

**Insurance
and
Superannuation
Commission
Bulletin**

September 1995



FOREWORD

It gives me great pleasure to present this initial release of the new quarterly ISC Bulletin.

I believe the Bulletin, particularly its analytical articles and statistical tables, will greatly assist industry practitioners, the media, and other interested parties to develop a clearer picture of the size, structure and performance of the superannuation and insurance sector. It will also provide a forum where the views of the Commission on topical issues can be given wider and more timely circulation.

The statistical tables included in the Bulletin combine information compiled from the ISC's Annual Return regime, the new ISC Quarterly Survey of Superannuation and Australian Bureau of Statistics collections. Most notably, the introduction of the new ISC survey - which is the culmination of a highly successful collaboration between the Commission and the ABS - has resulted in a more timely and comprehensive range of statistics on the superannuation industry.

With a clear picture of market trends and commercial structures, policymakers in both financial and non-financial sectors are in a position to make sound decisions based firmly upon hard evidence. Used prudently, this information can provide the basis for the kind of inquiry and analysis that will result in the development of regulatory frameworks that are efficient, effective and truly crafted in the national interest.

Needless to say, the introduction of the Bulletin and the new ISC Quarterly Survey of Superannuation required considerable assistance and input from many industry stakeholders. Most importantly, I would like to thank the ABS for their cooperation in, and contribution to, the development and implementation of the Survey. I am confident this example of inter-agency cooperation will continue as we develop future initiatives in respect of other joint statistical projects. I would also like to express my appreciation to the industry associations, superannuation funds and administrators who assisted during the development process and whose continued support will ensure the Bulletin creates a cost effective and relevant information resource.

Over time, the Bulletin will be expanded to include further statistical information and analysis and I expect it will play a significant role - together with the Commission's other information products, such as the Life Insurance Quarterly Statistical Bulletin and the Superannuation Digest published by CCH - in allowing the debate surrounding superannuation and insurance to become better informed and more focused.

F G H Pooley
Commissioner
20 December 1995

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Welcome to the ISC Bulletin

Introduction

This Bulletin is the first edition of a new and continuing quarterly series to be produced by the ISC. Each issue of the Bulletin will contain special interest articles on contemporary industry issues, broad level statistical tables, extracts from topical speeches given by executive officers of the ISC and a list of other speeches given by ISC officers.

Early editions of the Bulletin will focus on the superannuation industry. The statistics will be drawn largely from the new ISC quarterly survey of superannuation, ISC Annual Returns lodged by regulated superannuation funds and the Australian Bureau of Statistics (ABS) survey of life insurance offices and investment managers. By combining these information sources in one Bulletin we hope to bring you a more complete picture of the superannuation industry.

This first edition contains only superannuation asset statistics. Over the coming year, however, we will expand the Bulletin considerably. For example, future editions will contain statistics and analysis in respect of superannuation financial and demographic inflows and outflows along with other related ISC statistics.

The new ISC survey of superannuation

This new survey is the culmination of an ISC initiative, undertaken in conjunction with the ABS, to develop and publish a timely and comprehensive source of information on superannuation. It collects a broad range of information on the structure and financial operations of approximately the largest 1 100 public and private sector superannuation funds and Approved Deposit Funds (ADFs). The surveyed funds account for around 90 percent of the total industry in terms of assets, membership, income and expenditure. The survey is administered on behalf of the ISC by the ABS.

ISC Annual Returns

Information collected through the ISC Annual Return regime provides the basis for the derivation of estimates for those superannuation funds and ADFs outside the scope of the survey. These funds fall into two categories:

- 'excluded funds' (i.e. superannuation funds with less than 5 members); and
- 'the balance of non-excluded superannuation funds and approved deposit funds' (i.e. all other superannuation funds and ADFs not large enough to be included in the survey).

These two categories of funds account for around 10 percent of the total industry aggregates, although they represent approximately 106 000 funds, or 99 percent by number of all funds.

ABS Survey of Balance Sheet Information

The ABS Survey of Balance Sheet Information (SOBSI) provides detailed information on superannuation and ADF assets managed by external investment managers or held in the statutory funds of life insurance offices. The ABS SOBSI survey covers all significant investment managers operating in Australia and collects data from the largest 25 life insurance offices. The surveyed life offices represent approximately 97 percent of all life office statutory fund assets and this information is extrapolated by the ABS to provide 100 percent coverage.

Statistical tables in this Bulletin

The statistical tables in this Bulletin present information detailing superannuation assets categorised by 'fund type' and manner of investment (table 1), and membership by 'fund type' (table 2), as well as showing assets by detailed asset allocation (tables 3 to 6).

The fund types used for table 1 and 2 are:

- *Retail* - pooled superannuation sold commercially through intermediaries, including master trusts and personal superannuation products;
- *Public Sector* - sponsored by a government department, agency or government controlled business enterprise;
- *Industry* - established under an agreement between the employer sponsor(s) and the relevant union;
- *Corporate* - sponsored by a single non-government employer, or group of employers; and
- *Excluded* - funds that have less than five members.

Tables 4 to 6 record the superannuation assets by manner of investment. Manner of investment refers to whether the assets are directly invested, placed with investment managers or held as life insurance policies (ie, invested in the statutory funds of life offices). These three tables are combined to create the table for total assets (table 3).

