2004 most of the action in regard to the diminution of the number of funds was in funds with less than $5 million in assets. This territory was largely the preserve of small corporate funds. The table also shows some hollowing out as years progressed in the $10 million to $50 million asset range. This would have been due to corporate funds being closed down, and the growth of funds into higher asset bands.

The table also clearly shows the rise in the number of all types of funds with more than $1 billion in assets. While some of the asset growth involved in this would have come from fund amalgamations and transfer of members, a lot of the growth came from growth in the number of members, contributions, and investment returns.

Table 1: Number of superannuation funds by asset size

Asset Range ($)	1997-98	2002	2004
<1m	1,826	649	450
1-5m	1,248	639	501
5-10m	506	207	182
10-20m	370	150	201
20-50m	342	287	160
50-100m	146	136	115
100-250m	145	123	121
250-500m	67	72	69
500-1,000m	45	62	61
1-5b	44	67	76
5-10b	4	9	12
10-20b	0	1	1
20b+	0	1	2
Total	**4,743**	**2,403**	**1,978**

Source: Assorted Financial Sector Levy Discussion Papers.

Michael Rice of Rice Walker Actuaries in a December 2004 article put the case for companies outsourcing their superannuation rather than continuing with their own fund in terms of the attractions of the better quality master trusts and industry funds. As he put it, these funds offer, or potentially offer:

- Significant reductions in operating costs.
- Access to ongoing compliance.
- More member services
- Services and systems that are updated as the market and legislation changes.
- Greater flexibility and control for fund members, including investment choice.
- The transfer of onerous responsibilities to an expert third party.

He noted that nearly 80% of those companies that had sought advice from Rice Walker decided to outsource. It would be fair to say though that companies which engage in a formal review of their superannuation arrangements generally do not need a lot of convincing to go the next step and outsource. The engagement of outsourcing consultants is not a random act by an employer sponsor.

However, more than 20% of the Rice Walker customers did not close down their fund, and hundreds of other companies decided to keep their respective funds as well. Reasons for this can involve the fund being a defined benefit fund, or having defined benefit divisions. Transfer of defined benefit members can be difficult and expensive, and where the fund has either a deficiency or surplus it is even trickier. Companies do not like crystallising defined benefit liabilities, nor do they wish to give up the benefit of a contribution holiday if one is available. As well companies may have a concern about potential loss of control, and the state of governance within master trusts.

As well, for those corporate funds which have achieved a critical mass it is feasible for them to have the internal resources, or access to external resources on reasonable terms, to conduct their activities without unduly drawing on the resources or management time of the employer sponsor of the fund. Access to the benefits of scale can be achieved in many instances by contracting out administration and investment functions.

In other cases the cost might not be a major concern, as a multinational company which has a policy of having a pension or like fund for the employees in each jurisdiction it operates will do whatever it takes to have such a fund.

3. Superannuation Licensing

The superannuation licensing regime was introduced into the *Superannuation Industry (Supervision) Act 1993* ("SIS") by the *Superannuation Safety Amendment Act 2003* ("SSAA"). For the industry, licensing has acted in conjunction with other reforms such as choice and more longer terms trends to bring about a more concentrated industry, albeit one with still quite a few players. Licensing has required some hard decisions about future participation in the industry by many funds and key stakeholders.

3.1 Objectives of Licensing

Despite it being three and a half years in the making, the policy objectives behind superannuation trustee licensing still remain somewhat elusive. Improving the safety of superannuation has been one of the usual publicly stated reason for the reforms. However, the initial October 2001 Superannuation Working Group (SWG) Issues Paper had little discussion of what was meant by

"safety".[2] The SWG's Final Report to Government in 2002 did summarise general concerns expressed by the Australian Prudential Regulation Authority (APRA) about certain conduct in the industry, but did little to analyse their significance or how the safety reform proposals, including licensing, would address similar issues in the future.[3] The SSAA's Explanatory Memorandum did refer to the failures of Commercial Nominees and general insurer HIH as well as "public concerns about the prudential framework governing superannuation".[4] However no explicit link was ever made between those particular failures and proposed reforms, in particular trustee licensing by APRA, nor was there any attempt to provide evidence of "public concern". Even APRA had to admit that very little money had been lost in the superannuation industry due to outright theft, fraud or gross mismanagement[5]. That Commercial Nominees itself was an APRA Approved Trustee made hollow any arguments that an expanded licensing regime would somehow necessarily improve safety.

