ISDA® Safe, Efficient Markets

Celebrating 40 Years

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Australian Superannuation Funds: Current and Future Uses of Derivatives

CONTENTS

EXECUTIVE SUMMARY

The funds under management (FUM) of Australian superannuation funds have grown substantially since legislation was introduced in 1992 requiring employer contributions. Over the past five years, total FUM has climbed from approximately A$2.3 trillion ($1.44 trillion) to A$4.1 trillion and is expected to continue growing for the next 10-20 years before stabilizing at approximately A$9 trillion.

Over the past five years, total FUM has climbed from approximately A$2.3 trillion to A$4.1 trillion

While FUM has rapidly increased, the number of individual funds has fallen from around 280 large and medium entities in 2015 to 135 at the end of 2023. The 10 largest funds now account for about 60% of total superannuation FUM and they continue to grow faster than smaller funds.

The Australian market has limited available investment opportunities, and these tend to be concentrated in the banking and mining sectors. As a result, many funds have looked to non-Australian markets for assets to complement and diversify their portfolios.

Superannuation funds have increasingly used derivatives to cost-effectively and efficiently manage their non-Australian-dollar currency and investment exposures. According to the Reserve Bank of Australia (RBA)[1], outstanding derivatives positions by Australian superannuation funds are estimated to stand at approximately A$900 billion, mainly in FX derivatives.

As a result, the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC) and the RBA are increasingly focusing on the superannuation sector and have turned their attention to systemic risks and operational capacity relating to derivatives.

Superannuation funds have increasingly used derivatives to cost-effectively and efficiently manage their non-Australian-dollar currency and investment exposures

The key regulatory requirements for registrable superannuation entities (RSEs) include APRA SPS 114 (Operational Risk Financial Requirement)[2], CPS 230 (Operational Risk Management)[3], CPS 226 (Margining and Risk Mitigation for Non-centrally Cleared Derivatives)[4], SPS 530 (Investment Governance)[5] and the ASIC Derivative Transaction Rules (Reporting)[6].

In addition to the regulatory requirements, funds need to have appropriate risk management systems, processes and staffing in place. Failure to do so could result in operational and reputational losses. While many of these risks are covered by the regulatory requirements, they will depend on the precise nature of the exposures and risk systems within each fund.

This report looks at how funds can navigate the regulatory requirements and effectively manage their use of derivatives. This includes:

[1] Reserve Bank of Australia (RBA), Financial Stability Risks from Non-bank Financial Intermediation in Australia, April 2024, https://www.rba.gov.au/publications/bulletin/2024/apr/financial-stability-risks-from-non-bank-financial-intermediation-in-australia.html

[2] Prudential Standard SPS 114 Operational Risk Financial Requirement, www.legislation.gov.au/F2024L01319/latest/text

[3] Prudential Standard CPS 230 Operational Risk Management, www.legislation.gov.au/F2023L01242/latest/text

[4] Prudential Standard CPS 226 Margining and Risk Mitigation for Non-centrally Cleared Derivatives, www.legislation.gov.au/F2022L01578/latest/text

[5] Prudential Standard SPS 530 Investment Governance, www.legislation.gov.au/F2022L01492/latest/text

[6] ASIC Derivative Transaction Rules (Reporting) 2024, www.legislation.gov.au/F2022L01706/latest/text

- Reviewing and documenting the operational, liquidity and regulatory issues associated with increased use of derivatives to manage non-Australian-dollar exposures.
- Investigating the systems, processes and standards to manage derivatives exposures.
- Examining the range of derivatives that can be used to hedge offshore investments.
- Planning for increased use of derivatives and the impact this will have, including on access to markets.
- Maintaining and increasing proactive interactions with regulators and other parties, such as central banks and industry associations.
- Adopting established technology solutions to increase efficiency and reduce operational and liquidity risks.

THE ROLE OF AUSTRALIAN SUPERANNUATION FUNDS IN GLOBAL MARKETS

FUM has grown substantially since the Superannuation Guarantee (Administration) Act was introduced in 1992. The rate of contributions has increased steadily from 3%-4% in 1992 and will reach 12% by July 2025. Alongside the higher contributions, FUM has also been bolstered by the reinvestment of returns (see Annex 1).

