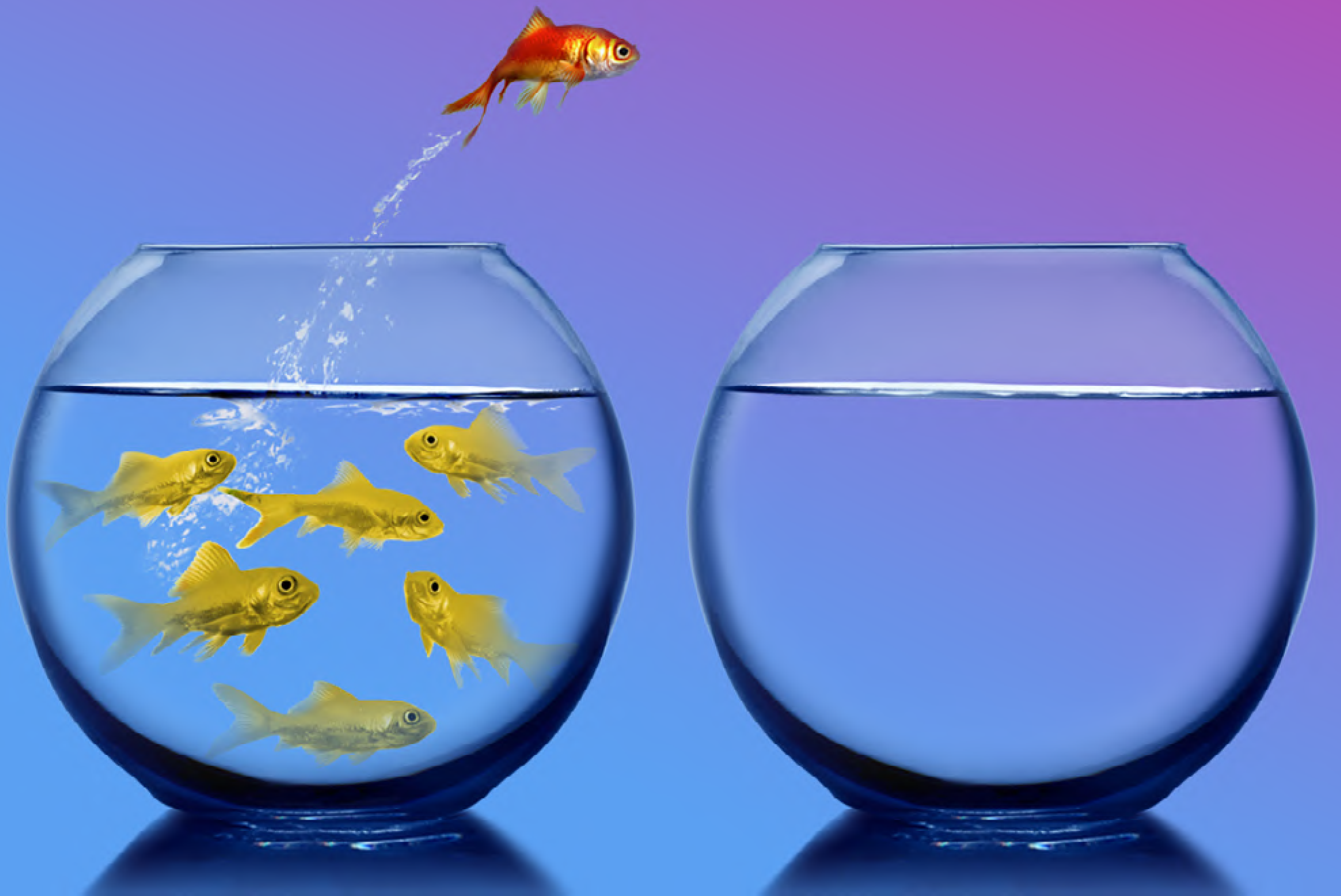
Mercer

Super Funds Survey 2021:

Challenge Accepted

Change is relentless in the superannuation industry – and it shows no signs of abating. Are funds ready to chart their course for future success? Or will constant uncertainty and change drive funds to distraction?



welcome to brighter

Contents

Foreword

In 2017, Mercer released *Change or be Changed: Are super funds prepared*. The report examined how the industry was thinking about superannuation at a time of much regulatory change. In the years since, that report remains just as relevant as it was in 2017, with government regulation and the need for scale still the biggest concerns keeping super executives up at night.

2021 is one of the most transformative years the super industry will see for a long time. How are CEOs and senior executives of super funds thinking about the future now? What did they learn from 2020?

The inside word on super

To find out what's on the mind of those who lead our super funds, we asked them.

We conducted qualitative research in the form of one-on-one interviews from November 2020 and January 2021. Respondents consisted of 13 CEOs or senior executives from super funds of all types and sizes.

To add further depth to our analysis, this was followed up with a quantitative survey of 37 respondents across the super industry in February 2021.

In this report, we reveal what's keeping super executives up at night as they plan for the future. Are funds ready to chart their course for future success? Or will constant uncertainty and change drive funds to distraction.

2020 turned out to be a year like no other and the pressures of previous years quickly paled in comparison.

From devastating bushfires across Australia to a global pandemic, lockdowns and empty supermarket shelves, our lives were quickly turned upside down.

COVID-19 had immediate consequences for the $3 trillion super industry. In addition to volatile investment markets and working from home, the government announced the COVID-19 early release of super scheme.

The government also moved ahead with the regulatory reform agenda that flowed from the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services*.

Also in 2020, the number of super fund members with insurance in super reduced significantly as the *Putting Members' Interests First* (PMIF) legislative changes took full effect from 1 April, 2020, removing opt-out insurance for new members under the age of 25, and low balance members.

In late 2019, the Australian Prudential Regulation Authority (APRA) issued its MySuper Heatmaps, which publicly identify MySuper products that are underperforming and where they need to improve.

The 2020-21 budget also announced *Your Future, Your Super* (YFYS) proposals which involved the stapling of funds, an annual performance test, an Australian Taxation Office (ATO) portal whereby super products will be ranked and published, and new obligations for trustees.

These measures were to apply from 1 July, 2021. However, as announced on 17 June, 2021, the Bill has now passed the Senate with one significant amendment – the deferral of the super stapling start date to 1 November, 2021. The start date for the other measures remains 1 July, 2021. As they say, the devil is in the detail.

YFYS is expected to change the industry beyond recognition. Indeed, what happens over the next two years is expected to shape the industry for the next 20 years.

So what does this all mean for super funds?

It's likely that there will be fewer funds, some very large funds and some moderate-sized funds for niche markets. There will be more competition, but hopefully, improved member benefits and enhanced member engagement.

So, what are fund executives thinking as they head into this brave new world?

Our latest research contained in this report and titled Challenge Accepted provides an update and valuable insights into their views.

It explains why the environment is set to become challenging for all funds and why funds must accept these challenges if they are to secure their future for the short- and long-term.

It's time for funds to say Challenge Accepted.

Dr David Knox
Senior Partner and Senior Actuary
Mercer Australia

A glimpse of 2020

30 Jan 2020
World Health Organisation declared COVID-19 a Public Health Emergency of International Concern

18 March 2020
Australians advised to work from home

22 March 2020
Federal Government announced early release of super scheme

6 October 2020
Your Future, Your Super announced in Federal Budget 2020-21

20 November 2020
Treasury released the Retirement Income Review report

Research Highlights

What's keeping super fund executives up at night?

#1 No surprises here. Regulatory change is the number one biggest challenge facing funds.

Merger Mania : Getting the deal done

47% While merging is a hot topic of conversation, it's not easy getting the deal done with 47% citing roadblocks.

Delivering the deal: Your people are your power

47% The stakes of ignoring people risks are high! **Forty-seven per cent** of deals don't succeed due to a lack of strategic planning and people risks.

Investment returns top of mind

76% The pressure to deliver improved investment returns has well and truly solidified its position as front of mind for funds with **76%** citing it as their #1 most important strategic goal and activity for 2021.

Members are boss ... or are they?

5% Given only **5%** of respondents ranked member engagement as having the greatest influence, is improving member services and engagement an important priority?

Embracing technology – are we there yet?

32% of funds said improving technology & digital experience is having the greatest influence on the direction of their fund. Yet only **5%** rank keeping pace with digital as a top challenge.

Retiring members

27% Despite $1 billion of super being held by retirees, only 27% rank developing innovative solutions for retirement as one of their top 4 business goals and strategic objectives

Key recommendations

1. **Rethink regulation**
   - Accept the challenge by using this as an opportunity to establish a comprehensive compliance framework.
2. **Make your merger a success**
   - Match your fund to a partner who can provide scale and flexibility in their solutions – be that administration, technology, investment, governance or communications.
   - Don't lose sight of culture and human issues. Merging is not all about investments and administration considerations. "The most overlooked and undervalued lever of a successful deal is found in the management, or in many cases, the mismanagement of the people element," CFO, Fortune 500, US$28 billion in annual revenue.
3. **Your People are your Power**
   - Make digital and flexible working a common purposeful practice.
   - Evolve sophistication around data and employee listening.
4. **Investment returns**
   - Investment markets move quickly. To capitalise on investment opportunities, investigate whether your fund should insource or look to outsource some or all its investment capability.
5. **Let members be your priority**
   - Members are becoming increasingly active - they have wants and needs, and will exercise their choice to stay with your fund. Innovate for members' changing needs with new products, more focus and better options that will retain members as lasting clients of your fund.
6. **Embracing technology**
   - Embrace technologies to eclipse your competitors with a more compelling offer. The bottom line is when a member reads your email or visits your website, they expect personalised messaging – no matter which device they're on.
7. **Keeping members in retirement**
   - Find ways to better educate and engage members on the different retirement solutions available.