A fund may use a mix of investment strategies. For example, it may have half of its assets directly invested into the markets, one third of its assets

placed with external investment managers, and the remaining one sixth of its assets held in life insurance policies. That portion of its assets which are directly invested will be reported in table 4, that portion of its assets placed with investment managers will be reported in table 5, and that portion of assets held in life insurance policies will be reported in table 6.

The total for directly invested assets are sourced from data reported in the Survey and additional estimates for the directly invested component of the assets of superannuation funds and ADFs outside the scope of the Survey (i.e. the 'balance of non-excluded funds and ADFs' and 'excluded funds').

Superannuation assets placed with investment managers and superannuation assets invested in life insurance statutory funds are sourced from the ABS SOBSI collection. The non-directly invested components of the assets of funds outside the scope of the Survey are accounted for in the ABS collections, and hence included *within* the appropriate non-directly invested tables.

It is important to note that the total asset figures include superannuation assets that are not regulated under the Superannuation Industry (Supervision) Act 1993. These assets include assets attributable to investment vehicles such as deferred annuities and immediate annuities, that are regulated under the Life Act 1995. These assets relate to products sold in the retail superannuation market and are therefore attributed to the 'retail' fund type.

The total superannuation asset figures do not include any provision for the unfunded superannuation liabilities of Australian governments to public sector superannuation funds. However, the total assets figures do include the assets of some public sector superannuation funds that are exempt from ISC direct supervision.

Reporting Basis

Participants in the survey are requested to follow, as far as possible, the Australian Accounting Standard AAS 25 and to report assets at net market valuation. Net market value refers to the amount which could be expected to be received from the disposal of an asset in an orderly market after deducting costs expected to be incurred in realising the proceeds of such a disposal. Respondents to the ABS SOBSI survey are requested to report assets at their market value.

Data quality

In interpreting the statistics contained in this Bulletin, users are advised that with any new statistical survey there will be an initial period of consolidation before results can be considered robust. Although users can be confident of the broad level aggregate figures, interpreting finer

level detail should be performed cautiously as participating superannuation funds and ADFs may need time to become fully familiar with the concepts and data definitions underpinning the Survey.

Revisions

This Bulletin contains revisions to previously published statistics. Where figures have been rounded, discrepancies may occur between sums of the component items and totals.

Comparability with Other Superannuation Statistics

The statistics contained in this Bulletin are reasonably comparable at the broad level with the annual statistics previously released in the ISC's 1990-91, 1991-92 and 1992-93 Superannuation Bulletins. However caution should be used when making comparisons, particularly at the detailed level. This is because statistics contained in this Bulletin are compiled using collection methodologies that vary from those used to compile figures published in previous ISC annual bulletins. Moreover, new asset class and fund type categories are now utilised.

Apart from those tables sourced directly from the ABS (ie tables 5 and 6), information contained in this Bulletin is not directly comparable with statistics contained in the ABS publication "*Assets of Superannuation and Approved Deposit Funds*" (Cat. 5656.0). However, to assist users of those statistics, statistics for quarters prior to June 1995 are included where applicable. Importantly, there are major differences between the Survey and previously published ABS data on superannuation assets due to an expansion in coverage by the new Survey and a significant change in the Survey's scope to include estimates for the directly invested component of all superannuation and ADFs.

Unpublished Information

A wide range of information, subject to strict privacy constraints, collected via the Survey and ISC Annual Returns is available on request from the ISC on a fee for service basis (a data request form may be found at the end of this Bulletin).

More information on investment managers and the assets of life office statutory funds is available on request from the ABS.

Copies of the speeches included in the Bulletin are also available by contacting the ISC Statistics Unit. For more details see the "Order Forms" section at the end of this Bulletin.

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Understanding Australia's superannuation industry

Overview & background

Superannuation is now the preferred way in which Australians save for their retirement. Largely as a result of Australians recognising the importance of investing in superannuation, the Superannuation Guarantee arrangements and the favourable taxation incentives provided by government, there are now around 6 million people (87 percent of the labour force) who together own \$230 billion in superannuation assets. This equates to an average share of around \$38 000 for every member.

In contrast, in 1983 only around 2 million people (40 percent of the workforce) were covered by superannuation, with the entire superannuation savings pool amounting to only \$32 billion.

The rapid growth of superannuation has also been accompanied by an increase in the depth and sophistication of the industry. For example, superannuation members, through their trustees, now have options about whether to invest directly into the markets themselves, place money with external investment managers, buy superannuation policies with life insurance companies, administer the fund internally, have the fund externally administered, purchase units in pooled superannuation trusts, maintain the fund as a separate employer sponsored fund or roll it into a retail superannuation fund or product administered through an Approved Trustee.

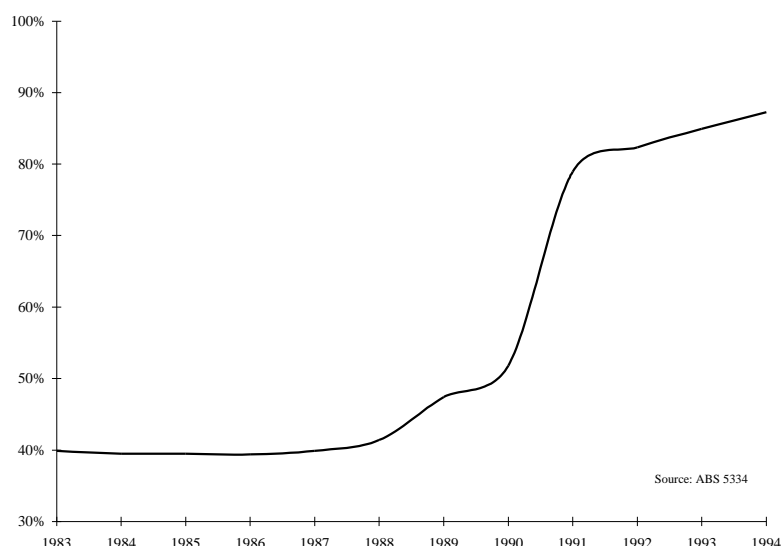
The Superannuation Industry Supervision (SIS) Act is the Government legislation that determines the legal basis for the trustee structure that underpins the superannuation industry. People wishing to understand how the industry operates in practice however, require an understanding of how industry participants have translated the regulatory framework into a working commercial system. The new ISC quarterly survey of superannuation has been designed with this in mind.