The Australian market has limited available investment opportunities for the largest funds, and these tend to be concentrated in the banking and mining sectors. The total market capitalization of all companies listed on the Australian Stock Exchange is around A$3 trillion and so superannuation funds – with a current FUM of approximately A$4.1 trillion – have outgrown the available assets in Australia. As a result, many of these funds have looked to non-Australian markets for assets to complement and diversify their portfolios.

The total market capitalization of all companies listed on the Australian Stock Exchange is around A$3 trillion and so superannuation funds – with a current FUM of approximately A$4.1 trillion – have outgrown the available assets in Australia

The larger funds currently hold approximately 50% of their FUM in currencies other than Australian dollar (AUD). While the returns and investments are in non-AUD currencies, member returns are in AUD. To manage the exchange risk, funds use derivatives, and this will likely continue at increasing levels to match the growth in FUM and offshore investments.

Recent surveys from National Australia Bank and JP Morgan (see Annex 2) confirm that:

- There is a clear trend towards the internationalization of investment portfolios.
- Large funds have greater offshore investments compared with medium and small funds due to the need to diversify their portfolios and their ability to access derivatives markets to transfer returns into AUD.
- A substantial proportion of large funds (71%) plan to increase their offshore investments in the future.
- Funds typically hedge fixed income, property and infrastructure investments fully against currency risk, and hedge approximately one third of their equity investments.

The Use of Derivatives to Manage Investment and Currency Risks

The returns on non-AUD investments will depend on asset performance and the AUD exchange rate. The FX risk of the returns and the investment principal can be managed with derivatives, including FX forwards, cross-currency swaps and FX options.

The larger funds primarily use FX forwards to manage non-AUD cashflows. While the market for FX forwards is very liquid and many bank counterparties actively offer pricing and liquidity in the product, the maturities are relatively short (0 to six months), which does not match the multi-year maturity of many investments.

Cross-currency swaps could be used as these can have longer maturities. However, this market is much smaller and is unlikely to have the capacity to accommodate the full needs of superannuation funds.

Interest rate and total return swaps are also employed by funds to manage investment return profiles and gain or reduce exposure to certain markets. For example, total return swaps are utilized to synthetically replicate a preferred investment return when direct investment may be difficult. Funds can also reduce their exposure to an investment return with an opposite total return swap.

As FUM grows and non-AUD investments become larger, the use of derivatives by the superannuation sector will likely grow as funds manage their exposures.

APRA AND ASIC REGULATORY PRIORITIES AND REQUIREMENTS

Operational Risks: APRA

APRA has published prudential standards that address the operational risks likely to be present in RSEs. These are designed to ensure funds manage their operational risks and have effective monitoring and escalation processes. The standards include:

- SPS 114 (Operational Risk Financial Requirement), which requires RSEs to maintain, manage and utilize their financial resources to protect beneficiaries from losses due to operational risks. For derivatives, operational losses can occur as a result of inadequate systems and booking errors.

- CPS 230 (Operational Risk Management), which obliges all APRA-regulated entities (including RSEs) to identify, measure and manage operational risks within their organizations and monitor those posed by third parties. RSEs are expected to monitor and escalate operational risks, with the board and senior management held accountable. This includes close monitoring of third parties that provide services to RSEs.

While these standards are generally applicable across RSE activities, they are very relevant for funds' use of derivatives. RSEs are expected to comply with these standards and provide effective reserves and oversight of operational risk management.

Margin Requirements for Non-cleared Derivatives: APRA

- CPS 226 (Margining and Risk Mitigation for Non-centrally Cleared Derivatives) requires an APRA covered entity (which includes most RSEs) to have appropriate margining practices for non-centrally cleared derivatives. This includes the ability to exchange variation margin (VM) and post and collect initial margin (IM) for most derivatives transacted with covered counterparties.

  Funds often use FX forward contracts to manage currency exposure to non-AUD investments. While these are exempt from regulatory IM requirements, many banks require their fund counterparties to provide IM on a discretionary basis (called independent amount) to reduce credit and capital charges.

  RSEs are expected to model the impact of stressed market conditions on liquidity required for margin. This includes the amount and duration of the funding, as well as any available sources of cash or securities within the funds to satisfy margin requirements within the time required (usually one day).

Liquidity Risks and Market Stability: APRA

- SPS 530 (Investment Governance) covers a wide range of requirements for RSEs to prudently select, manage and monitor investments on behalf of members. This includes a liquidity management plan that is relevant to derivatives positions.

