Australian Institute of Superannuation Trustees

2 September 2016

Australian Competition & Consumer Commission
GPO Box 3131
CANBERRA ACT 2601

Email: mergers@accc.gov.au

Attn: Fiona Sam/Karina Geddes

Dear Ms Sam and Ms Geddes,

Response to request for submissions: Link's possible acquisition of Pillar

In brief: While taking a neutral position on commercial matters, AIST notes that superannuation funds have increasingly limited alternatives for the provision of superannuation administration, with there being constraints to insourcing. There is already a high level of market concentration from any perspective, and any increase could also increase systemic risks. New market entrants are possible, but not known.

Thank you for the opportunity to make this submission in response to your letter of 17 August 2016. Our submission addresses some (but not all) of the questions in Attachment B of that letter.

AIST has a neutral position in relation to possible acquisition of Pillar by Link (and indeed by one other possible purchasers) but seeks to draw the ACCC's attention to market concentration issues. Owing to the increase in market concentration of superannuation administration providers, a consequence could be an increase in systemic risk.

Fundamentally, AIST seeks to ensure that the superannuation industry continues to act in the best interests of members, operating efficiently and safeguarding the integrity of the system.

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Responses to issues raised

1. ***Please provide a brief description of your business or organisation and the reasons for your interest in the possible acquisition***

- *Description of AIST*

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $650 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

- *Reasons for AIST's interest*

In the Australian superannuation system, many functions are outsourced by many super funds. These functions may include administration, custody and insurance. For the purpose of regulation by the Australian Prudential Regulation Authority, the outsourcing of administration is regarded as a material business activity, and is regulated by Superannuation Prudential Standard SPS 231. This Prudential Standard requires that all outsourcing arrangements involving material business activities entered into by a super fund be subject to appropriate due diligence, approval and ongoing monitoring.

All risks arising from outsourcing material business activities must be appropriately managed to ensure that the super fund is able to meet its obligations to its beneficiaries. The ultimate responsibility for the outsourcing policy of an RSE licensee rests with its Board of directors. These risks exist both at fund and system level and were identified in the Super System Review in 2010:

A few very large administrators have emerged over the past 20 years. Their role in the superannuation system is critical to its success. The corporate failure of any one of them could create a very difficult position for the industry, while the operational collapse of any of them could create a real crisis[1].

[1] Super System Review: Final Report – Part Two: Recommendation packages pp 169-170

The number of administrators has reduced since 2010, and the remaining administrators are larger and have greater market share.

2. ***Please outline any commercial relationship/s you have with either Link or Pillar, including where relevant:***
    a. ***the specific types of services you acquire from Link or Pillar***
    b. ***the terms on which you acquire those services (such as the value and duration of any contracts).***

AIST has no commercial relationships with either Pillar, or the Link Group, although both organisations have attended events organised by AIST and, in some instances, have provided support for these events.

Superannuation fund members of AIST have various arrangements for the administration of their funds, and include both insourced and outsourced arrangements. Members that outsource their administration use various providers, including both Pillar and Link.

Superannuation administration services

3. ***Do you think it is necessary for a superannuation administration services provider to offer a full range of administration services to compete effectively? Are these services generally acquired as a bundle, and to what extent is it possible or desirable to acquire them separately? Please provide reasons.***

Historically, super funds have contracted a wide range of bundled services from their administrator. These services may include contact centres, data analytics, telephone advice services, insurance administration, finance and accounting, data feeds for members and employer online portals, statistical and regulator reporting, and, in some instances, trustee office support. Small to medium sized funds are still more likely to have bundled administration arrangements, while larger funds are more likely to have or be contemplating unbundled services.

Larger funds have started unbundling to some degree e.g. insourcing contact centres, data analytics, website front ends, but they are still reliant on administrator for core administration service and registry system software

These capabilities can be acquired separately but close integration of technologies is desirable for better member service and efficiency.

Closeness of competition

5. *Do you consider that Link and Pillar compete closely for the supply of superannuation administration services? If so, please outline the extent to which you consider they compete.*

Relevant factors may include their service offering, their pricing, the extent to which they target similar customers, and/or participating in tender processes.

Link and Pillar compete for the supply of administration services, and both have participated in tender processes in recent years. They offer broadly similar offerings, although Pillar is regarded as having greater Defined Benefit Fund capability, and Link has greater scale capability.