While the financial options and industry practices may appear confusing at first, this need not be so. We will now outline some of the major features of the superannuation industry.

All funds are not alike

There are currently around 107 000 separate superannuation funds in Australia. The overwhelming majority of these funds, 99 000 or 94 percent, are called *excluded* funds that contain fewer than five members. These funds are popularly referred to as small self-managed DIY funds. They represent a total of only 200 000 of the 6 million individual Australians who have superannuation. The remaining 8 000 funds are defined in terms of the SIS Act as either *standard employer* or *public offer* funds. These funds represent 97 percent of all member accounts. The top one percent of these funds (which are now included in the new ISC quarterly survey of superannuation) cover approximately 90 percent of all members and assets.

Figure 1 Growth in superannuation coverage



In terms of industry structure, however, it is more meaningful to focus upon the categories of corporate, industry, retail or public sector funds. These functional categorisations for the 8 000 non-excluded funds better reflect how the superannuation industry itself operates in commercial reality. Importantly, these categories reflect how the industry in fact views itself.

Corporate funds are sponsored by a single employer or group of related employers. Industry funds, often organised through industrial workplace arrangements, cater for members as a result of an agreement between the parties to an industrial award. An individual industry fund usually draws members from a large number of usually unrelated employers often across a single industry.

Retail funds are publicly offered superannuation funds that members join by purchasing investment units or policies that are sold through intermediaries such as life insurance agents or financial planners. Members of retail superannuation funds may include self employed people or people wishing to top-up their other employment based superannuation arrangements. Employers may use retail superannuation products to meet their superannuation obligations in respect of their employees, for example, by using a retail master trust. A fund is considered to be a public sector fund if the sponsoring government agency or business enterprise is majority government owned.

The number of excluded funds has grown from 57 000 in 1991 to 99 000 in 1995. Over the same period, the number of non-excluded funds decreased from 17 000 to 8 000. This polarisation within the superannuation industry partly reflects moves by medium and large funds to simplify and consolidate their arrangements.

For example, some retail fund providers have combined separate funds to create a smaller number of larger funds, while some medium sized employers have rolled their corporate funds into retail master trusts or have rolled their employees into industry funds. At the same time, the growth in the number of excluded funds probably reflects a growing desire by high net-worth professionals and small business proprietors to take greater control of their own investments.

Another key aspect differentiating superannuation funds is whether the fund is an accumulation or a defined benefit fund. Many long established corporate and public sector funds are defined benefit. Nearly all retail, industry and excluded funds are accumulation in nature. In accumulation funds members bear the investment risk. In defined benefit funds the employer sponsor bears the investment risk.

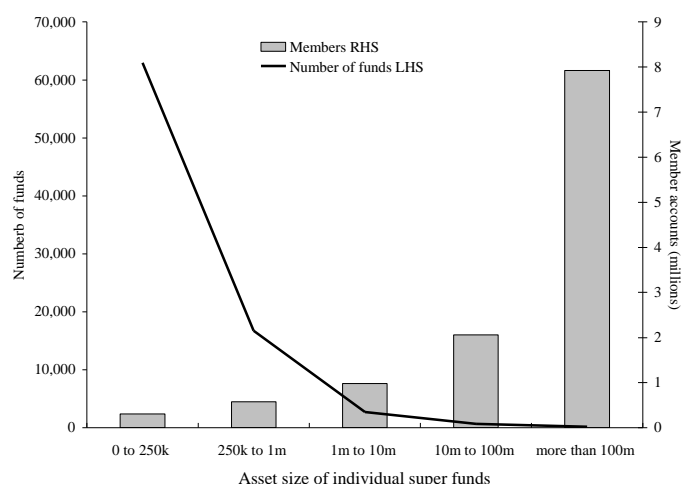
Defined benefit funds were commonly designed to attract and retain employees, rather than to comply with the Government's retirement income policies. In defined benefit funds, the employer sponsor is liable for the fund benefit payments irrespective of whether past contributions and accumulated earnings are sufficient to cover these benefit payment liabilities.

Most defined benefit funds in the private sector are fully funded whereas a significant number of

defined benefit funds in the public sector are only partially funded. These public sector funds are able to reliably meet their benefit payment liabilities as a result of their employer sponsors contributing capital on an emerging basis.

Following the advent of compulsory superannuation, many defined benefit funds have

Figure 2 Concentration of superannuation funds 1993-94



been closed with new members required to join accumulation funds. Reinforcing this shift away from defined benefit funds by employer sponsors is the fact that it is generally more expensive to administer a defined benefit fund than an accumulation fund.

Management of superannuation funds

Superannuation funds are managed by trustees who are directly and legally responsible for all fund decisions and activities. The trustee structure of superannuation funds may differ depending upon particular characteristics of each fund.