What’s keeping super fund executives up at night?

1. Regulation overload

More than ever, funds are facing constant regulatory change. Indeed, regulatory change was listed by 32% of fund executives as the biggest challenge facing their fund – a higher percentage than any other challenge.

In addition, more than a third (35%) said responding to government and regulatory change will have the greatest influence on the direction of their fund.

As highlighted below, the second biggest challenge facing funds is delivering better member outcomes – listed by 24% of fund executives. Next in equal placings (19%) are remaining competitive, investment performance and merger roadblocks. Leveraging scale was listed as a top concern by 16% of funds.

Chart 1: Biggest challenges facing your fund

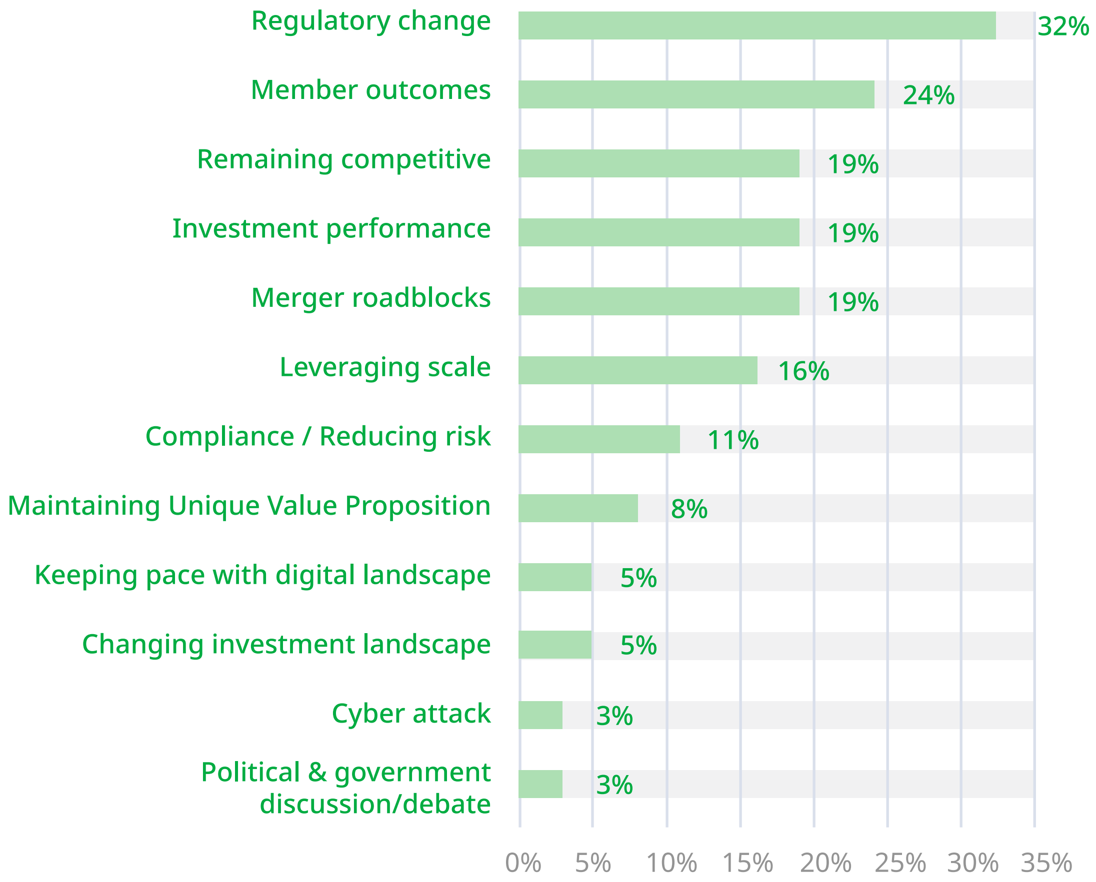
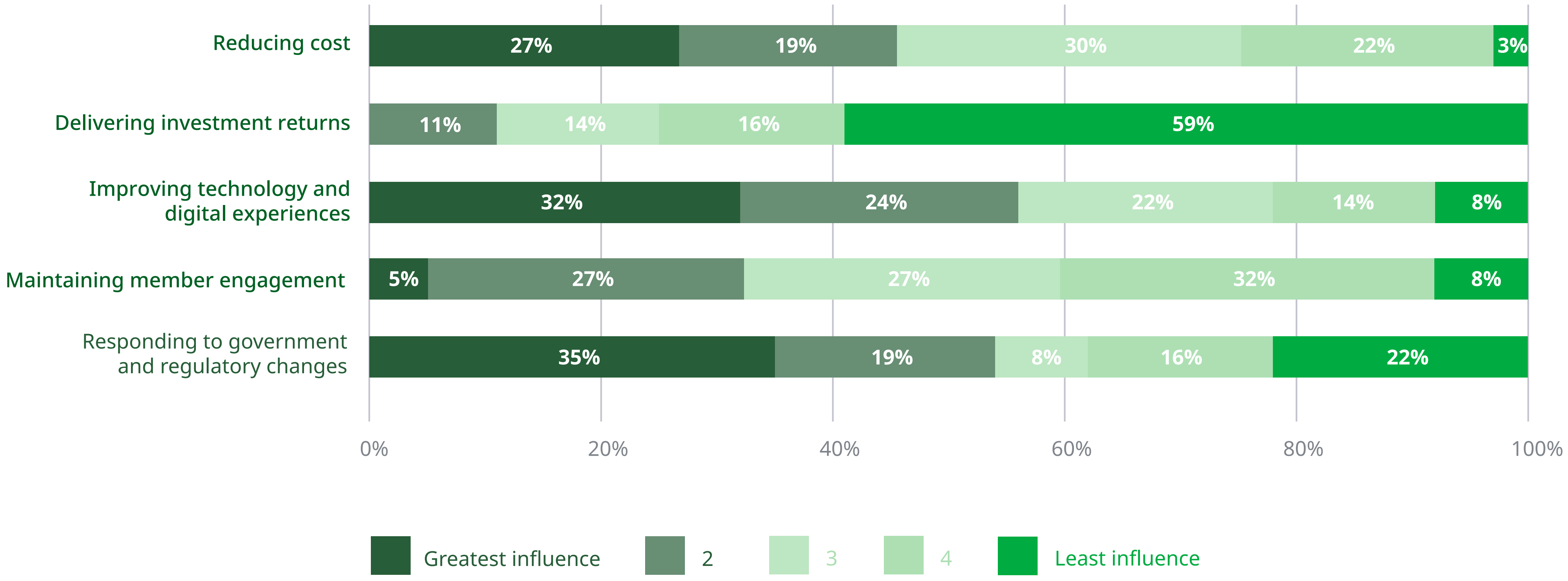


Chart 2: Which of the following has the greatest influence on the direction of your fund?