Pillar has recently re-platformed to Financial Synergy's Acurity platform and transformed their operating model, while Link has the well-established AASpire platform, and has transitioned four of the five major SuperPartners client funds onto it.

Potential competitive constraints

6. *Who are the alternative suppliers of superannuation administration services, and how closely do they compete with Link and/or Pillar? Relevant factors may include their service offering, scale, pricing and service quality/standards. Please provide specific examples where possible.*

Mercer is the largest alternative supplier of superannuation administration services, although there are other small superannuation administration providers. These include IFAA Administrators and Advisers, Trustee Partners and The Trust Company.

Notwithstanding this, the view of some AIST members, especially some larger super funds is that they already have very few alternate administration providers to their existing provider. This lack of intermediary competition makes it difficult to test the market, and fulfil all of the requirements of APRA Superannuation Prudential Standard SPS 231.

Paragraph 26(b) of SPS 231 requires that:

An APRA-regulated institution must be able to demonstrate to APRA that, in assessing the options for outsourcing a material business activity to a 'third party', it has:

…

(b) undertaken a tender or other selection process for selecting the service provider;…

It is difficult to meet this requirement in the absence of a competitive market.

7. *Does the ability of superannuation funds to perform their administration services in-house constrain Link and/or Pillar? Why/why not? Please provide specific examples where possible.*

Notwithstanding longstanding debate within the superannuation industry, few super funds with outsourced administration have moved to insourced administration, and AIST is not aware of any funds where this is currently under active consideration. Some funds however, such as HostPlus and First State Super, have unbundled contact centres from their other outsourced administration arrangements and insourced these.

The cost, time, opportunity-cost, and risk of transitioning systems - together with the time and cost to build internal expertise in administration - are barriers to insourcing.

8. *If Link attempted to increase prices by around 10% after acquiring Pillar, do you think it is likely that:*
    a. *customers would (and could) switch to an alternative service provider or commence in-sourcing administration services? In addressing this point, please consider what would be involved in customers switching, as well as any history of such switching*
    b. *competing suppliers of superannuation administration would have the ability to expand supply to a level that would enable them to constrain Link? In addressing this point, please consider scale and any obstacles to expansion such as access to/investment in the relevant IT platforms.*

AIST is not speculating on this question.

9. *To what extent can superannuation administration services be provided by an overseas service provider? Please comment on any regulatory and logistical barriers.*

It is possible that an overseas provider could provide superannuation administration services, and there have been limited examples in the past of overseas providers entering the market. However, complex tax, contributions, insurance and other regulatory requirements make the investment for an overseas provider high. Australian privacy requirements would add to these complexities. In addition, overseas providers would face the same scale and capability challenge as existing smaller Australian providers of superannuation administration services. Overseas providers have tried to serve this market previously and have exited after failing to build sufficient scale in the business.

Barriers to entry and expansion

10. Who do you consider to be potential entrants to the supply of superannuation administration services?

Technology providers could be potential entrants. As superannuation administration becomes more digital and digitised, core technology and surrounding systems will become a more critical factor in the supply of superannuation administration services.

11. Please comment on the ability of the following to commence supplying superannuation administration services (if possible, identify examples):

a. a superannuation fund which currently performs administration services exclusively for its own in-house needs commencing supply to third parties

This is unlikely to gain traction in the market. Most funds would look sceptically on a fund offering administration services on top of its own fund. The natural questions would be focused on priority of services and change requests vs. the owner funds needs and how any competitive issues might be resolved if the owner fund and client fund were competitive with each other.

Another fundamental issue is the sole purpose test, which would discourage funds from entering this adjacent business.

b. a non-superannuation administration services provider, for example a registry services provider, an IT company or providers of similar IT platforms. In addressing this point, please consider any similarities in relation to the IT platforms required and the need to satisfy any regulatory requirements.

As above, this is a scenario that could potentially occur in the future. However, there are significant hurdles that technology firms would face in entering the superannuation administration services market.

Technology firms, registry providers and outsourcing providers have all considered entering the market to provide superannuation administration services, but a credible provider has yet to emerge.