Corporate, industry and public sector funds (that is, standard employer funds) are generally required to provide for member representation when structuring their fund's trustee arrangements. Under this principle the number of employer representative trustees equal the number of trustees directly elected by the employees. Standard employer superannuation funds have on average six trustees. By consulting with their trustees, members have direct influence into how their fund operates.

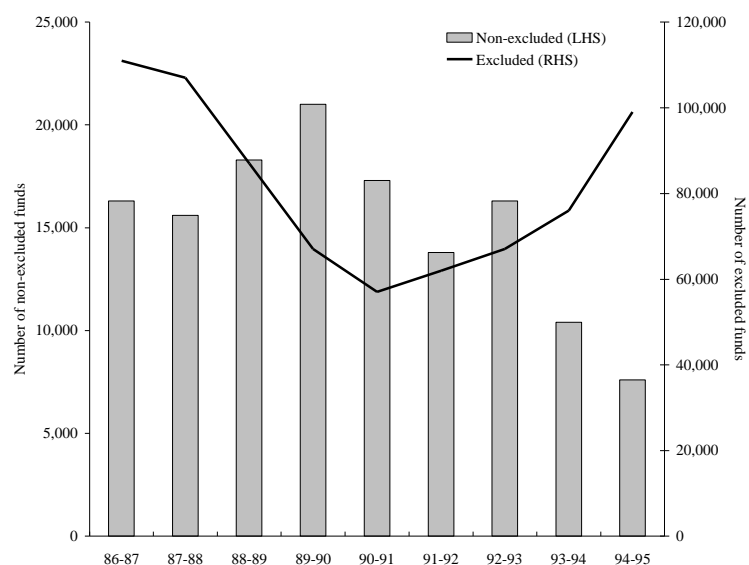
Retail (ie, public offer) funds are managed by an Approved Trustee company, that is, a company that has been formally approved by the ISC to offer superannuation products directly to the public. In addition to monitoring all superannuation funds in their own right, the ISC directly monitors Approved Trustees to ensure that they act in the best interests of all their funds' members. There are now approximately 168 investment management and

fund administration companies - including life office, banking and merchant banking groups - operating in the market as Approved Trustees. Approved Trustees may also act as trustees for corporate or excluded funds, however their market penetration of these industry segments is not substantial.

Administration

Superannuation fund administration is the process of receiving and allocating contributions, crediting investment returns, making benefit payments and

Figure 3 The changing number of funds



generally ensuring that the fund is managed effectively and efficiently in accordance with SIS requirements. Major elements of these requirements concern how the fund reports to members, reports to government and avoids excessively risky investments.

Following on from this, an important way to distinguish funds is to examine the manner in which each fund is administered. For example, a major decision for the trustees is whether their fund should be administered internally or externally.

Internal administration occurs when the fund employs its own staff to manage and organise the fund and ensure that it complies with regulatory requirements, the trust deed and trustees' directions.

External administration occurs when the fund trustees outsource this function to an external organisation, such as an accounting or superannuation consultancy company.

Analysis conducted by the ISC reveals that, as a general rule, the more members in a fund the more likely it is that the fund trustees will employ an external administrator. However, once a fund becomes very large, the trustees are equally likely

to employ an external administrator as they are to conduct their administration inhouse. This trend appears to reflect economies of scale considerations in so far as very large funds are sophisticated financial entities in their own right and are often quite capable of effectively managing their own administration very cost effectively.

Further analysis of fund administration arrangements conducted by the ISC indicates that only 17 percent of all funds use external administrators. However 62 percent of large funds use external administrators while 70 percent of funds with between 51 and 10 000 members use external administrators.

External fund administrators are clearly a very significant component of the superannuation industry. Indeed a more striking illustration is that of the 1 150 superannuation funds selected to participate in the new ISC quarterly survey of superannuation, around 60 percent are administered by around a dozen different administration organisations. In other words, professional superannuation administration is a relatively concentrated market - especially among large funds.

While the ISC has no formal jurisdiction over these external administrators as under SIS fund trustees maintain full responsibility for all aspects of their fund's operations, the ISC nonetheless recognises the importance of liaising with these organisations.

For example, a major ISC initiative conducted through our Melbourne office has been the establishment of a proactive ISC-administrators joint liaison group.

Through this group, ISC financial supervisors are able to effectively consult with representatives of thousands of individual superannuation funds. This enables them to streamline, target and resolve many issues that may be of concern to ISC fund review specialists as well as discuss any issues that may be concerning the administrators.

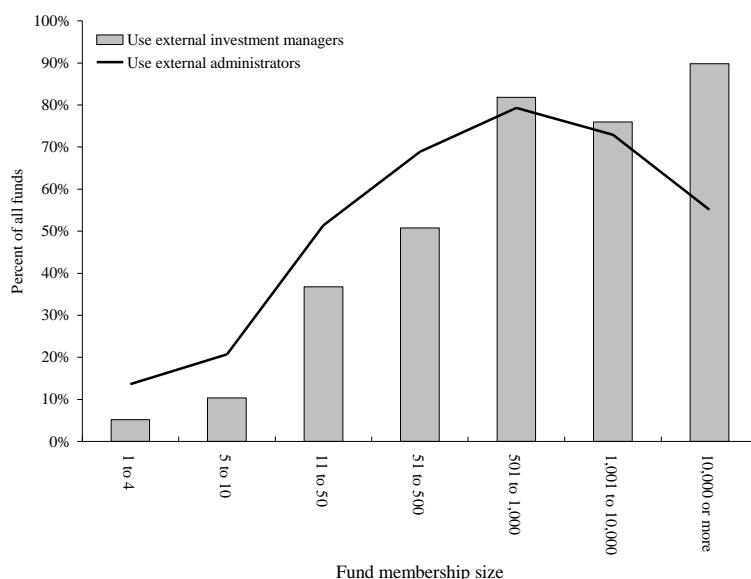
Asset management

In addition to the issue of whether a fund is administered internally or externally, fund trustees must also decide whether the fund's investments should be managed internally or externally.