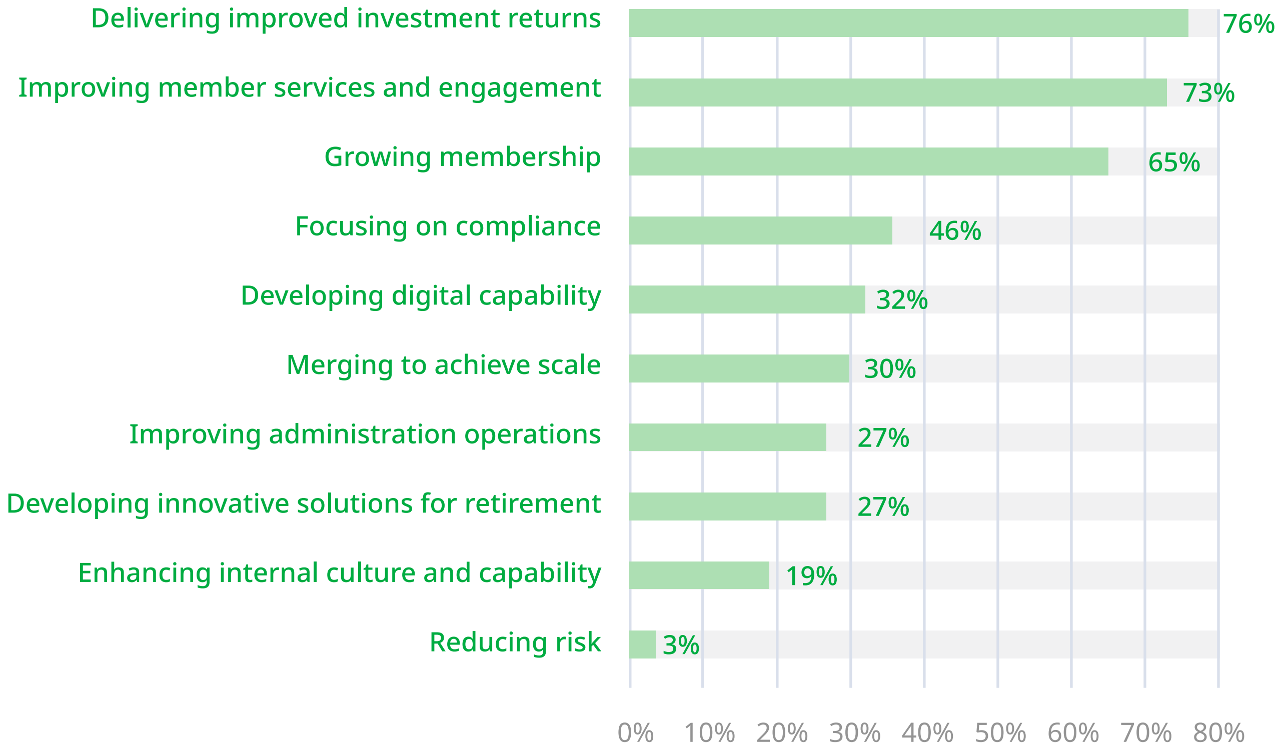


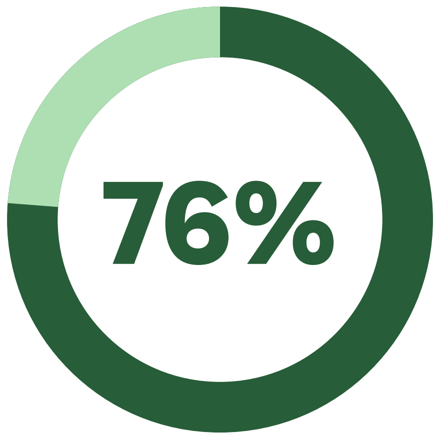
Our 2021 survey reveals that the main issue for funds is ensuring that they can continue to deliver strong returns for members. However, because of increased regulation and the YFYS performance test, funds are also worried about current performance.

Many are looking to deliver fee reductions through scale and mergers, but say this is a distraction for them. There are also worries that executives could lose their jobs through mergers.

Furthermore, the proposed YourSuper comparison tool has fund executives scrutinising peer relative performance, while many are kept awake at night pondering how to deliver reasonable returns in a near-zero interest rate environment.

Chart 3: What are your fund's top 4 most important business goals & strategic activities?





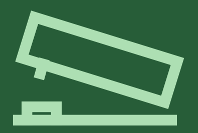
of funds ranked delivering improved investment returns as their top business goal and strategic activity

The key YFYS changes:

1 July 2021
Annual performance test

1 July 2021
YourSuper comparison tool

1 July 2021
Members' best financial interests requirement



1 November 2021
Super 'stapling'

2. Regulatory change: Are funds being driven to distraction?

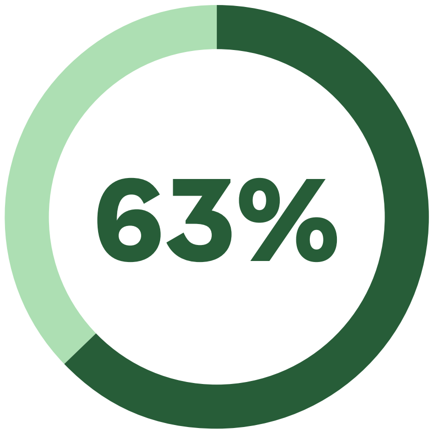
In the words of one well-known super fund CEO, 'Has Business As Usual become Business As Unusual?'

As expected, a higher proportion (63%) of respondents in the 2021 survey reported a greater level of regulatory pressure compared to the 58% who said the same in 2017.

As one CEO said: "It's hard to argue with trying to bring efficiency into the system." But there is a clear sense of frustration with constant regulatory change. Another said: "The government's immediate priority should be reminding everyone what the purpose of super is. Get back to basics, stop touching it and let us get on with running funds."

Funds continue to juggle the changing environment. However, the degree of difficulty for this juggling act has been significantly intensified by the APRA Heatmaps and YFYS proposals.

One CEO described the increased focus on members' outcomes in YFYS as "the most significant change in 20 years." Another said "the focus on the 'best financial interests' of members changes the game," while another described it as "a curve ball".



63% of fund executives reported a greater level of regulatory pressure

Regulators and their new tools and powers

After the Hayne Royal Commission, APRA and ASIC were given new regulatory tools and powers. Fund executives participating in the qualitative part of our research were asked what effect, if any, this had on their fund.

Several said this hadn't had much impact. Some suggested the changes were costly to manage and focused on the short-term.

Another fund executive said: "The Royal Commission focused on retail funds and it appeared that industry funds were looked over, but now it is clear that ASIC and APRA are getting more focused and targeted across all funds. For the fund, it has meant that key roles were reviewed, such as key risk officer and APRA liaison. These roles are becoming more important and will continue to be so in the future."

What is Your Future, Your Super?

The YFYS reforms as announced in the 2020/21 Budget outlines the following four changes:

1. Reducing multiple super accounts, members will be 'stapled' to their super so a new account isn't set up every time they start a new job.
2. Launching a new YourSuper comparison tool to make comparing and moving between superannuation products easier.
3. Requiring MySuper and many choice products to meet an annual performance test. Funds must write to members of products that fail the test and cannot accept future contributions if the product fails the test in two successive years.
4. Strengthening trustee obligations to ensure superannuation fund actions are only undertaken in members' best financial interests.

Recommendations

for proposed *Your Future, Your Super* changes

- **Review your investment portfolio construction, investment menu and product fees** in light of the proposed measures to understand and quantify any new risks these could introduce.
- **Review the impact to the ongoing operation of your fund** including potential changes to new member acquisition levels, distribution channels and fund sustainability.
- **Review the impact on your insurance arrangements** – this review can be considered alongside compliance with the *Insurance in Superannuation Voluntary Code of Practice*, and to reflect changed coverage levels following implementation of Putting Members' Interests First (PMIF) and Protecting Your Super (PYS).

3. Stapling of super accounts

One part of the proposed YFYS measures causing much anxiety is member stapling.

While many fund executives in our survey agreed with the principle of reducing multiple accounts for members, 80% raised concerns. Only 20% saw stapling as a growth opportunity.

What fund executives had to say about stapling

> "A significant hurdle for corporate funds will be maintaining relevance when stapling is introduced."
>
> "Many agree with non-multiple accounts, but they're fraught with danger."
>
> "If members don't engage with their super, they risk being stuck in unsuitable products."

Fund executives expressed concern that stapling could result in members being stuck in a poor performing fund throughout their working lives, especially if they were not well engaged.

They also noted that stapling might result in members being stuck in the fund from their first job, perhaps in retail or hospitality. These might be poor performers or not the best fund suited for their needs during different stages throughout their careers.

The shifts will affect total membership numbers and funds under management. As a result, some funds may have to cut costs and perhaps reduce staff.

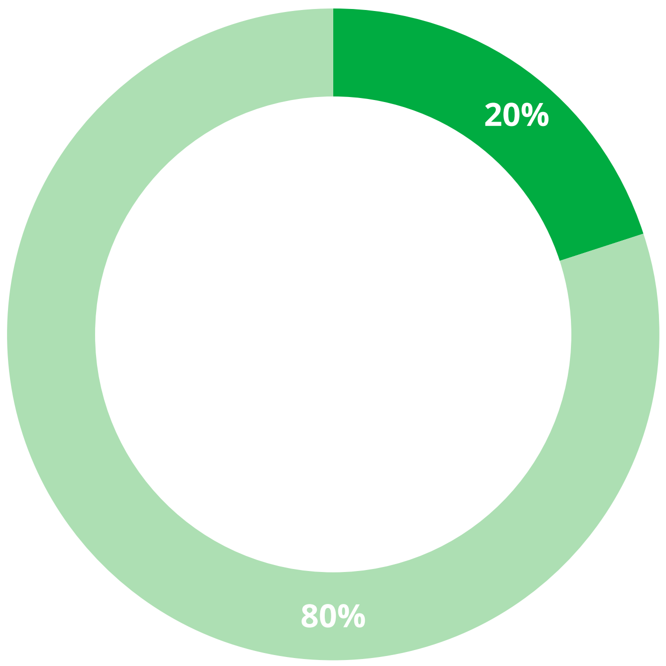
There will of course be members who will change funds when they change jobs, adversely affecting the sustainability and costs of some of the better performing small and medium-sized funds. Those with union alignment or specialist features relevant to specific sectors of the economy will need to find new ways to identify and attract new members, or face an existential threat.

While stapling does raise concerns, it does highlight the need for funds to produce stronger returns and remain competitive. Interestingly, funds said delivering improved investment returns is front of mind (76%), yet only 19% cited remaining competitive as one of their 'biggest challenges' (charts 1 and 3).

Surprisingly, **only 54%** of funds told us that they believed they had a unique offering that set them apart from their competitors (chart 5).