  Under certain market conditions, derivatives will create a cash excess or shortfall that needs to be managed by the fund. This standard requires RSEs to ensure they have sufficient liquidity to manage their cash requirements under stressed conditions. This is particularly important for CPS 226.

Derivatives Reporting Rules: ASIC

- The ASIC Derivative Transaction Rules (Reporting) have been updated, and the new requirements came into effect in October 2024. A reporting entity (ie, most RSEs) are obliged to report new derivatives trades and update key details of existing transactions daily. Non-compliance and/or error can attract significant penalties.

The regulatory priorities and requirements for RSEs are very broad, and many include derivatives in their scope. The obligations can be effectively managed, but a compliance failure can attract regulatory oversight and possible penalties.

ISSUES TO CONSIDER WHEN USING DERIVATIVES

Derivatives can provide significant value by enabling funds to transfer risks and lock in exchange rates. However, funds must be aware of several key regulatory, operational and liquidity issues that need to be managed.

Regulatory-driven Obligations

- **Regulatory obligations:** Derivatives are subject to multiple regulatory obligations. These include margin requirements (CPS 226), reporting of positions (the ASIC reporting rules), effective oversight (CPS 230), operational risk (SPS 114) and liquidity risk (SPS 530).

- **Oversight of third parties:** Third parties might enter derivatives positions on behalf of funds (external fund managers) or provide services to support derivatives (custodians and technology/service providers). The effective oversight of these outsourced activities is a key focus for regulators[7]. Ineffective management of third-party relationships can result in operational losses, attract regulatory attention and lead to remediation costs.

- **Documentation and counterparty credit risk:** Comprehensive and standardized documentation is a feature of derivatives trading. The ISDA Master Agreement is the industry standard for documenting a trading relationship and is supported by a suite of other documents, including the credit support annex (CSA). The CSA sets out the terms for collateral exchange between parties, so is a critical component of managing credit risk.

Hedging and Risk Management

- **Matching exposure and derivatives maturity:** Investments are often long dated (eg, equity has no maturity date and infrastructure has long-dated horizons) but derivatives hedges such as FX forwards almost always have shorter tenors. This mismatch means hedges need to be reestablished and extended as they mature, creating ongoing operational and repricing risks that must be monitored and managed.

- **Meeting internal policies:** The exposure of the investments and the derivatives hedges should be aligned to the fund's requirements and policies. This necessitates a full understanding of the risks of the underlying position and the impact of derivatives on this risk.

- **Suitable and effective operational processes:** Derivatives positions need settlements, confirmations and hedge-effectiveness testing. The systems and processes to support derivatives trading and cash management differ from other systems and need to be implemented and/or maintained.

- **Ensuring adequate liquidity for margin calls:** As prices for derivatives change, regulatory VM must be calculated and provided/accepted each day[8]. This is operationally complex and must be modelled for current and stressed market conditions. Margin requirements can affect funds' returns if assets need to be sold to raise cash or buy/borrow specific eligible securities. While FX forwards are exempt from regulatory margin requirements, many larger funds may post IM[9] and VM to mitigate counterparty credit risk. Many large funds also expect dealers to require IM and VM more widely so they can continue to provide services to funds at attractive prices.

[7] On October 17, 2024, the Australian Prudential Regulation Authority (APRA) released a material service provider register template. The use of the template is APRA's preferred method for regulated entities to submit their registers to APRA for meeting the requirement of paragraph 51 of Prudential Standard CPS 230 Operational Risk Management (CPS 230), www.apra.gov.au/operational-risk-management

[8] Prudential Standard CPS 226 Margining and Risk Mitigation for Non-centrally Cleared Derivatives, www.legislation.gov.au/F2022L01578/latest/text

[9] An upfront amount intended to cover potential losses in the period between a default and the close-out of a trade

- **Contingency planning:** Market liquidity can be disrupted under stressed conditions, which can lead to challenges when reinstating FX forward hedges or raising cash to meet margin calls. Alternative sources of cash liquidity would likely be needed under these conditions.

- **Access to clearing:** Some large funds access central counterparty (CCP) services to reduce counterparty risks and costs. CCPs require the posting of IM and VM, which affects funding liquidity calculations for funds.

Market Liquidity and Third-party Oversight

- **Ensuring adequate liquidity for cash settlement:** If FX forward positions are not collateralized, there is still a funding liquidity impact each time a contract matures and is replaced by one based on current FX rates. Alternative sources of cash liquidity could be needed and should be included in contingency plans.