With the increasing sophistication of the capital markets, it is perhaps easy to understand why funds

would be inclined to employ external investment managers. In fact, ISC analysis reveals that the larger a fund the more likely it is to use external investment managers. For example, 90 percent of funds with more than 10 000 members use external investment managers while only three percent of excluded funds do so. This figure does not include excluded funds' holdings of pooled investment instruments such as unit trusts or life insurance policies which amount to a further 12 percent of their combined assets.

Figure 4 Funds using administrators and investment managers



The importance of investment managers is demonstrated by the fact that there are around 100 major individual investment management organisations who are responsible for managing in aggregate slightly more than 70 percent of all superannuation savings. A major implication of this is that if an enterprise or project wishes to present a significant investment proposal to the superannuation industry it will, depending upon the investment management arrangements of particular funds, be more effective if it markets the proposal to these 100 major investment managers. Of course, a major consideration would be the size of the proposed investment.

Another feature of the investment management market is its strong concentration. The 1995 annual report for the Australian Investment Managers Association (AIMA) revealed that the four leading investment managers that were members of AIMA accounted for nearly 40 percent of assets managed by external investment managers. The 10 leading investment managers accounted for nearly 60 percent.

Investment managers tend to favour large scale projects because of the inherent financial flexibility

offered by such projects and because of the availability to use secondary markets to trade the resultant securities. Another reason is that such projects allow investment managers to optimise their information and administration costs. Small superannuation funds, on the other hand, would usually only invest in such projects through pooled or unitised arrangements which in anycase would most probably be organised by large scale investment managers.

The issue of using investment managers is made more complex however when you consider that a fund has the added flexibility of investing only some of its assets with an investment manager. ISC analysis has found that funds that predominantly use investment managers have on average 75 percent of their assets invested through their investment managers. The remaining 25 percent of assets are directly invested by the fund itself, usually in real property or long term bonds which the fund may intend holding until maturity.

A recent industry study conducted by the Association of Superannuation Funds of Australia (ASFA) in February 1995 revealed that funds that use investment managers usually use a panel of around six different investment managers. This confirms the trend away from funds using a single investment manager to manage a balanced portfolio. Instead, funds appear to favour using different specialist investment managers to manage specific components of their fund's investment portfolio. The specific level of exposure to each asset class is set either by the fund's trustees themselves or is set in consultation with asset consultants that have been employed by the trustees to provide this type of advice.

Should a fund choose to place money with an investment manager there are several options for how this may be accomplished.

One option is for the fund trustees to purchase a superannuation investment policy from a life insurance company. The policy will be held in the name of the superannuation fund with the premiums payable under the policy invested through the life company's statutory funds alongside the investments of other policyholders. The insurance

company would then use their investment management operations, usually a subsidiary of the life company, to place and manage the investments. The investments are held in the name of the statutory fund and the fund is credited an annual rate of interest based upon the investment performance. Should the superannuation fund wish to redeem the investment it may either surrender the policy or wait until it matures. Alternatively, the fund may sell the policy on the recently established secondary market for insurance policies.

Another option is for the fund to purchase units in a collective superannuation investment product such as a unit trust or a pooled superannuation trust (PST). The decision of whether a fund should purchase units in a unit trust or a PST would be determined in large part by the individual superannuation fund's taxation position and advice should be sought from qualified advisers. The major advantages to a fund in purchasing units in these types of instruments is that by purchasing units across a range of products the fund may very cost effectively create a diversified investment portfolio, irrespective of the actual size of its overall investments.

Unit trusts and PSTs may be selected that specialise in, for example, cash, Australian equities, overseas equities, fixed interest, or property investments. Should the superannuation fund at any time wish to redeem these investments, it may sell the units back to the investment manager at the current market price.

A small to medium sized superannuation fund may, because of the relatively small amount of money it has available for investment, be limited to retail investment products. A large superannuation fund however wishing to place a more sizeable

investment may be able to gain access to wholesale investment products. The advantage of using wholesale investment products is that they usually attract lower fees while providing a more competitive level of performance.