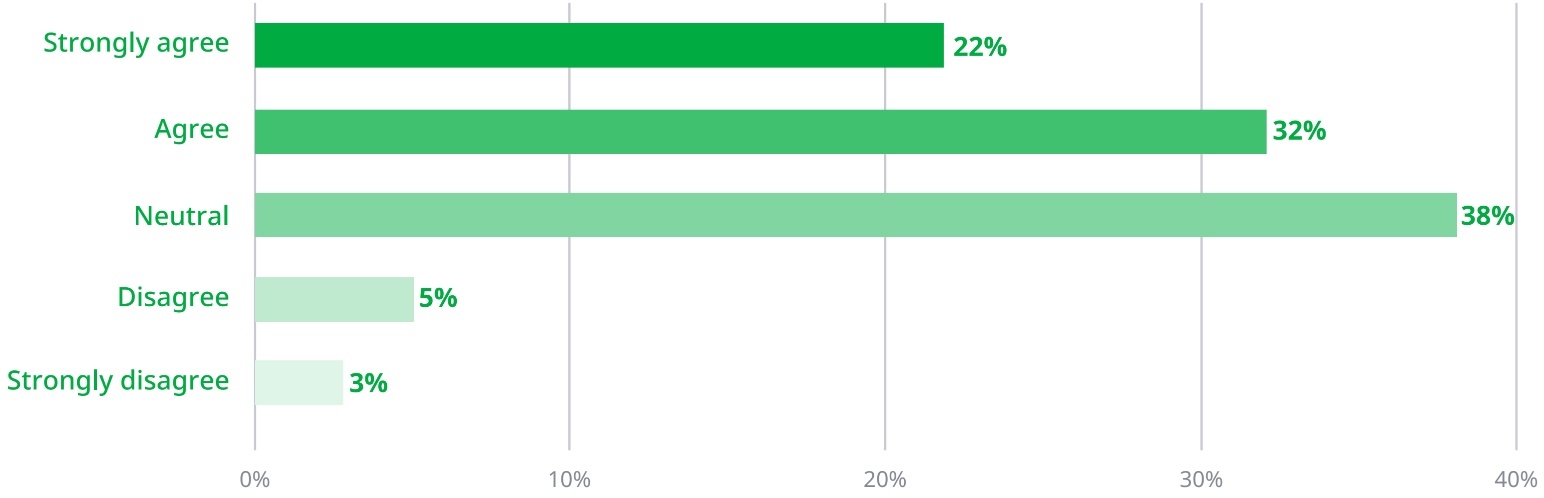
Isn't now the time to put the wheels in motion and start to seriously think 'outside the box'?

Chart 4: How does your fund view member-stapling?



	See stapling as a hurdle	80%
	See stapling as an opportunity	20%

Chart 5: To what extent do you agree with this statement:
Our unique member offering is what sets us apart from our competitors



A key way for funds to differentiate themselves is via enhanced and more effective member communications and engagement.

Funds need to nudge and prompt members throughout their careers. Just as we don't drive the same car when we are aged 18, 35 or 50, members need to consider whether the fund they started with at 17 is the best fund for them at 35 or 50.

Another way funds can differentiate themselves is through their insurance offerings. People move through different roles in life. At 17, they may take up a job in retail, hospitality, or construction. Later they could go to university and take up a managerial role or professional services role.

They will need to compare whether the insurance is still appropriate or whether another fund can offer them better rates and coverage. Enhanced communications and engagement can help them through this process.

Other ways funds can differentiate themselves include establishing a responsible investment approach (see page 21) and through member servicing.

If 46% of funds don't believe they have a unique offering, how will they stand out from the crowd?

4. APRA Heatmaps are heating up

The APRA Heatmaps, which examine investment performance, drew varying responses from survey respondents.

When discussing them, 56% highlighted their benefits – for example, greater transparency and potential opportunities – while 44% pointed to the cons.

Indeed, among those who highlighted APRA Heatmaps as a con, nearly three in five (57%) cited concerns about negative media coverage and a lack of member understanding. Twenty-nine per cent called for better member education and communications because they believed the Heatmaps are difficult to understand. Furthermore, more than half (55%) indicated they were considering amending costs due to the Heatmaps, while 36% said costs would remain the same and 9% were undecided.

Chart 6: Have the APRA Heatmaps changed your thinking on costs?

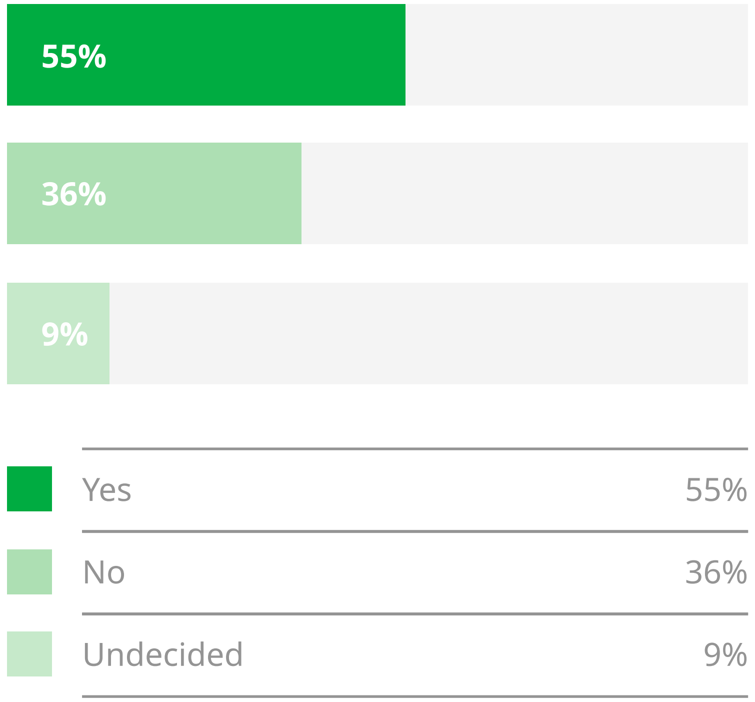
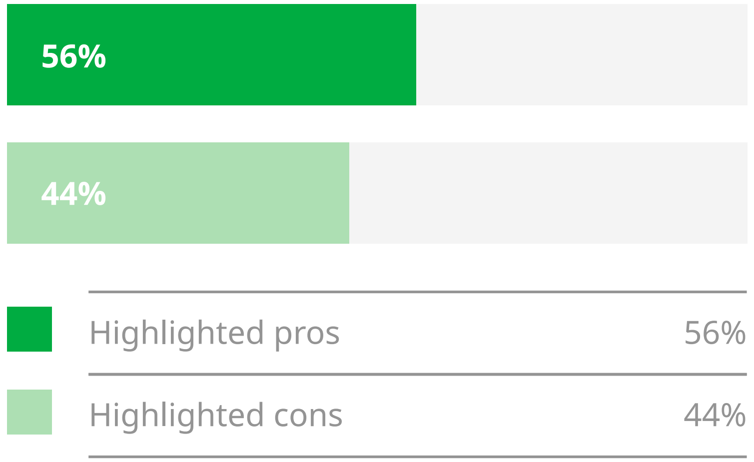


Chart 7: How does your fund view APRA Heatmaps?



> APRA Heatmaps can be confusing, particularly for members, but also, they could be dangerous when the press sensationalises the results… Short-term returns may force the wrong short-term behaviour to switch funds.
>
> - Anonymous CEO

Super: A big opportunity for cyber criminals

Cyber criminals are becoming increasingly sophisticated and it's often said that it's not if they will attack, but when.

Yet, our survey found that only 3% (chart 1) of survey participants ranked a cyber attack as one of their biggest challenges. That is despite reports claiming the risk of an attack has grown since the start of COVID-19, when more people began working remotely, and without the same level of cyber security found in the workplace.

Cybercrime threat in Australia

Large-scale cyber attacks on critical financial infrastructures are becoming more frequent, complex, and sophisticated and it's costing Australian businesses approximately $29 billion[2] every year. More concerning is that the motivations are changing from purely achieving financial gains to disrupting critical infrastructures. This was recently evidenced when the Nine Network fell victim to a cyber attack, with hackers threatening news services nationwide.

The super industry is considered an attractive target for cyber criminals because of its large account balances and low member engagement. Many members look at their super accounts or statements infrequently which means that missing or altered amounts can go unnoticed for long periods. Many members are also ill-informed about cyber risks and the need for cyber hygiene.