12. If Link attempted to increase prices by around 10% after acquiring Pillar, would this be likely to attract new entry? In addressing this point please consider:

a. economies of scale and the minimum efficient scale of market entry, for example how many customers or member accounts would a new provider need to 'win' in order to achieve sufficient scale

b. costs of market entry, and the extent to which these costs would not be recoverable on market exit

c. timeframe for market entry

d. any regulatory barriers, such as superannuation regulations and requirements

e. customer willingness to switch providers, including switching costs and risks

f. the importance to a new entrant of having, or having access to, the relevant IT platform/s

g. market growth/decline and any examples of recent market entry or exit.

The fundamental issue is scale and credibility. While there are many players in the market, the risk averse nature of superannuation funds reduces the possibility of new entrants or existing sub-scale players being able to compete effectively with Link, after any acquisition of Pillar. This is evidenced by the fact that there aren't any new entrants in recent years.

13. If customers were dissatisfied with Link, to what extent could they bypass Link by:

a. switching to in-sourcing their supply of superannuation administration services, or

While in-sourcing administration services is a potential viable option for some funds, the barriers to insourcing are very high and include the costs of insourcing and core data transition, as well as the risk of failure or complications in transition.

Multiple examples exist of administration transitions that have failed or encountered significant issues, making in-sourcing an unlikely option for most funds, unless there were other reasons that made insourcing attractive.

b. sponsoring new entry for example by a company with IT platform/s similar to those required to provide superannuation administration services?

While unlikely due to the need to establish credibility in superannuation administration services, it is possible that a technology provider could establish a foothold in the administration services market. This would entail investment in servicing / processing divisions that work on top of core platform software and related applications provided by technology firms.

Other information or competition issues

14. Please provide any additional information or comments, or identify other competition issues, that you consider relevant to the ACCC's consideration of the possible acquisition under section 50 of the Act.

Additional factors to consider:

If Link acquires Pillar, the strategic risk flowing from increased market concentration would become an additional consideration for the superannuation industry. In any scenario where Link goes offline, a significant portion of Australian superannuation would also "go dark". This risk of concentration is real where Link becomes systemically important if it is managing enough of Australia's pension / retirement system, measured by assets or members.

If Link acquires Pillar, it is likely to migrate Pillar's clients onto AASpire, Link's core platform. This also introduces risk as the technology supporting Australia's superannuation system would become more concentrated as well. Core platform technology is one of the key enablers of administration and effective functioning of the system, so additional concentration and less competition in technology could also introduce additional risk to the effective functioning of the superannuation system.

History has also shown that investment in core technology for superannuation administration is costly and risky. This market history has made investors hesitant to fund new platform development or fund new entrants to the sector, because of the perceived risk and complexity.

We note that, as this table from Donald et al (2014) demonstrates, there is far smaller concentration for superannuation fund services from members themselves, rather than in markets supplying the superannuation industry[2]:

[2] Donald, S., Arnold, B., Bateman, H., Buckley, R. and Liu, K. (2014). *The implications of complexity for systemic risk in the superannuation system*. CLMR research paper series working paper no. 13-3. [online] Sydney: Centre for Law, Markets and Regulation, p.13. Available at: http://tinyurl.com/gq67pqy [Accessed 31 Aug. 2016].at page 13.

Table one

	No of providers	Market share		HHI		Sample coverage
		Top 5	Top 10	Members	AuM	
Actuarial services	20	71%	89%	2271	1268	52%
Member benefit administration	46	45%	73%	612	630	95%
Asset consulting	10	96%	100%	2296	2358	57%
Auditing	16	92%	99%	1728	2469	95%
Custodial services	16	84%	98%	2094	1982	96%
Insurance	12	74%	99%	1249	1379	85%

Donald et al (2014) wrote that[3]:

Table 1 [showing overall industry concentration] *demonstrates quite clearly that there is considerably more concentration in the custody, member benefit and insurance industries that serve the trustees of funds, than in the list of superannuation funds themselves. Using the DoJ terminology, this level of concentration is associated with "moderately concentrated markets" and a change in the HHI* (Herfindahl-Hirschman Index) *of 100 as the result of a merger or exit would prompt concern (DOJ and FTC, 2010: 19).*

They (Donald et al, 2014) then go on to note a similar pattern when comparing member benefit administrators[4]. Donald et al (2014) consider that one reason for this potential lack of diversity is important[5]:

> *This potential lack of diversity is important... it suggests the possibility that the system may not be as resilient as it appears: there are potentially vulnerabilities in the system that are not apparent from observation of the (still comparatively large) number of regulated entities acting as trustees of the funds.*