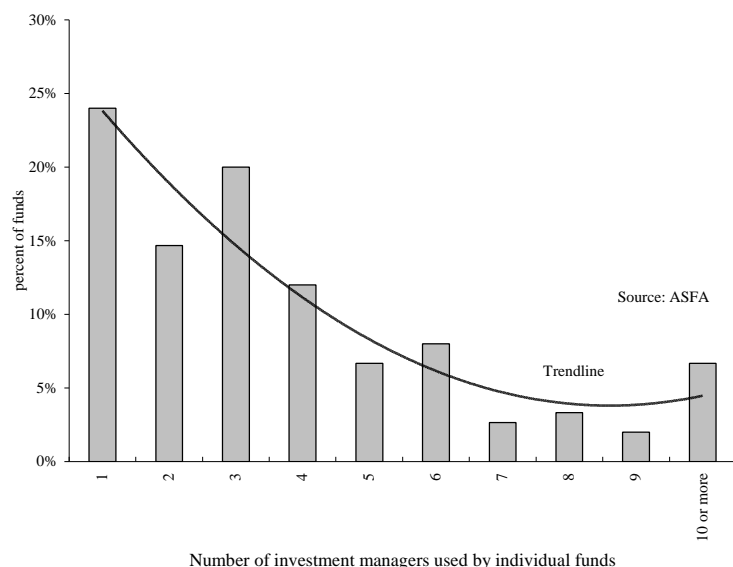
An industry survey published by AIMA in June 1995, revealed that 37 percent of superannuation assets managed by investment managers are in retail products with the remaining 63 percent being in wholesale products. Investment managers themselves recognise the advantages of wholesale investment, derived largely through economies of scale, and will sometimes bundle assets invested in retail products and reinvest them into wholesale products.

The practice of bundling retail superannuation investments into wholesale investments provides greater investment and performance options for superannuation funds. It is nonetheless important that fund trustees recognise the potential for fee layering. Strong competition within the investment industry however puts downward price pressure on such fee layering. For example, while retail investment management fees may average around two percent of assets under management per annum, it is not unusual for wholesale investment management fees to be less than one percent of assets under management per annum.

If a fund has a very large amount of money available for investment it may wish to contract an investment manager to manage its investments as an individually managed portfolio. Even though AIMA estimate around 36 percent of investments placed with investment managers are under such arrangements, this option would normally only be available to very large superannuation funds.

External investment managers clearly play an important and crucial role in how superannuation assets are managed. Nonetheless a significant portion of superannuation assets remain in the direct control of superannuation fund trustees. The fact that only 15 percent of assets from the 99 000 small self managed superannuation funds are placed in the pooled instruments that are offered by investment managers indicates that there may be other, though unquantifiable, factors influencing funds in how they choose their investment strategy.

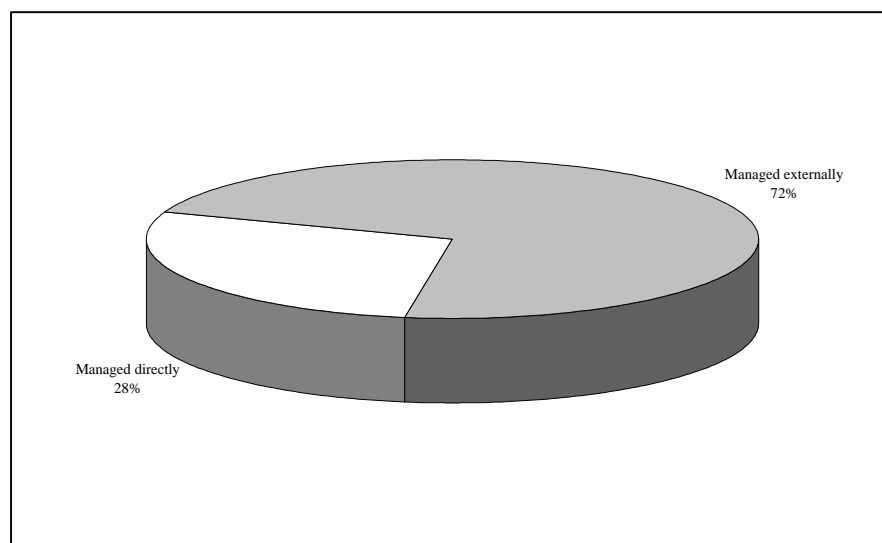
Figure 5 Funds that use investment managers



These factors may include concern with the level of performance achieved by investment managers, concern with the level of fees and charges, and a

The real cost of managing superannuation funds

Figure 6 How are superannuation assets invested



The cost structure of a particular fund often reflects the fund's administration arrangements. While many standard employer funds employ external administrators, not all of these funds explicitly charge the associated costs back to the members' accounts. It may therefore be difficult to properly compare cost ratios across different funds.

A significant number of corporate funds, for example, do not explicitly charge member accounts

desire for greater autonomy in investment decisions.

The issue of how fees are charged by external investment managers is also important for trustees to understand. The usual practice within the industry is for investment managers to return net investment income to their client. This means that the investment manager deducts their investment management fees and trading costs from the fund's gross investment income in the form of a percentage charge upon the value of assets under management. Moreover, investment managers will often also pay investment taxation on behalf of their client superannuation fund (especially in the case of PST investments).

The implication is that even though a superannuation fund may, for example, receive a nine percent net return from their investment manager, the real cash flows relating to the fund's investments may reveal that the gross investment return was 13.5 percent while two percent was deducted for management fees, half of one percent was deducted to pay trading costs and brokerage fees, with a further two percent deducted to pay the investment taxation expense.

Importantly, the classes of assets held by the investment manager and the degree of trading conducted by the manager would also have an impact upon these expenses. For example, imputation credits derived from Australian equity investments would be offset against investment taxation expenses payable on bond or property investment returns. This would result in the fund paying in reality an effective investment taxation rate considerably less than the notional rate of 15 percent.

for the cost of administration as this cost, or part of it, may be absorbed by the employer sponsor. The notional investment performance credited to each member's account would then most likely exceed the investment performance credited to member accounts in funds that do explicitly charge for administration costs. For defined benefit funds, of course, the administration expense is of minimal concern to the members as their retirement benefit is determined with regard to their pre-retirement salary and is not necessarily related to the actual account balance of the fund.