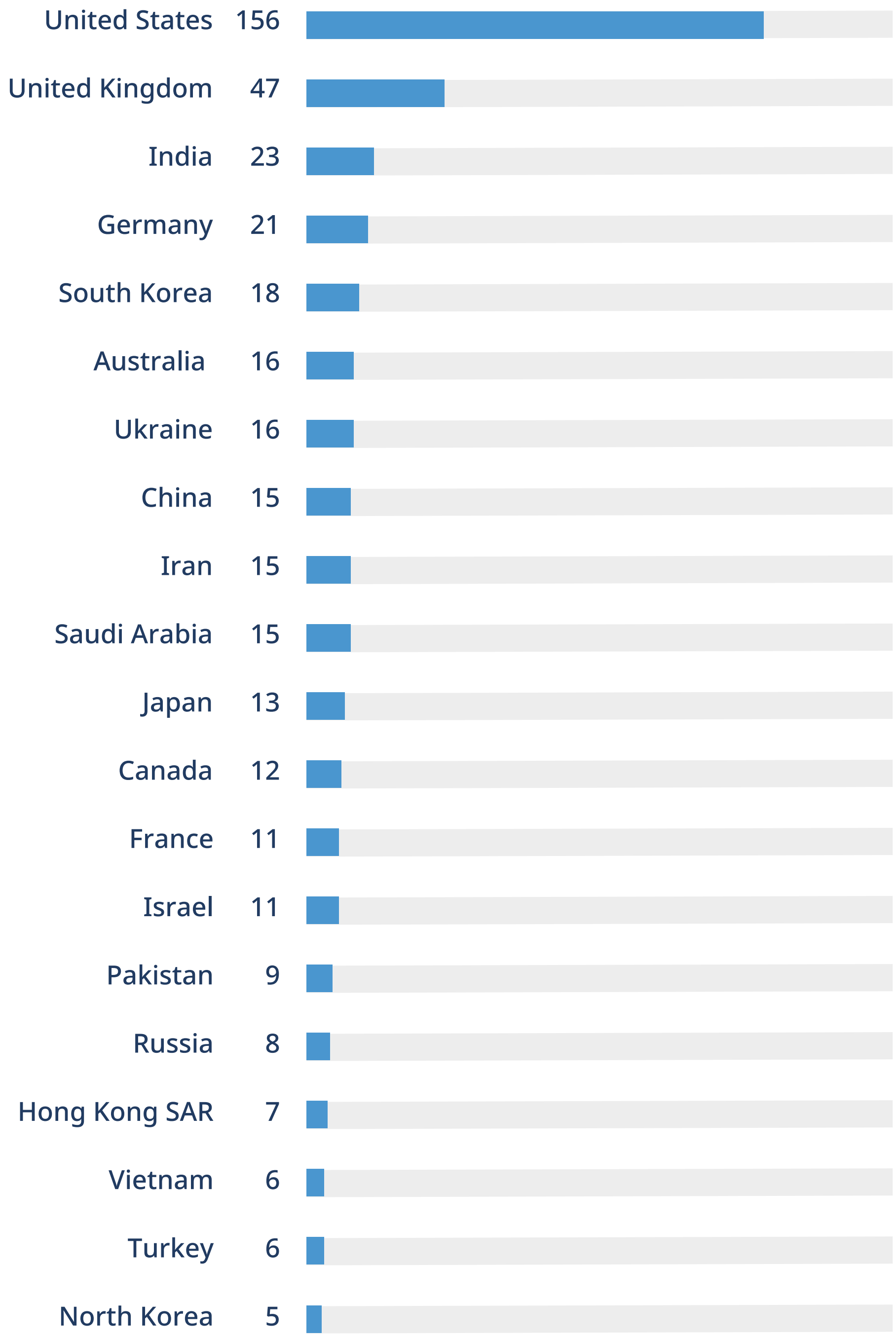
In addition, the super industry also relies on third-parties such as administrators, financial planners and other providers who perform services or engage with members on its behalf.

This, unfortunately, boosts the range of potential attack points for cyber criminals in areas where the fund does not have direct visibility.

The time for action is now!

[2] ACSC Annual Cyber Threat Report

Chart 8: Countries experiencing significant cyber attacks 2006-2020



Source: World Economic Forum,The Global Risks Report 2021 16th Edition

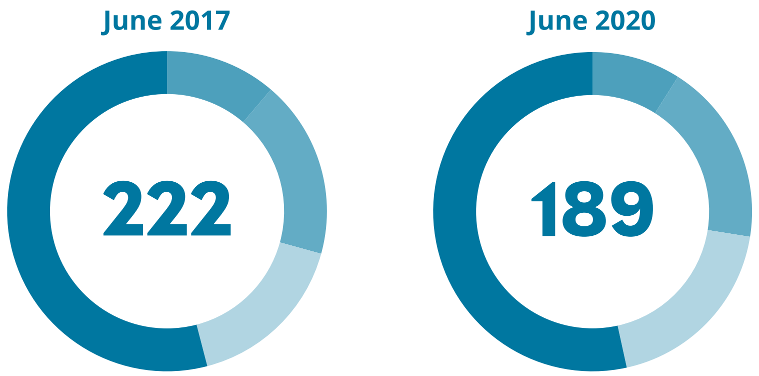
Insight 1
Merger mania

Merger mania

In 2017, 68% of the fund executives surveyed believed that there would be consolidation of funds, but only 13% expected it to happen to their fund. Superannuation leaders weren't proactively responding to merger opportunities back then, nor were they willing to talk about them.

Since then, the number of APRA regulated super funds has rapidly declined, dropping from 222 in June 2017 to 189 in June 2020.

Chart 9: Decline of APRA regulated funds from June 2017 to June 2020[3]



APRA regulated funds	2017	2020
Corporate funds	25	17
Industry	40	35
Public sector	37	36
Retail	120	101

[3] Source: APRA Annual Superannuation Bulletin for the year ended 30 June 2020

In a complete turnaround, funds are openly discussing mergers in 2021. Indeed, as previously shown in chart 3, 30% of funds rank merging to achieve scale as one of their top four business priorities. But it's not easy, with nearly half (47%) facing barriers during merger discussions (chart 10) and 19% (chart 1) of funds listing merger roadblocks as the biggest challenge facing them.

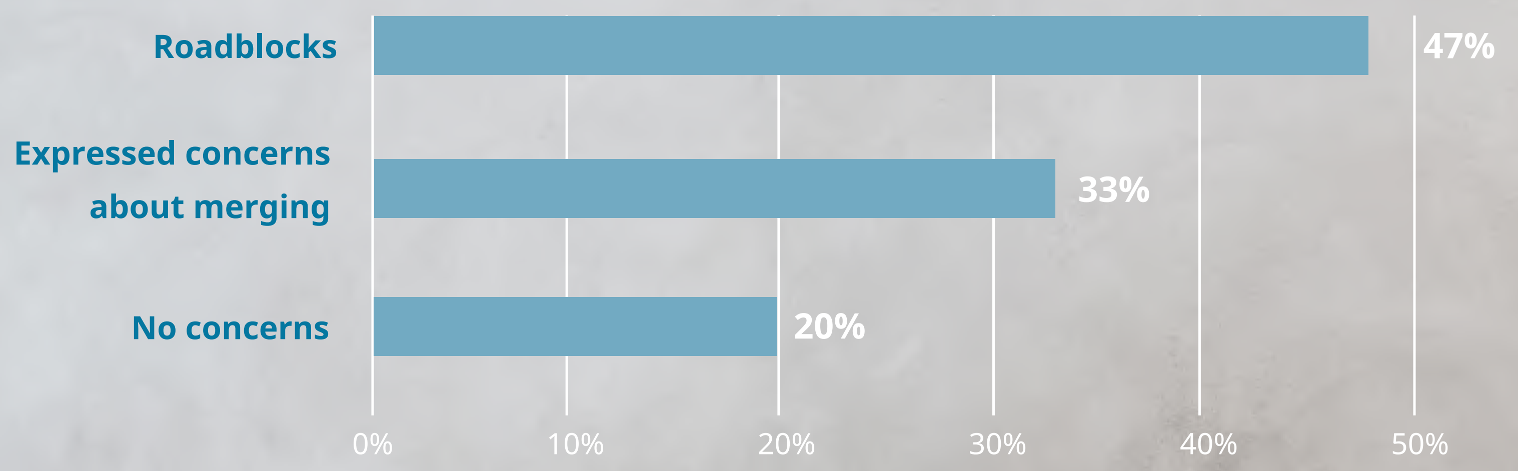
The questions exposing merger roadblocks

- What's the new point of difference or niche?
- What value is the merged entity creating?
- Is the board in alignment?
- Does a merger align with members' best interests?
- Who gets which new roles in the newly merged entity?

When discussing mergers, funds are looking primarily at investments and administration considerations, although there are a wide range of differences in their focus. However, losing sight of culture and human issues could be a big risk for funds that plan to merge. According to a Mercer survey conducted across more than 750-experienced deal professionals from Fortune 1000 companies, 47% of deals that fail do so primarily because they do not adequately anticipate, or address, people risks (see page 20).

Some funds say they are holding off on a merger right now because they don't want to put members and staff through a double merger or triple merger. They'd rather do it in one big step.

Chart 10: Merger discussions: What are funds facing?



Mergers: who's talking to who?

- First State Super, VicSuper and WA Super merged in 2020 (rebranded as Aware Super)
  AUM: $126.4 billion
  Members: 1.1 million

- Tasplan merged with MTAA Super (rebranded as Spirit Super)
  AUM: $23 billion
  Members: 326,000

- In progress, QSuper and Sunsuper
  AUM: $200 billion
  Members: 2 million

- In progress, Cbus and Media Super
  AUM: $70 billion
  Members: 850,000

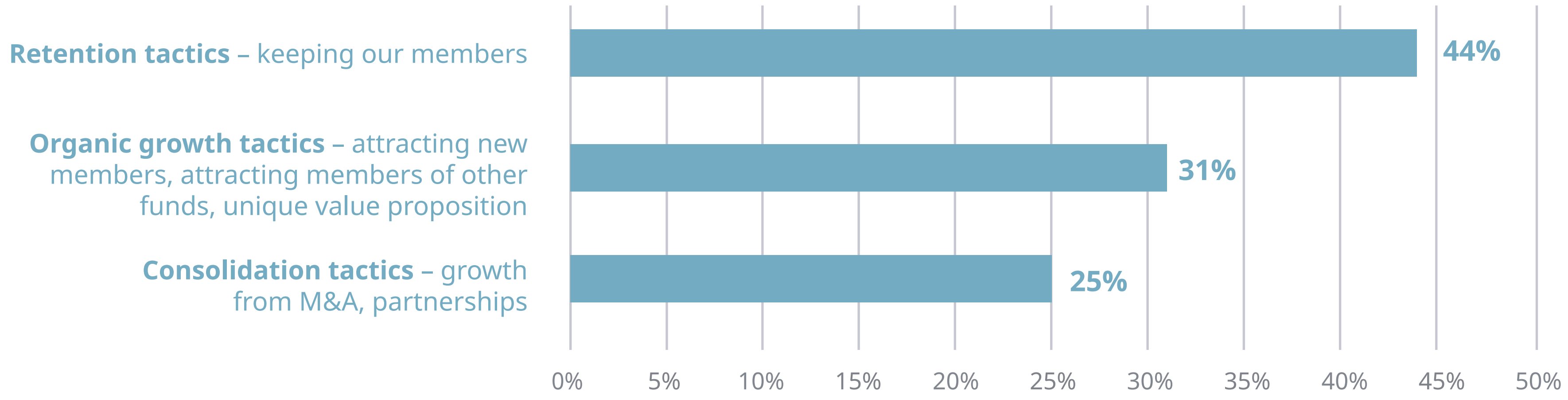
Only 25% of funds identified consolidation through mergers and partnerships as a way of growing their fund membership.