They also note that this represents a challenge to APRA's regulation of this sector[6]:

> *Many of the critical nodes in the system lie outside APRA's regulatory jurisdiction. Although APRA has jurisdiction with respect to superannuation funds and their trustees, as well as to the banks and insurance companies with which they interact, key service providers such as custodians, member benefit administrators and investment managers lie formally outside APRA's jurisdiction (Cooper, 2010: 76 and 170 respectively). As we have seen, failures of*

[3] Donald et al (2014) at page 15.
[4] Donald et al (2014) at page 16.
[5] Donald et al (2014) at page 17.
[6] Donald et al (2014) at page 18.

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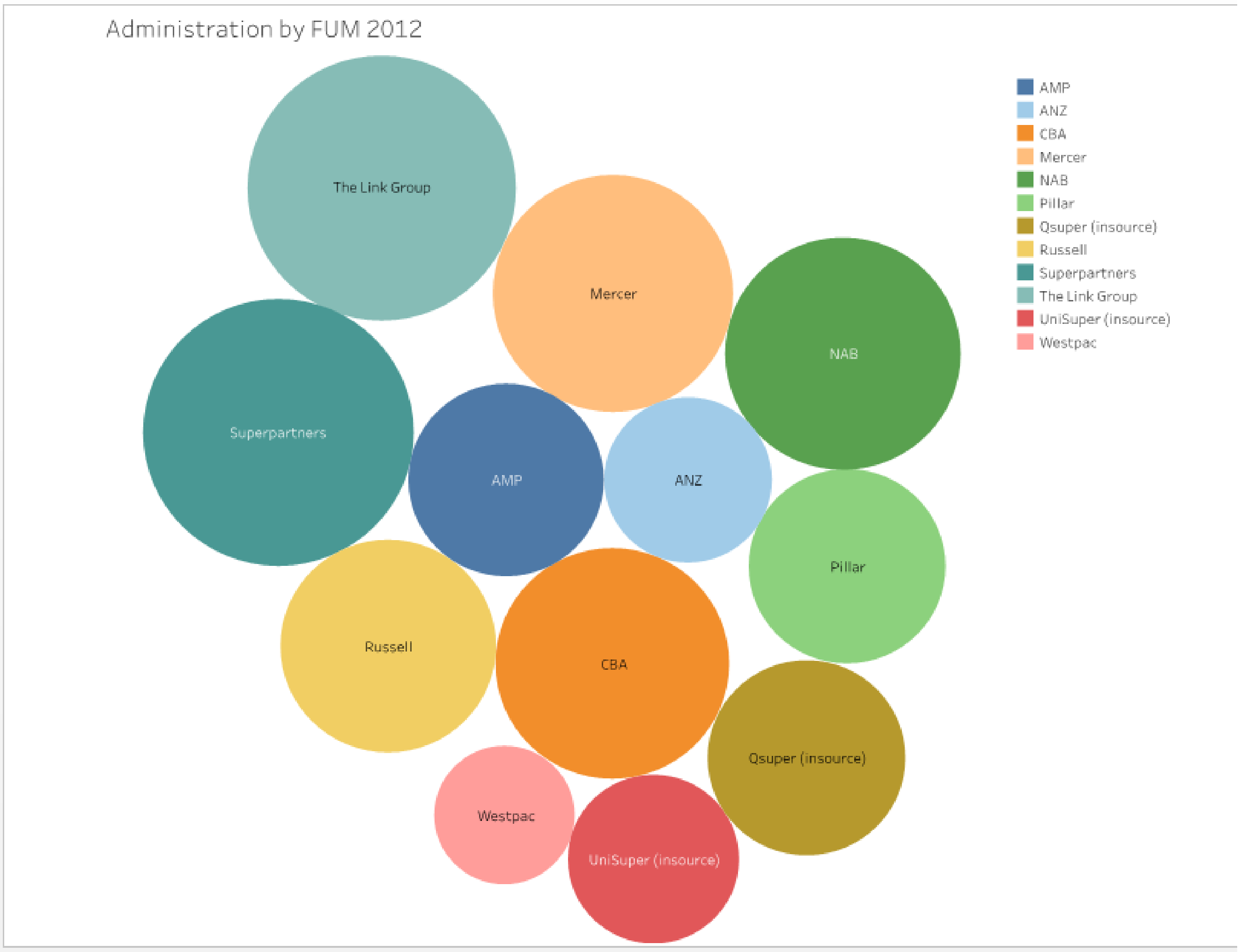
these service providers, or disturbances caused by them, can in certain circumstances represent a material systemic risk.