- **Market liquidity when trading large volumes in the same direction:** Given the very substantial size of their portfolios, funds trade large volumes with dealers. They typically have a single side to the trades where they hedge non-AUD returns and investments back to AUD. Transactions in the same direction are referred to as one-sided trades. Dealers and intermediaries may find the sheer volume of one-sided trades increases risk and raises the cost of providing market liquidity, with a consequent impact on fund returns.

- **Third-party relationships:** Superannuation funds have many third-party relationships, including with custodians, clearinghouses, technology providers and external fund managers. Failure of any of these third parties represents a significant risk to returns and liquidity management.

METHODS USED TO MANAGE EXPOSURES

Many financial firms have well established processes and systems to manage derivatives exposures. The following examples describe some of the actions taken by firms to address derivatives risk management.

Derivatives have specific regulatory obligations, such as mandatory position reporting and collateral management. These obligations must be consistently maintained

Regulatory Compliance

Derivatives have specific regulatory obligations, such as mandatory position reporting and collateral management. These obligations must be consistently maintained, and any regulatory or legal enquiry must be addressed in a timely manner. This can be managed effectively by:

- Maintaining an accurate and timely record of regulatory obligations.
- Appointing dedicated staff to monitor regulatory obligations and test ongoing compliance with the requirements.
- Regularly testing compliance of internal fund processes and those of third parties.

Operational Risk Management and Internal Controls

- **System of record and risk calculation:** Appropriate systems are key to risk management. Derivatives systems are designed to provide position and risk management, as well as calculate settlements. They differ from other systems primarily in their ability to provide accurate risk calculations specifically required for derivatives.
- **Trading and analysis staff:** Like most financial products, derivatives transactions require appropriately skilled staff to accurately calculate risk positions, as well as price and record the transactions. Derivatives positions need to be accurately assessed with reference to the underlying exposures that are being hedged, which requires staff with relevant derivatives experience.
- **Risk and operations staff:** Risk oversight and operations staff support derivatives positions and provide reporting to senior managers. Skilled staffing is essential for effective oversight and management and demonstrates appropriate compliance with APRA obligations (CPS 230). Meeting regulatory margin requirements (CPS 226) also requires staff with the necessary skills to assess and ensure the sufficiency of margin amounts.
- **Liquidity stress testing:** The available cash and securities for settlement and collateral must be managed and tested under stressed conditions. This requires systems and inputs to ensure there is adequate funding liquidity and a tested process to sell assets or invest excess funds as required.
- **Legal and documentation:** Derivatives have specific legal and documentary requirements. Trained staff are required to negotiate, maintain and support this documentation.

Use of Derivatives for Risk Management

- The returns on offshore investments will depend on asset performance and the AUD exchange rate. The FX risk of the returns can be managed with derivatives, including FX forwards, cross-currency swaps and FX options.

- Interest rate and total return swaps can also be used to diversify portfolios and increase or reduce exposure to markets and asset classes.

- Derivatives positions create a portfolio that is often used to hedge a collection of investment exposures. This aggregation of positions into a consistent set of risk measures is essential to correctly calculate the FX position and maturity profile.

- A full understanding of the investment, return and derivatives hedge portfolio is critical to managing the exposures. For example, over or under hedging can have significant effects on performance.

ISDA'S ROLE IN MANAGING DERIVATIVES AND MARKET RISKS

ISDA has played a key role in derivatives markets since its inception 40 years ago. With over 1,000 member firms from 76 countries, ISDA's focus is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivatives.

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ISDA represents all market participants globally, promoting high standards of commercial conduct that enhance market integrity, and leading industry action on derivatives issues. Areas of focus include:

Standardized documentation: A fundamental part of ISDA's mission has been to develop robust legal standards and documentation, including the ISDA Master Agreement, which sets out the terms for a derivatives trading relationship and allows two counterparties to net their various obligations into a single payment in the event of a default. This has continued to be a priority for ISDA, and the suite of standard industry documents and best practices now runs into the hundreds, including CSAs to govern the exchange of IM and VM. ISDA has also developed ISDA Create, an online solution that allows financial institutions to automate the creation, negotiation and execution of key derivatives documentation, while extracting and storing key structured legal and commercial data[10].