A higher number planned to grow their membership through retention tactics (44%) or organic growth (31%) thus attracting new members through offering a unique value proposition.

Funds that are considering mergers are busy examining where they fit in the market, where they can differentiate themselves and what their advantages are. Here, it's been all about their unique value proposition.

Mergers, however, are not the only growth strategies on the minds of fund executives. Many want to be masters of their own destiny and would like to retain parts of their identity and brand. For them, thinking more about other creative strategies for growth is key – for example, hybrid business models, including master trust arrangements, partnerships and a mix of insourced and outsourced solutions.

Chart 11: How will your fund achieve new member growth?



Big or small, the industry needs them all.

Mergers are not on the table for everyone. A third of funds (33%) highlighted the need for niche funds.

Moreover, two in five (38%) funds cited small- to mid-sized funds as having a competitive advantage due to their agility, niche growth strategies, member engagement and ability to offer a unique value proposition.

This gives small- to mid-sized funds an opportunity to attract partners who can enhance member engagement in their own special way. More and more smaller players are looking at banding together via mutually beneficial arrangements, each bringing their own strengths – from technology to investment strategy – to the overall relationship.

There is still a view that there is a place for niche funds in the industry and that too much consolidation will not serve the diverse needs of members.

A key challenge for niche funds will be maintaining their presence in an already flooded market – member engagement, brand and a trustee-focused view on members' best interests must all be on the strategic agenda.

However, there is potential for the industry to polarise into the "Big 10" and then possibly a raft of mid-sized "niche" funds that serve a particular membership base or value proposition.

Merging is not the only solution

With one in six (16%) funds citing leveraging scale as one of their biggest challenges, merging to gain scale has been a solution for many funds. However, merging is not the only option. Funds can tailor solutions such as outsourcing one or all functions of their operations, technology, investment and client services to drive efficiencies and access the benefits of scale.

What fund executives had to say:

> "Opportunities exist and can be taken if funds are willing to compromise."
>
> "Boutique funds can focus on retention and servicing existing clients with a Rolls Royce service."
>
> "Why can't a fund be niche?"
>
> "We can't work with a monopoly."

Insight 2
Getting the deal done: Your people are your power

Delivering the deal

To survive in an economy so impacted by the pandemic, many business leaders are turning to deals to adapt and survive. Fifty-seven per cent of leaders anticipate an increase in deal activity in 2021 and 2022, according to a Mercer survey*, yet a majority of deals fail to deliver value because they fail to focus on people.

However, the stakes of ignoring people risks are higher than we think with 47%* of deals failing because they do not adequately anticipate or address people risks.

> In a deal, people cannot be left to chance. Failure to address pain points in your people strategy can have catastrophic consequences.
>
> - CHRO, global supply chain and logistics company, US$48 billion in annual revenue

Traditionally, people are considered an expense, and therefore, the value they bring to deals is on the cost side of the ledger. What gets missed is that people are the delivery vehicle for revenue. The right leadership team, the right skill sets and the right understanding of organisational goals are what drive deal value. Yet these issues are frequently neglected in putting a deal together. And, in many cases, they are viewed as items that will “get figured out” or be dealt with after day one.

Chart 12: Key aspects of people strategy that derailed deals when left unaddressed

*Mercer 2021 Research Report: Delivering the deal. The unrealized potential of people in deal value creation.

Noticing the red flags

There are often red-flag statements that signal the presence of unresolved people issues in a deal. These statements do not explicitly call out people risks. Instead, they suggest that significant misalignment of goals and misinterpretation of messages among the workforce is likely.

Phrases like **“This is a merger of equals”** can imply that nothing needs to change and that people should continue what they were doing and how they were doing it, even after the deal is made.

Saying that **“We’re not going to change anything”** ignores the fact that the situation has already changed — there is new ownership.

“We’re only getting rid of what doesn’t work and keeping what does” may seem great in theory, but in practice, no two people will agree on what does not work. The presence of subjectivity gives license to each person to create and execute on their own agenda.

And finally, **“Our people are smart. They’ll figure out what needs to get done”** typically implies that many issues will be allowed to work themselves out versus having a clearly communicated execution plan.

None of these statements explicitly reference people issues, but far too often, they suggest a lack of proactive identification of potential people risks and strategic planning for how to mitigate them. Business leaders need to recognise the impact people have on deals when it comes to both cost and revenue.

What does it all mean?

Deals are done to create value in the form of revenue and cost synergies. The structure and form may vary, but the bottom line is value creation. This bottom line is put at risk when key people issues are not strategically and proactively considered, such as:

- What behaviours do we need the leadership team to model and reward?
- What cultural components will reinforce the required operating environment?
- How do we retain and attract a workforce with the skill sets needed to deliver the deal thesis?
- Will differences in each organisation's approach to diversity, equity and inclusion hinder our strategy?

These and many other people-related questions can be better understood and addressed as part of a robust deal process. It is up to business leaders to demand that this happens in each deal.

The Way Forward

The findings from the Mercer Mergers & Acquisitions survey are a wake-up call to every business leader, highlighting the importance of considering people risks at the earliest stages of deal thesis formulation. As more and more organisations undertake deals, the role of people issues must be appreciated.

Savvy deal professionals understand that considering these issues proactively and intentionally in partnership with a dedicated people adviser is the key to capturing the promised deal value.

[Delivering the deal: The unrealised potential of people in deal value creation]

Internal culture and capability

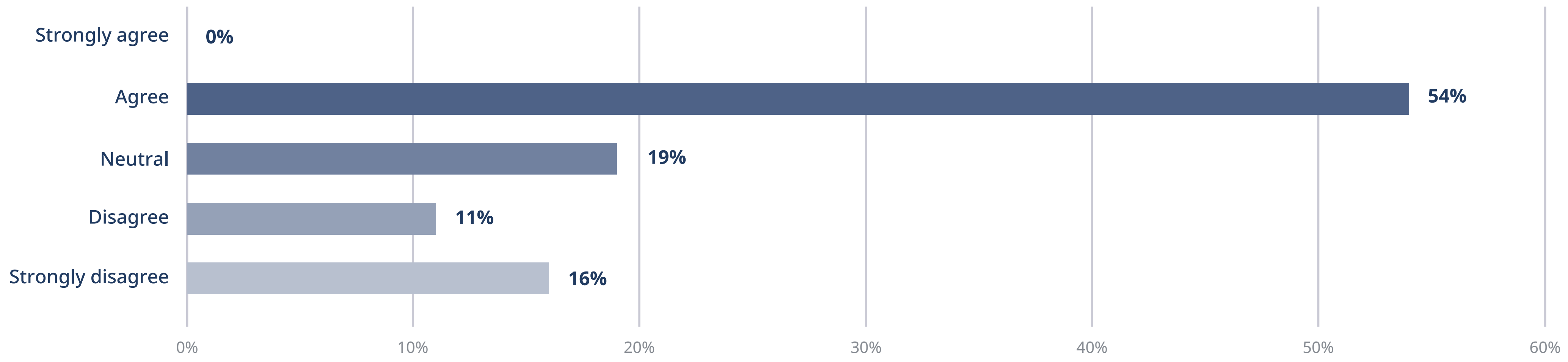
When asked what their top four most important business goals and strategic objectives were, fund executives ranked enhancing internal culture and capability second last at 19%.

However, 54% agreed that engaging their employees and improving their employee experience was a top priority for their leadership team. Interestingly, no one strongly agreed with this statement, while 19% were neutral, 11% disagreed and even more (16%) strongly disagreed.

That said, achieving this priority could be a challenge in the COVID-19 environment. The pandemic has vastly changed the working environment and has created a need to understand the engine room better than ever and to continually nurture and empower from within. Moving from office to home tested many trustee offices with security, infrastructure and OH&S considerations.

Given these challenges, it's no surprise that according to Mercer's Global Talent Trends study, the top transformation priorities in 2021 for Australia's HR leaders are reinventing flexibility (59%), followed by upskilling/reskilling critical talent pools (54%).

Chart 13: To what extent do you agree with this statement: Engaging our employees and improving employee experience is a top priority for our leadership team



Recommendations for moving forward

- **Make digital and flexible working a common purposeful practice.** Embed flexibility and engage in purposeful work, workplace and workforce design that enables virtual collaboration and gives employees and managers the tools to succeed in the digital world of work.
- **Enable employees to see and co-design shared futures.** Good career management connect the employee's talent plan and the organisation's business plan. Create ways to show employees what future skills and capabilities the business needs, amplify relevant opportunities, and reimagine pathways for roles along your organisation's value chain.
- **Evolve sophistication around data and employee listening.** Increase capability in data engineering, data science and data virtualisation to benefit from the insights data can provide. Implement sophisticated and nuanced employee listening techniques to fully understand employee, customer/member and stakeholder interactions.
- **Prioritise HR transformation.** Look at how the HR model needs to change . Break away from traditional HR models to reflect how we live digitally now and our new ways of working.