The following three charts demonstrate the increasing concentration of member benefit administrators:

Chart one – Concentration of member benefit administrators prior to Link's acquisition of SuperPartners

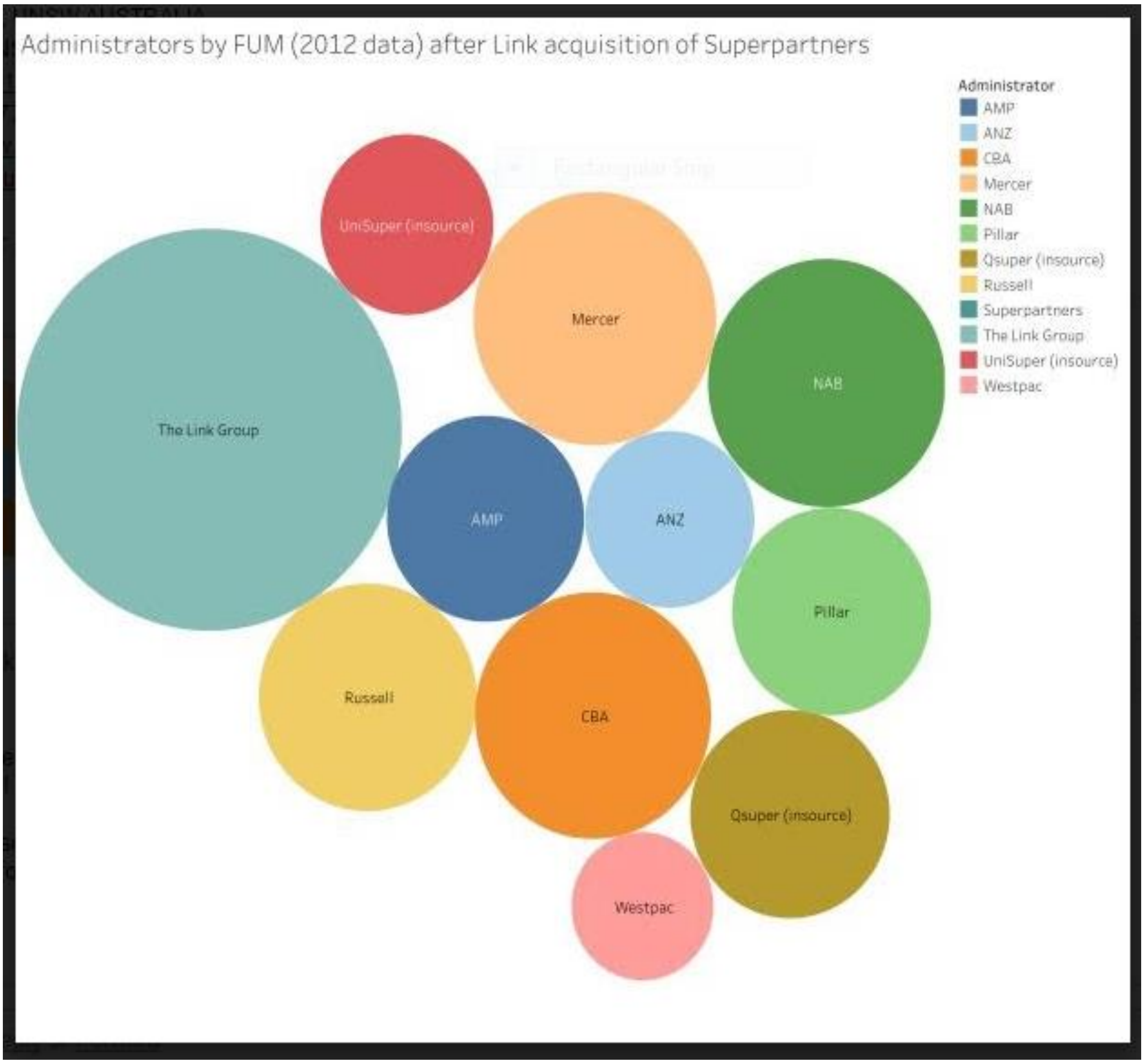


Source: Dr Rob Nicholls[7]

[7] Dr Rob Nicholls, UNSW Business School and a visiting fellow in the Centre for Law, Markets and Regulation (using 2012 data and as provided to AIST September 2016).