Market infrastructure for derivatives trading, clearing, margining and reporting: ISDA has developed a variety of mutualized solutions to address common industry problems. This includes the ISDA Standard Initial Margin Model (ISDA SIMM)[11], which provides a common methodology for the calculation of regulatory IM requirements, cutting costs for market participants and mitigating the potential for disputes. The ISDA SIMM is widely used around the world to support the efficient exchange of regulatory IM and has strong support from the official sector.

Another example if the ISDA Digital Regulatory Reporting initiative[12], which uses the open-source Common Domain Model[13] (CDM) – a standard for financial products, trades in those products and the lifecycle events of those trades – to transform an industry-agreed interpretation of new or amended regulatory reporting rules into unambiguous, machine-executable code. This makes implementation of reporting requirements more efficient and cost effective and reduces the potential for regulatory penalties for misreported data.

The CDM has also been used to bring greater automation and data standards to collateral management, with the aim of reducing operational, liquidity and counterparty risks, improving collateral velocity between counterparties and custodians and reducing the potential for disputes[14].

[10] www.isda.org/isda-solutions-infohub/isda-create/

[11] www.isda.org/isda-solutions-infohub/isda-simm/

[12] www.isda.org/isda-solutions-infohub/isda-digital-regulatory-reporting/

[13] www.isda.org/isda-solutions-infohub/cdm/

[14] www.isda.org/2023/02/16/isda-collateral-initiatives/

An advocate for effective risk and capital management: ISDA has worked with authorities around the world to make the case for netting and develop the necessary legislation to ensure its enforceability and has published 90 netting opinions for countries around the globe[15]. By allowing counterparties to offset their various obligations into a single net amount owed by one party to the other, netting significantly reduces credit risk and increases the capacity for firms to lend and trade.

Regulatory advocacy and policy development: ISDA works with regulators around the world (including the RBA, APRA and ASIC) to shape global derivatives rules and represent the interests of derivatives market participants.

Australia is a key derivatives market and ISDA has consistently devoted resources to education and advocacy in the country.

[15] www.isda.org/opinions-overview/

RECOMMENDATIONS AND NEXT STEPS

With the rapid and continuing growth of FUM across the Australian superannuation sector, managing increasing exposure to non-AUD investments presents new challenges.

Enhancing Risk Management and Compliance

- Review and document the operational, liquidity and regulatory issues associated with increasing use of derivatives to manage non-AUD exposures.
- Enhance or implement the systems and processes to manage derivatives exposures.
- Investigate the range of derivatives products that can be used to hedge offshore investments.
- Plan for increased use of derivatives, the impact of one-sided trading and access to markets.

Engaging with Regulators and Market Participants

- Maintain and increase proactive interactions with regulators (APRA and ASIC) and other parties, such as the RBA.
- Work closely with ISDA to assist with derivatives management.
- Be proactive in managing counterparties and third-party suppliers.

Early planning and investment in appropriate systems and processes will help funds manage operational issues

Developing Long-Term Strategies for Sustainable Derivatives Use

- Increasing the use of derivatives will bring new challenges to the superannuation sector. However, early planning and investment in appropriate systems and processes will help funds manage operational issues.
- Review the use of all derivatives products to match requirements. For example, most funds rely on FX forwards to manage non-AUD investment returns. In some cases, other products, such as cross-currency swaps, may help match maturity profiles.
- Implement and maintain long-term plans to manage operational risks, such as trade execution, liquidity and risk oversight. These plans and processes should be tested against stressed market conditions and liquidity events.

Adopting Technology Solutions to Reduce Operational and Liquidity Risks

- Take advantage of established and proven industry standards, solutions and technologies, such as the ISDA SIMM and the ISDA DRR, to increase efficiency and reduce operational and regulatory risks.

CONCLUSION

Australian superannuation funds have grown substantially since 1992 due to the gradual rise in contribution percentages and the reinvestment of returns. Funds are expected to continue to grow until 2035 at least before they stabilize at around A$9 trillion. This growth is expected to propel Australian superannuation FUM to second place globally behind the US.

Superannuation funds must adapt through enhanced governance, compliance and operational strategies that address their increased use of derivatives

APRA-regulated funds represent the largest component of the Australian superannuation sector. These funds have significant and growing investments in offshore assets but need to provide returns in AUD for members. About half of non-AUD exposures are managed with derivatives, such as FX forwards and cross-currency swaps. The size and complexity of derivatives portfolios are expected to increase in line with rising FUM and offshore investments. As a result, derivatives exposures must be managed and reported appropriately to maximize the returns for fund members.