Insight 3
Investment returns top of mind

The global pandemic resulted in unprecedented stimulus, market volatility and record low interest rates. This has severely challenged investment teams. However, the government's decision to allow people access to their super changed the industry overnight.

According to APRA, since the introduction of the COVID-19 Superannuation Early Release Scheme, more than $37 billion has been withdrawn from the super system as at 31 January 2021. For some funds, this outflow meant making some crucial decisions about their investment strategies.

Pile on a flurry of regulatory activity to drive better outcomes for members, and now the pressure to deliver improved investment returns has well and truly solidified its position as front of mind for funds.

Indeed, as shown in chart 3, 76% ranked delivering improved investment returns as their number one most important strategic goal and activity for 2021. This was closely followed by improving member services and engagement (73%).

This is a massive shift from our 2017 study where funds ranked member service, outcomes and engagement (39%) twice as important as investment returns (19%).

Although investment performance is clearly a top strategic priority, only one in five (19%) said it's one of the biggest challenges facing their fund. Even less (5%) said the changing investment landscape was the biggest challenge. That's because there are bigger hurdles to overcome, such as the rush of regulatory reforms coming their way (chart 1).

Fund executives noted that the whole investment environment has changed. With interest rates near zero, the biggest challenge for super funds is to continue to deliver strong returns for their members.

In the new environment, expected returns across all asset classes are likely to be compressed. At the same time, the risk levels for each asset class will probably be similar. This means that funds will be getting a lower nominal return for the same risk.

While cash and bonds are currently not viable from a performance point of view, investing in many other asset classes will not provide them the same defensive characteristics.

This also creates challenges around investing for those closer to retirement who would normally go for conservative portfolios. It's possible that retirees will need to take on more risk than in the past and that the journey through retirement will be more volatile than it was for previous generations.

In addition, reliance on traditional modelling and historical asset movements might be misplaced in this new investment world.

There are also concerns that the YFYS performance test, which examines a fund's performance over eight years, may encourage investment teams to take less risk versus the APRA benchmarks, provided the fund is on course to beat the benchmarks given their retrospective nature.

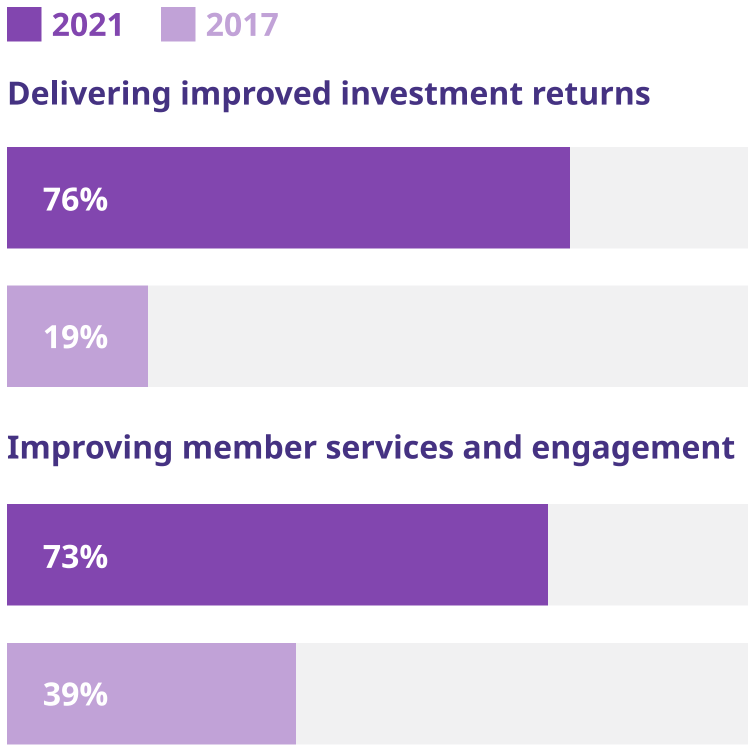
Similarly, they may be more likely to focus on the short-term which, of course, is problematic given the long-term nature of super. Plus, as one fund executive noted: "Short-term investment decisions are now looking to be more 'passive'."

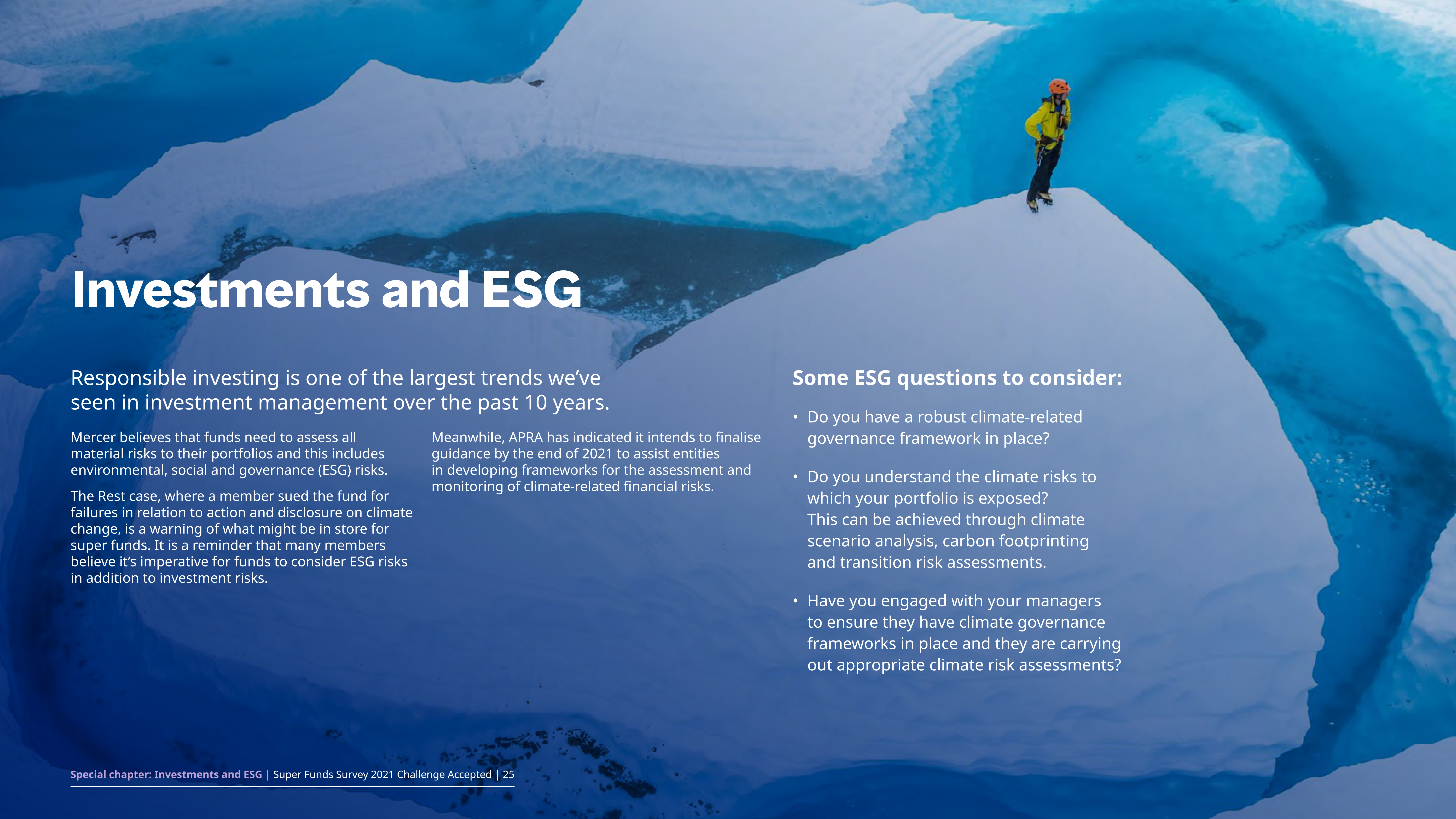
Funds withdrawn from the super system through the Early Release Scheme*:

$37.3 billion

*As of 31 January 2021

The highest ranked strategic goals and activities important strategic goal and activity





Investments and ESG

Responsible investing is one of the largest trends we've seen in investment management over the past 10 years.

Mercer believes that funds need to assess all material risks to their portfolios and this includes environmental, social and governance (ESG) risks.

The Rest case, where a member sued the fund for failures in relation to action and disclosure on climate change, is a warning of what might be in store for super funds. It is a reminder that many members believe it's imperative for funds to consider ESG risks in addition to investment risks.

Meanwhile, APRA has indicated it intends to finalise guidance by the end of 2021 to assist entities in developing frameworks for the assessment and monitoring of climate-related financial risks.

Some ESG questions to consider:

- Do you have a robust climate-related governance framework in place?
- Do you understand the climate risks to which your portfolio is exposed?
  This can be achieved through climate scenario analysis, carbon footprinting and transition risk assessments.
- Have you engaged with your managers to ensure they have climate governance frameworks in place and they are carrying out appropriate climate risk assessments?