Regardless of the rights or wrongs of this reform, whether the prescription suited the ill - the Commonwealth Government made its decisions that a package of safety of superannuation initiatives was required. Licensing of superannuation trustees and registration of superannuation entities was prominent amongst these.

3.2 The APRA Licensing Process

A supposed aim of the licensing process has been to improve safety by lifting standards within the sector. The implication of this was that not every trustee was able to meet these standards and/or chose not to try. This outcome was not entirely dependent on the standards imposed being relevant. For instance, if every trustee were required to pay an application fee of $100,000 with every director of the trustee required to demonstrate proficiency in Swahili then you would also most likely get a diminution in the number of trustee entities. However, some trustees might find Swahili easier to master than the intricacies of the language of the SIS Act and Corporations law and prefer such a test.

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2 *Options for Improving the Safety of Superannuation Issues Paper*, Commonwealth Treasury, 2 October 2001.

3 *Final Report of the Superannuation Working Group*, Commonwealth Treasury, 28 March 2002.

4 Explanatory Memorandum, *Superannuation Safety Amendment Bill 2003*, House of Representatives, 27 November 2003.

5 Speech by Charles Littrell, "Safety in Australian Superannuation", 29 August 2002.

Licensing should make life both easier and harder for APRA. There will likely be fewer funds to supervise, and those funds will have better documentation and procedures. On the other hand, APRA will be expected to supervise the remaining entities more intensively. It will now be hard to blame deficiencies in the regulation of funds on flaws in the legislation or licensing process, but no doubt attempts will be made to do so in the unlikely event a fund does fail. At the very least APRA should be able to count the number of funds they supervise more or less accurately.

Funds faced substantial direct and indirect costs in obtaining an APRA licence. A number of funds had costs in excess of $100,000 associated with preparing the assorted documentation required, but some with cheaper lawyers and/or an enthusiasm for do it yourself managed to undertake the work at a lower monetary cost. As well, the application fee for a licence payable to APRA was both substantial and non-refundable. A fee of $20,000 was payable by applicants for a public offer or extended public offer licence. A public offer licence allows a trustee to offer superannuation products to the public at large without the need for involvement of an employer sponsor, while an extended public offer allows a trustee to take on the responsibility of a corporate or other fund on a commercial basis. APRA encouraged larger funds with multiple employer sponsors to apply as public offer funds, if they did not already have this status[6].

The fee for other licence applications was $5,500, with a discount for existing trustees with assets under $5 million. However, in regard to the latter discount, there may have been only one case of it being claimed. While APRA may not have had anything necessarily against small standalone funds, the new licensing regime certainly has got rid of a lot of them.

APRA supposedly received some 400 indications of intention to apply for a licence out of the 1,000 or more trustees existing in early 2004 and it based the level of its licence application fees and internal costing on this basis. In reality, there were 325 applications, with 17 applications withdrawn and one rejected. The net result of this was that APRA fell short by over $1 million in their cost recovery through licence fees of the APRA costs of the process. This shortfall will be recovered through operation of the supervisory levy charged annually on all funds.

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[6] Ramani Venkatramani "Superannuation: Industry Overview", *APRA Insight - 4th Quarter 2004*, p. 10.

3.3 Licensing outcomes in terms of fund numbers

Outcomes of APRA licensing are reasonably in line with sensible industry projections, including my own, with a marked reduction in the number of funds, particularly smaller funds. However, contrary to expectations of at least some commentators, a number of relatively small stand alone funds (under $20 million in assets) have remained in business by obtaining their own trustee license or making use of the services of a professional trustee.