Chart two examines the concentration of member benefit administration following Link's acquisition of SuperPartners:

Chart two Concentration of member benefit administrators after Link's acquisition of SuperPartners

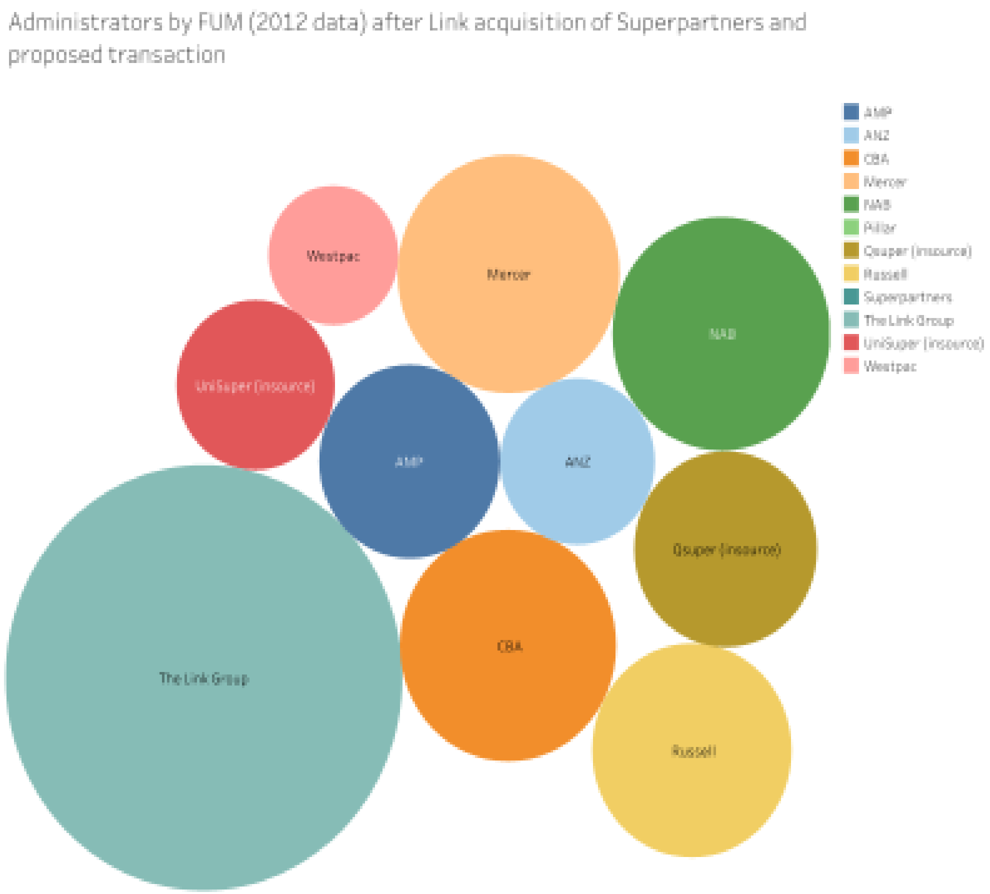


Source: Source: Dr Rob Nicholls[8]

[8] Dr Rob Nicholls, UNSW Business School and a visiting fellow in the Centre for Law, Markets and Regulation (using 2012 data and as provided to AIST September 2016).

Chart three examines the concentration of member benefit administration following Link's acquisition of SuperPartners:

Chart three Concentration of member benefit administrators after Link's acquisition of SuperPartners and including the proposed transaction



Source: Dr Rob Nicholls[9]

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[9] Dr Rob Nicholls, UNSW Business School and a visiting fellow in the Centre for Law, Markets and Regulation (using 2012 data and as provided to AIST September 2016).

AIST would welcome the opportunity to discuss our submission with you. Please contact David Haynes, Executive Manager Policy & Research on 03 8677 3800 or at dhaynes@aist.asn.au .

Yours sincerely,

Tom Garcia
Chief Executive Officer