Similarly, the crediting of net investment income by investment managers means that some fund trustees may be unaware of the real costs of using external investment managers. Furthermore, funds that manage their investments internally would have higher explicit costs than funds that use external investment managers.

As a consequence, any comparison of cost structures within the superannuation industry must have regard to these issues if the results are to be meaningful. The new ISC quarterly survey of superannuation has been explicitly designed to take these factors into account.

Other advisers used by funds

The complexity of the issues involved in managing superannuation funds have given rise to a plethora of service providers who provide advice and other services to the industry. The most obvious service providers are the external administrators and investment managers that we have already discussed.

There are however many other services available to superannuation funds. They include asset

consultants, actuarial consultants (necessary for defined benefit funds to establish whether the fund is in surplus or deficit), legal advisers, accounting and audit advisers, regulatory compliance advisers, insurance advisers, computer system advisers and communications advisers.

While the many types of advisers available to superannuation fund trustees may at first glance appear to be a potential drain on the benefits ultimately accruing to members, the services provided by these advisers can assist superannuation fund trustees operate their fund more efficiently and effectively in the best interests of all their members. It is up to the trustees of each fund to decide which of these advisers are necessary within the constraints of their fund's cost structure and management arrangements.

Regulation of Derivatives by the ISC

The ISC recognises that derivatives may have a useful role to play in a financial entity's investment strategy as they introduce the possibility of greater risk-adjusted investment returns. However, we continue to strongly emphasise that derivatives should be used only for appropriate and prudential purposes, and not for leverage and speculation.

Three separate ISC Circulars on the prudent use of derivatives by general insurance companies, life offices and superannuation entities were issued on 23 November 1995.

The principal objective of the guidelines contained in the Circulars is to ensure that superannuation funds and insurance companies have in place proper risk management policies and procedures if they propose to use derivatives.

This will have to be documented in a Risk Management Statement (RMS) covering such issues as the fund or company's derivatives policy (including overall investment objectives), and limits on exposures across physical and derivatives positions. There will also have to be a system of checks on compliance.

Primary responsibility for risk management lies with superannuation fund trustees and insurance company managements. A critical factor in the prudent use of derivatives is, therefore, the accountability of trustees and managers for the maintenance of adequate internal controls. ISC officers will look closely at whether internal controls are in place and operational on their inspection visits to insurance companies and superannuation entities.

Life insurance companies will need to have a formal RMS in place by 31 December 1995.

General insurance companies will need to have a formal RMS in place at their first balance date on or after 30 June 1995. However, general insurers currently using derivatives will be required to have satisfactory risk management practices in place, as per an initial RMS, which is to be lodged with the ISC for information purposes by 31 March 1995.

Superannuation entities will not need to have a formal RMS in place until 1 July 1996. This is mainly due to complex practical implementation issues that the application of the RMS-based approach to the superannuation sector raises, particularly in relation to funds that do not invest directly but use the services of one or more external funds managers.

A Task Force has been established, comprising industry experts and chaired by the Commission, to report on these operational issues by the end of December 1995. Additional guidelines will then be released early next year.

Information on direct investment in derivatives by funds will be available in early 1996 through the collation of data obtained from the 1994-95 superannuation annual returns to the ISC. The new ISC/ABS Quarterly Survey of Superannuation will also collect information on *direct* derivatives usage by funds. The extent to which superannuation funds are *indirectly* exposed to derivatives will be highlighted from mid 1996 through ABS quarterly asset surveys of life insurance statutory funds and investment managers.

Copies of the ISC Circulars on the prudent use of derivatives can be obtained by telephoning Ms Jennifer Cheffers on (06) 201 8561 or Ms Andrea Baum on (06) 201 8591 or by writing to the ISC at GPO Box 9836 Canberra ACT 2601

Copies of ISC Circulars on superannuation matters are routinely distributed through the ISC's arrangements with publishing house CCH in the "ISC Superannuation Digest"

Highlights

Main features

- At the end of the September quarter 1995 the value of total assets of superannuation funds (including ADF's) was \$230.7 billion.
- During the September quarter the value of total assets rose by \$6.6 billion (3%).
- The overwhelming majority of superannuation assets, 85 percent, are invested in Australia.
- Superannuation assets are concentrated in retail and public sector superannuation funds that account for 43 percent and 26 percent of total superannuation assets respectively. The remaining assets are shared among corporate funds (18%), excluded funds (8%) and industry funds (5%).
- At the end of September 1995 some six million Australians held 15 million superannuation accounts. Therefore, the average number of accounts per individual member is 2.5.
- On average, superannuation equity per individual member is approximately \$38,000.

Important note to users of the statistical tables

The tables contain information compiled from the new ISC Quarterly Survey of Superannuation (see *Welcome to the ISC Bulletin* on page 1 of this Bulletin for a full explanation of this new survey), ISC Annual Returns and the ABS surveys of investment managers and life insurance offices. Also included, for the periods prior to June 1995 are statistics for directly investing funds derived from the now defunct ABS survey of

superannuation funds - which has been replaced by the new ISC survey.

Data from the new ISC survey is not directly comparable with that from the earlier ABS survey.

The ABS survey was limited to the very largest directly investing funds. In contrast, the new ISC survey captures data from the largest 1 150 funds in Australia and has increased coverage of funds that directly invest only some of their assets. Therefore, this approach significantly expands coverage of directly investing funds. Also included in Tables 3 and 4 are estimates for the directly investing components of small non-excluded and excluded funds. These estimates, while included in previously published ISC annual return statistics, have never before been included in official quarterly estimates of superannuation.