The death of the corporate fund also has been somewhat overstated by a number of industry commentators, as there appears to be after licensing possibly some 240 corporate funds in existence with around 125 of these having their own specific trustee. The number of corporate funds could even be higher than this, depending on what has happened to the number of retail funds. At this stage, the publicly available data only provide are in regard to the total number of funds in all sectors after licensing. Even with this number there may be some uncertainty given that there are assorted superannuation entity types such as Eligible Rollover Funds, Pooled Superannuation Trusts and Retirement Savings Accounts that can complicate aggregate counts.

Table 2 gives a breakdown of trustees and funds by asset levels. At the very small end of the scale there are 41 funds with less than $3 million in assets each. Some trawling through the APRA registers of funds and trustees suggests that these funds make use of professional trustees in a manner similar to Small APRA Funds, and indeed the same relatively limited pool of trustees specialising in small funds is used for both. These small corporate funds most likely are in that classification rather than the Small APRA Fund classification because they have 5 or more members. Preliminary research indicates that the number of larger funds making use of a professional trustee might be in the 40 or 50 range. The extent of this is difficult to determine from the APRA public registers. The register of funds tends to be dominated in terms of the number of funds by the Small APRA Funds. Three specialised providers dominate this market, with one, Australian Executor Trustees Limited, responsible for most SAFs.

Professional trustees were used by a number of corporate funds, including large funds such as BHP, prior to licensing. Professional trustees looking to take over formal responsibility for corporate funds in the run up to licensing discovered that some, but not many, corporate funds were interested in such arrangements. Closure or continuation with current trustee were the most common approaches adopted by corporate funds.

Table 2 - Structure of the superannuation sector after licensing

Asset Range ($)	Funds Nos 2004 (a)	APRA fund Nos 2006	APRA 2006 Trustee Nos (b)
<1m	649		
1-5m	639	41 less than $3m (no standalone trustees)	
5-10m	207		
10-20m	150		40
20-50m	287	183 between $3m and $50m (97 trustees for these funds)	57
50-100m	136		30
100-250m	123	138 between $50m and $250m (68 trustees)	38
250-500m	72		38
500-1,000m	62		26
1-5b	67	191 funds between $250m and $5b (117 trustees)	53
5-10b	9	33 funds greater than $5b (33 trustees)	19
10-20b	1		11
20b+	1		3
Total	**1,978**	**586**	**315**

(a) 2004 figures were early APRA estimates which were subsequently revised.

(b) Preliminary APRA estimates of the distribution by assets under trusteeship after licensing. Some applications were withdrawn after preparation of these estimates.

As shown by the table, there has been a significant diminution in the number of medium sized funds, with a rise in the number of what could be termed "large scale" funds, that is, funds with more than $5 billion in assets. In 2004 there were only 11 funds with assets in excess of $5 billion in assets, and by 2006 this number had risen to 33. This has come from both market growth of specific funds, and from amalgamation or absorption of funds as a result of licensing.

However, closure of the many hundreds of the very small corporate funds with assets of less than $5 million each did not lead to massive asset flows. Up to $0.5 billion may have flowed into SMSFs of owner managers, with perhaps another $3.5 billion flowing from corporate funds with less than $20 million in assets into retail funds in most instances.

For the corporate funds with assets between $20 million and $250 million, the fund closures would have led to something in the order of $15 billion flowing to other funds. Up to 80 per cent of this amount would have flowed to group arrangements provided by retail funds, but this percentage could be lower depending on the success of industry funds in accessing this market.

While there still will be over 300 trustee entities and nearly 600 different superannuation funds, it appears that there has been an increase in the proportion of assets and members in funds with over $1 billion in assets. This has been due to both closure of corporate funds, and growth in member numbers and investment returns. The 33 largest funds have $270 billion out of the $485 billion in superannuation assets subject to the 2006 supervisory levy, with around $199 billion in funds with assets between $250 million and $5 billion. Funds with assets between $3 million and $50 million have $2.7 billion in aggregate assets, with the 41 funds under $3 million each in assets only have $41 million in total.