The APRA and ASIC regulatory frameworks relevant to funds are also evolving. This introduces an expanding range of compliance risks that need to be closely monitored and managed.

Superannuation funds must adapt through enhanced governance, compliance and operational strategies that address their increased use of derivatives. Use of established technologies and standards can also improve efficiency and reduce operational and regulatory risks.

Collaboration with regulators, counterparties and industry groups like ISDA is key to navigating these changes and ensuring safe and efficient use of derivatives by Australia's superannuation sector.

ANNEX 1: FUND SIZE AND GROWTH

Australia now has substantial superannuation assets worth 180% of GDP and this will continue to grow as contribution levels increase and reinvested returns are added to FUM

Australian superannuation funds have grown in both size and complexity since the Superannuation Guarantee (Administration) Act of 1992[16] was introduced. There have been several subsequent updates to the legislation. In 1992, employers were required to contribute 3%-4% of an employee's salary to superannuation and the rate increased gradually to 9% by 2002. Further increases will bring the contribution rate to 12% by July 1, 2025.

Australia now has substantial superannuation assets worth 180% of GDP[17] and this will continue to grow as contribution levels increase and reinvested returns are added to FUM.

Global Pension and Superannuation Funds

Table 1 shows the top 10 countries by pension fund assets, plus the split between defined benefit (DB) and defined contribution (DC) pension models[18].

Table 1: Global Pension/Superannuation Assets Per Country and Model

Country	FUM (US dollar billion)	DB/DC %
US	38,380	33/67
UK	2,426	74/26
Australia	2,169	12/88
Netherlands	1,742	94/6
Canada	1,601	56/44
Switzerland	1,330	
Japan	1,207	95/5
Denmark	826	
South Korea	577	
Germany	291	
Total of Top 10	50,548	42/58

Source: Organisation for Economic Co-operation and Development (OECD), June 2024[19]

According to the Organisation for Economic Co-operation and Development, Australia is the third largest[20] in terms of FUM and has the highest proportion of DC funds.

Chart 1 shows the projected growth of Australian superannuation FUM compared with the UK and Canada. Australian FUM is expected to be second only to the US by 2030, according to research from the Super Members Council (SMC)[21].

[16] Superannuation Guarantee (Administration) Act 1992, www.legislation.gov.au/C2004A04402/2020-12-18/text

[17] Super Members Council, Australians' Super Savings on Track to Become Second Largest Globally by the Early 2030s, https://smcaustralia.com/news/australians-super-savings-on-track-to-become-second-largest-globally-by-the-early-2030s/

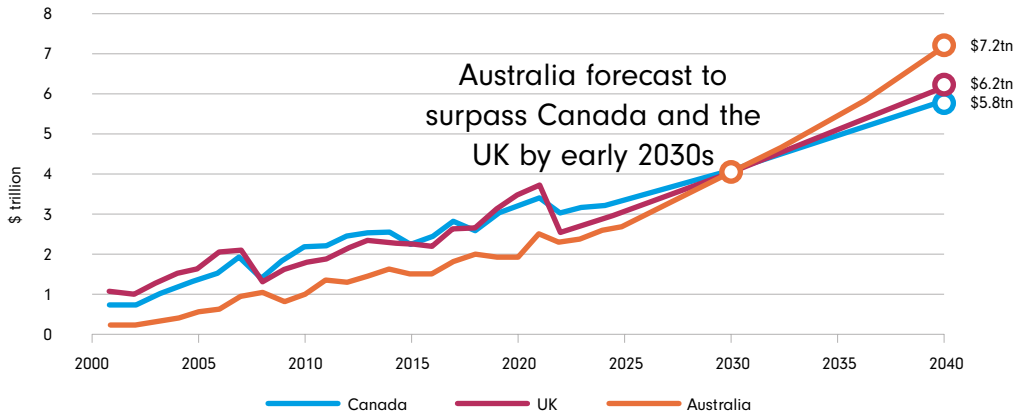
[18] Global Pension Assets Study – 2025, www.thinkingaheadinstitute.org/research-papers/global-pension-assets-study-2025

[19] Organisation for Economic Co-operation and Development, Pension Markets in Focus Preliminary 2023 Data, June 2024, www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/asset-backed-pensions/PMF-2024-Preliminary-2023-Data.pdf