Strategic responses to consider

- Ensure you clearly understand how much additional risk you are willing to take on to generate extra return.
- Think of risk in its many forms, for example, peer risk, business risk, regulatory risk and inflation.
- Ensure investment teams, investment committees and trustee boards are aligned on their priorities and objectives so they can work together cohesively.
- Consider different scenarios as well as base cases.
- Investment markets move quickly. To capitalise on investment opportunities investigate whether your fund should insource or look to outsource some or all its investment capability.
- Diversify your portfolio to benefit from a wider range of return drivers and to lower your risks.
- Consider new ideas. Less liquid and alternative strategies might boost returns.
- Remain nimble. Review of governance processes to allow for faster decision-making and greater opportunism in future.
- Focus on active management selection where it is likely to be most rewarded.
- Simplify investments in asset classes which offer lower potential “added value-to-effort” ratios.
- Try to remain focused on the longer-term rather than reacting to shorter-term changes.

Insight 4
Are members boss?

Three-quarters (73%) of funds in our 2021 survey ranked improving member services and engagement as their most important strategic activity (up from 39% in 2017).

But when they were asked to rank the greatest influence on the direction of their fund, maintaining member engagement was ranked fourth out of five categories. Only 5% of those surveyed ranked member engagement as having the greatest influence (chart 2).

That's a change from our 2017 survey where respondents ranked member engagement as the greatest influence on the direction of their fund second after regulation.

For many funds, improving member engagement translates into improving digital capability. Interestingly, only a third (32%) rated digital capability as a priority business goal in 2021, with significantly fewer (5%) ranking the changing digital environment as a key risk (charts 3 and 1 respectively).

Members' needs must be at the core of funds' products and processes. But our survey did not find keeping pace with the digital landscape to be the biggest challenge for many funds. Only 5% said it was.

Developing a fund's Unique Value Proposition fared only slightly better, with 8% citing it as a fund's biggest challenge. That said, 22% of fund executives strongly agreed and 32% agreed that they had a unique member offering that set them apart from competitors. On the other hand, 38% were neutral on this topic, 5% disagreed and 3% strongly disagreed (chart 5).

Membership is optional

Fans become members of their sporting club; professionals become members of their industry body. But loyalty like this does not exist between Australians and their superannuation fund – just as it does not exist between their bank, health insurer, or internet provider. Superannuation is a service, and it is a fund's privilege to provide it.

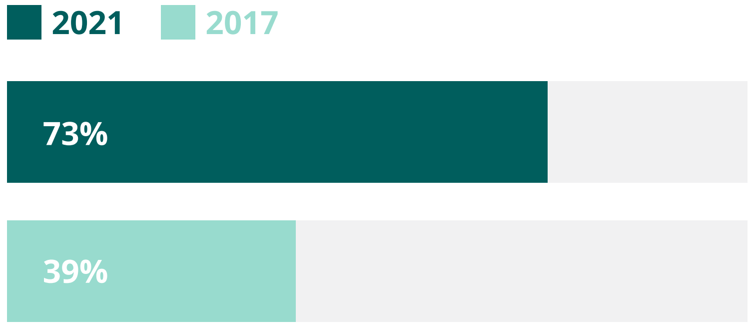
Superannuation members are increasingly active. They have wants and needs, and will exercise their choice to stay with your fund according to the quality of experience you provide. In a world where Australians are getting great brand experiences every day, why should superannuation be any different?

Be guided by your members

Members are the purpose of every fund, so put them at the centre of everything you do:

- Design for members with true member research, guidance and testing to ensure funds are meeting their needs.
- Give members a good reason to join and an even better one to stay.
- Put member outcomes, wealth-building and ultimately, retirement income at the centre of fund strategy.

Funds that ranked improving member services and engagement as their most important strategic activity



32%

rated digital capability as a business priority

5%

rank the changing digital environment as a key risk

Super Funds Survey 2021 **Challenge Accepted** 28

Insight 5
Embracing technology

Technology – are we there yet?

In one of 2020's greatest sink-or-swim challenges, COVID-19's lockdowns and social distancing demanded a digital-first approach to members.

Funds had to take a leap of faith when adopting technology, especially some of those that were traditionally 'old school'. They had no choice and it worked.

One CEO put it best by observing: 'While it was scary, we were braver.'

Members across all demographics embraced the online member engagement tools and more can be expected going forward. However, there is little room for complacency.

A Mercer survey of Mercer Super Trust members conducted in December 2020 found that 85% of respondents preferred personalised email communications with only 1% indicating a preference towards paper communications, clearly highlighting the accelerating member expectations around digital delivery.

There was also a push for greater website presence and accessibility with 30% of respondents noting members preferred to access information via a fund's website.

The challenge for funds now is to separate themselves from the crowd. They must continue to evolve to meet the expectations of a technological and a data-driven world, and be able to engage, grow and retain members better than those around them.

Fund executives comments

> "2020 has shown us we can work remotely and engage digitally. However, all the websites look the same — so that's now front and centre."
>
> "We will be less scared to try new technologies after COVID-19."

Digital vs 'old school'

85%
Prefer personalised email communications

30%
Prefer info from a website

1%
Prefer paper communications

Source: Mercer survey conducted amongst Mercer Super Trust members in December 2020

One size does not fit all

We need to face the reality that a one-size-fits-all approach to members is no longer acceptable. In fact, more than half of consumers say they are likely to switch brands if a company makes no effort to personalise their communications.

The bottom line is when a member reads your email or visits your website, they expect personalised messaging - no matter which device they're on.

Insight 6
Keeping members in retirement

With the baby boomer population heading into retirement, funds must consider what products they will need to develop if they want to keep them as members.

While the superannuation system has generally served members well during their accumulation phase of life, it has not focused as much on meeting members' needs in retirement. Furthermore, as members are retiring with increasing balances and less support from the government, the focus for funds must shift.

Back in 2017, our survey indicated that 55% of funds didn't have a clear strategy on how to service the needs of retirees and pensioners. However, our 2021 survey found that funds were beginning to embrace this challenge, although not all had started yet. Others said they would work on this after their mergers.

When asked about their top four most important business goals and strategic objectives, developing innovative solutions for retirement came in at 27% – the third lowest rank for this question.

Survey respondents raised concerns about defaulting members into post-retirement products, especially when funds didn't know enough about them. One fund executive stressed that a lot of the value in this area would come from financial planning.

The independent Retirement Income Review Final Report, released in November 2020, confirmed that the Australian retirement income system is effective, sound and its costs are broadly sustainable. While it did not make any specific recommendations, the review was supportive of the Retirement Income Covenant, which is set to come into force in July 2022.

Questions to consider when devising your strategy for your retiring members include:

- How are your members drawing down their savings in retirement and is this both adequate and sustainable? If not, how can you improve this?
- What are the different cohorts of members at retirement and how do their needs differ?
- Do you have retirement solutions that will meet your retiring members' differing needs and are they structured in a tax efficient way?
- Do you have an effective communication and engagement strategy leading up to and into retirement to help guide your members through this challenging process?
- How should your fund construct its target market determination, as prepared for the Design and Distribution Obligations, for its retirement products?

Despite that

$1 billion

in the system is already held by retirees*

only

27%

of funds rank developing innovative solutions for retirement as one of their top 4 strategic goals & activities

*This includes both APRA funds and SMSFs

Conclusion

Throughout this report, it's clear that super funds have come a long way since the original findings of our 2017 report Change or be Changed. But, more needs to be done if funds want to survive.

Regulatory overload, achieving member growth, investment performance, digital disruption and the future of work. The challenges are vast. Yet, so are the possibilities.

As one of Australia's longest-serving superannuation specialists, Mercer sees this as an opportunity to break away from outdated thinking and find new and innovative solutions that will create brighter futures for all Australians and help shape the future of superannuation.

We believe funds should approach these challenges on two fronts.

First, build your resilience to today's unique environment while you prepare for a post COVID-19 world. Put simply, your fund and your members should be ready to take on any change, big or small.

Second, as funds begin to transition from a 'business as unusual' phase to the 'great reinvention' phase, relinquish the crisis mindset and see that journey as a long-term endeavour.

Are you ready to accept the challenge?

**Find out how Mercer can help you build brighter futures for you and your members.
Email Mercer Australia today.**

welcome to brighter

Challenge Accepted.

About Mercer

In a competitive landscape that is subject to ongoing reform, superannuation funds need to continually evolve to meet the expectations of a data-driven workforce becoming increasingly reliant on technology, and be able to engage, grow and retain their membership better than those around them.

We take a partnership approach to doing business, designing solutions that are tailored to a fund's specific needs, including:

- Products to help small and mid-size super funds reduce costs, increase efficiency and deliver member outcomes, growth and fund sustainability
- A total administration and investment outsourcing solution that helps funds take charge of their member services without having to manage the infrastructure
- Fund-branded total outsourcing solutions that allow funds to maintain their identity and actively communicate with their members
- Simplification strategies that can improve cashflow, increase retention and improve business performance
- Implementation of governance strategies and frameworks to support Boards and management teams. Mercer's team of governance consultants have a broad range of superannuation experience, including administration, legal, operations, project management, compliance and risk.
- A suite of consulting services and tools to help transform your HR function, accelerate digital implementation, and support change management to deliver exceptional employee experience

At Mercer we believe in building brighter futures by reshaping retirement and investment outcomes, redefining the world of work, and unlocking real health and well-being. Mercer's approximately 25,000 employees are based in 43 countries, and the firm operates in 130 countries. Mercer is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people, with 76,000 colleagues and annual revenue of over $17 billion. Through its market-leading businesses, including Marsh, Guy Carpenter and Oliver Wyman, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment.

Go to mercer.com.au/ChallengeAccepted to learn more.

Mercer

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