Returning to the issue of corporate funds, the aggregate assets of corporate funds could drop by around one-third from what they would otherwise be as a result of fund closures (rather than choice of fund decisions by members which appear to have had very little impact in aggregate in the corporate sector), with the number of corporate funds falling by a much greater proportion. The level of corporate fund assets is likely to bottom out at a still substantial level ($50 billion or so in today's dollars) because there are a number of multi-billion dollar corporate funds that will be viable following APRA licensing, and investment returns have been good in recent years. In fact, assets of corporate funds have held up remarkably well. Around 90% of the aggregate assets of the corporate funds was prior to licensing in the larger funds with assets of over $50 million each, and the attrition rate for such funds has been relatively mild compared to smaller corporate funds. The corporate fund sector might be in decline, but it certainly does not appear to be a decline to anywhere near extinction.

Table 3, which is based on some rather tedious manual extractions using not always helpful trustee details from the APRA Register of licensed trustees together with some ASFA Research estimates, indicates that there are likely to be around 240 corporate funds or more remaining after licensing, with around 125 of these (mostly the larger corporate funds) having a standalone trustee. Over 100 corporate funds appear to have outsourced the trustee function, with many if not most of these funds being relatively small. Retail is the other sector where some trustees are responsible for more than one fund, including funds in the corporate sector, and it is not easy to precisely estimate the number of retail funds remaining.

Table 3: Distribution of Trustee type by Fund Sector

	Exempt Public Sector	Non Public Offer	Public Offer	Extended Public Offer	Total Fund Numbers
Industry		34	38	3	80
Retail			67	13	220
Corporate		123	2		240
Public sector	19	18	2		39

3.4 Where various funds sit in the size distribution

Compiling a complete list of funds in size order is not an easy thing to do, as not all funds publicly report their assets either ever or on a regular basis. As well there still are nearly 600 funds in existence, including some hundreds of funds with assets in excess of $250 million.

However, the pecking order in terms of assets under management, appears to be AMP, MLC and the NSW public sector fund as the trustee entities with more than $20 billion in assets under management.

In the $10 billion to $20 billion range, funds and funds promoters such as Qsuper, AXA Unisuper, Commonwealth/Colonial, the Commonwealth public sector schemes, and the merged ARF/STA make an appearance. Some other retail entities might also make it into this band, but consolidated data are hard to come by.

The $5 billion to $10 billion band appears to have the larger industry funds, together with the largest corporate funds and some of the medium sized public sector funds. CBUS, Australia Post, Sunsuper, Commonwealth Bank Officers, REST, Qantas, Health Super, Super SA, ING, GESB, LGSS, Suncorp, and BT/Westpac are amongst the entities in this group.

The $1 billion to $5 billion range has a rollcall of industry funds operating nationally and/or in large industries. Some of the smaller public sector schemes and the next tier of retail schemes are in this range as well.

The vast majority of the several hundred corporate funds have assets under $1 billion. There are some with more, such as the bank staff funds, and large companies such as Telstra.

In regard the type of companies retaining corporate funds they are too numerous to list in entirety. However, by way of example they include multinational, often food or drug companies (Nestle, Kellogg, Unilever, Pfizer, GlaxoSmithKline), oil companies (BP, Chevron, Exxon/Mobil), car manufacturers (Ford, Holden, Toyota), most banks, insurance company staff funds (IAG), miners (Alcoa, Rio Tinto), most varieties of churches, law and accounting firms, and assorted major domestic manufacturing companies (Goodman Fielder, Hanwood, Reece, Effem, Smorgon Steel).

4. The Aggregate Impact of Licensing

Licensing (and choice of fund) certainly had an impact on the landscape of the superannuation sector, but the erosion of this landscape has been less than many people expected. It is likely that only around 2% to 3% of fund members have been affected by fund closures, with only around 3% or 4% of total superannuation assets on the move. You actually need a reasonably large population survey to detect the incidence of fund closures from a member perspective. Over 90% of employees are in fund sectors where there has not been much change. Of the 5% or so of employees in corporate funds as at October 2005 the great bulk of these were in large corporate funds which have remained in business.