This improved coverage and changes in scope have resulted in a significantly more comprehensive measure of superannuation. For example, the ISC figure for total assets in June 1995 was \$224 billion, \$26.2 billion (13.2%) greater than the ABS published figure for June 1995 of \$197.8 billion. This \$26.2 billion difference can be decomposed into \$8 billion identified by the improved survey coverage and \$18 billion from the inclusion of new estimates for the directly invested components small non-excluded funds and excluded funds.

Industry structure

The superannuation industry can be regarded as consisting of five major (and largely self explanatory) functional segments: corporate, industry, public sector, retail and excluded superannuation funds.

Retail superannuation funds represent 43 percent of all superannuation assets and 39

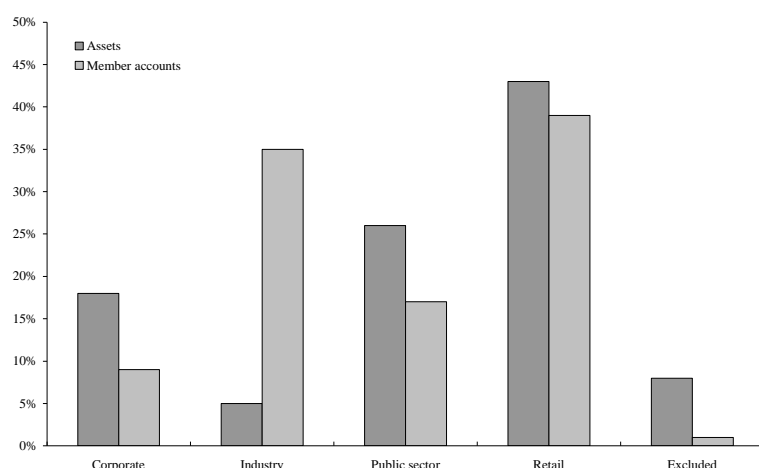
percent of all superannuation accounts. In contrast, Industry funds have only five percent of all assets but represent 35 percent of all accounts.

Manner of investment

Australia's \$230.7 billion in superannuation savings are controlled by 107 000 separate superannuation funds.

Funds invest their assets into the market by either purchasing life insurance policies (38 percent of

Figure 1 Industry structure



all assets), by placing money with external investment managers in pooled trusts or as individually managed portfolios (34 percent of all assets), or by direct investment (28 percent of all assets). In practice however, most funds use a combination of these strategies when choosing their investment strategy.

For example, while corporate and industry funds generally use very similar investment strategies, public sector, retail, and excluded funds tend to have very different approaches. In fact, the level of direct investment is very high for public sector and excluded funds while retail funds (as would be expected) hold most of their assets as life insurance policies.

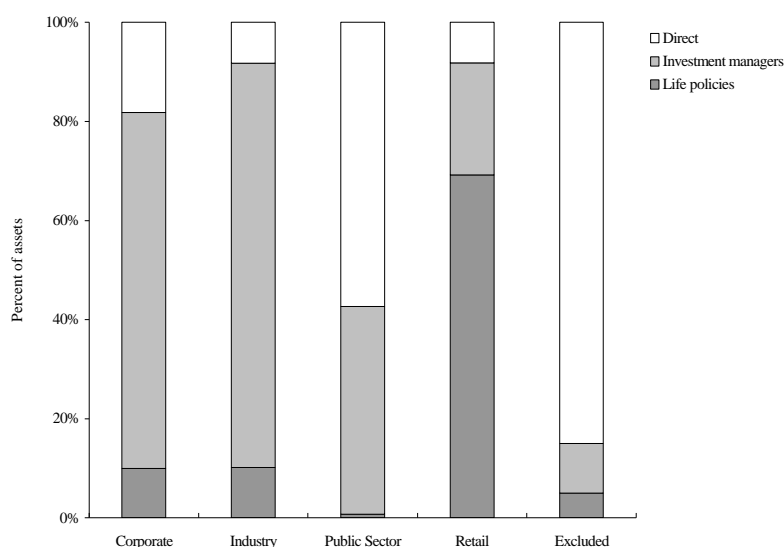
Where are super assets invested

The overwhelming majority of superannuation assets, 85 percent, are invested within Australia.

Investments in equities (28 percent) and bonds (28 percent) account for 56 percent of all superannuation assets. The mix between short and long term bonds is eight percent and 20 percent respectively. Further analysis of the bond holdings of superannuation funds reveals that 17 percent of superannuation assets are in government issues.

Unit trusts and other unitised investments account for a further eight percent of superannuation assets. While only three percent of the assets of large

Figure 2: Manner of investment by type of fund



superannuation funds (ie, those in the survey) are held as bank deposits, further analysis has revealed that excluded funds may hold up to 47 percent of their assets in bank deposits.

Multiple accounts

While around 6 million Australians are covered by superannuation, there are 15 million separate superannuation accounts in Australian superannuation funds. This suggests that each member has on average around 2.5 accounts. In contrast, in 1992-93 each member had on average 1.9 superannuation accounts.

This increase is most likely due to the impact of the Superannuation Guarantee arrangements, growth in the number of part time workers, and workforce mobility (especially for private sector workers). There is however, no difference between the average number of accounts for female members as compared to male members.

Public sector workers have a lower number of accounts per member than private sector workers.

Figure 3 Superannuation investments