However, 3% of a very large amount such as $900 billion is a considerable sum of money, and for the various funds seeking a share of $30 billion in successor fund transfers it has been an interesting time. Certainly getting additional funds under management has been easier through success in winning group arrangements than achieving a similar volume of new business through sales to individuals of superannuation products. This perhaps explains the excitement of various commentators about the impact of licensing, but when you look at the aggregate numbers it is difficult to say that for most or indeed even a modest minority of fund members there has been any noticeable change.

Fund closures have also had direct consequences for other participants in the sector. Fund secretaries of funds that have closed have certainly noticed a difference, and various service providers to corporate funds would also have had substantial changes to their business operations. There also have been implications for various industry associations which have or had corporate funds and/or trustees as a part of their membership. Corporate Superannuation Australia is a bit hard to find these days, and the Australian Institute of Superannuation Trustees Board has been in discussion with the CMSF Steering Committee regarding the possibility of both

organisations merging into a new entity in 2007. ASFA itself has had some significant changes in the composition of its members, with various consequences of this for its operations.

I know that a number of commentators and industry participants are on the public record as anticipating further substantial consolidation in the not too distant future. I will not name them, as I have grown weary of getting hate mail, but I do have some documents indicating that there are individuals who consider that there may be as few as 125 funds by 2015, that industry funds will have around $25 billion assets by then on average, and several funds or groups will have assets approaching $100 billion. Other commentators have even suggested that there will be mergers between industry and retail funds, and that in any event these types of funds will become largely indistinguishable.

However, my view is that the process of consolidation will slow down markedly after 30 June 2006 and that forecasts which are not much more than a "what if" exercise based on getting a ruler out and adjusting its angle on a graph page in order to project future values should be ignored. Basically the great bulk of licensed trustees have become licensed because strategic long term decisions have been made by the trustees and fund sponsors concerned. APRA licensing has been a resource intensive process, and one that was not entered into lightly by any participant. Applicants would have found out real soon in the licensing process about what was involved, even if they had any misconceptions prior to that.

The funds that remain have a real purpose in life, and I do not see any further substantial fund closures or amalgamations, at least in the short to medium term. Medium to large corporate funds that are licensed are likely to remain, in some cases due to strategic decisions taken by employer sponsors in Zurich or London, in other cases because defined benefit divisions are too hard to close down or good equity returns mean that the employer has a contribution holiday. Some trustees may realise they made a wrong decision about getting an APRA licence, but they are likely to be a very small minority. Organisations and individuals who have specialised in outsourcing of corporate superannuation arrangements are likely to go from a feast to a famine. This might in part explain the recent interest of a number of such providers in services oriented to fund members and not just funds or employer sponsors.

There also are going to be a fair few funds with assets in excess of $1 billion, which tends to make them viable in their own right, with $15 billion or $25 billion not really necessary for this.

When we talk about economies of scale and the viability of funds, we should remember that many (but certainly not all) functions can be contracted out, with the gains of scale captured in that way. One administrator has indicated that their price per member for a 60,000 member fund is not much different than the price per member for a 450,000 member fund. The prospects of further consolidation might be strongest amongst various types of service providers. For instance, there will be many more funds than administration companies. Further there are relatively few custodians operating in the market.

Moving from being a $1 billion fund to being part of a $20 billion fund might provide some economies of scale, but they could be of the order of no more than 10 cents a week per member in regard to administration, and a matter of basis points for investment costs. These mount up over many members and assets, but may not be a strong motivating factor when there are other considerations about control and responsiveness to take into account.

One area where we seem to have more providers in prospect is in the investment management area, with this trend likely to continue. With greater assets under management, large funds can have and often need to have a multiplicity of investment managers. Large investment managers might provide the core services, but there can be tens or scores of boutique or niche investment managers used as well. It might be worthwhile to pay a few more basis points in management costs in order to get enhanced investment returns.

If I am wrong in my prediction about the pace of change slowing I expect that I will have to come up with some plausible excuse for my error when I present my 20th paper to the Colloquium sometime next decade.