[20] Total funds under management (FUM) in Japan are likely to be higher than Australia's if all funds and cash are included rather than assets

[21] Super Members Council, Global Pension Rankings, https://smcaustralia.com/report-global-pension-rankings/

Chart 1: Projections for FUM in Australia, the UK and Canada (US dollar equivalent)



Source: Super Members Council analysis, OECD, Australian Prudential Regulation Authority (APRA), Australian Taxation Office, Superannuation, Pension, and other Retirement OUTcomes (SPROUT) Model

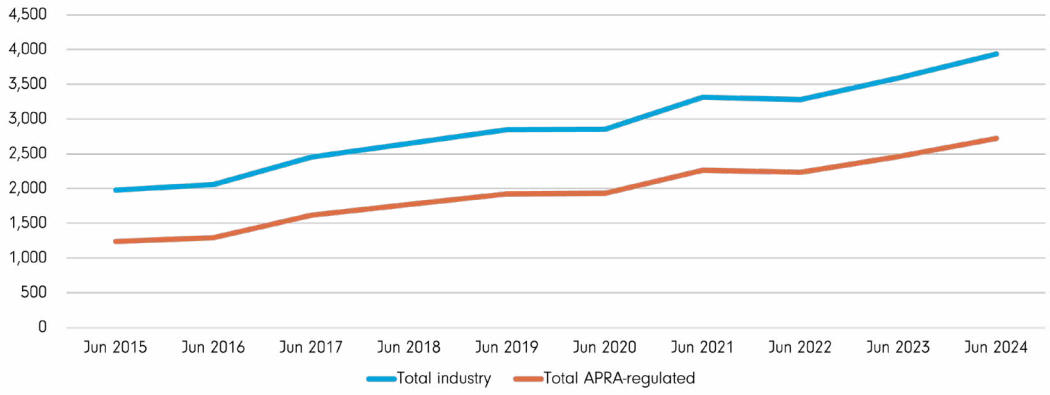
Size and Growth of Australian Superannuation Funds

In December 2024, the RBA published new research on superannuation funds[22]. This followed several significant speeches[23] and announcements[24] by both the RBA and APRA in 2024 about the growth and regulation of funds.

The RBA expects Australian superannuation FUM to continue to grow until 2035 and to peak several decades later. The report also highlights that actual FUM has consistently grown faster than 1995 forecasts to be twice the predicted size in 2023. The RBA notes that growth will have some impact on financial stability and will be considered in regulatory assessments.

The most recent APRA statistics[25] show the total FUM of the Australian superannuation industry in June 2024 (see Chart 2).

Chart 2: Growth of Australian Superannuation FUM (AUD billion)



Source: APRA

[22] RBA, The Future Size of the Super Sector: External Estimates, www.rba.gov.au/information/foi/disclosure-log/pdf/242512.pdf

[23] APRA, Deputy Chair Margaret Cole, Speech to the AFR Super & Wealth Summit 2024, October 2024, https://www.apra.gov.au/news-and-publications/apra-deputy-chair-margaret-cole-speech-to-afr-super-wealth-summit-2024

[24] Superannuation (Prudential Standard) Determination No. 6 of 20024, www.legislation.gov.au/F2024L01319/asmade/details

[25] APRA, Annual Fund-level Superannuation Statistics, January 2025, www.apra.gov.au/annual-fund-level-superannuation-statistics

Total FUM is approximately A$4.1 trillion as of June 2024. This comprises A$2.8 trillion across 85 funds regulated by APRA and A$1.3 trillion in other funds, including a significant number of self-managed super funds (SMSFs) and small funds. The largest 10 APRA-regulated funds are listed in Table 2.

Table 2: Largest 10 APRA-regulated Superannuation Funds June 2024

APRA-regulated Fund	FUM (AUD billion)
AustralianSuper*	360.1
Australian Retirement Trust*	310.2
Aware Super*	183.1
Unisuper*	143.1
Public Sector Superannuation Scheme	118.8
HOSTPLUS Superannuation Fund*	118.7
Colonial First State FirstChoice Superannuation Trust	96.8
CBUS*	95.4
Military Superannuation & Benefits Fund No 1	94.7
HESTA*	88.6
Total of Top 10	1,609.3

Source: APRA

* Industry funds

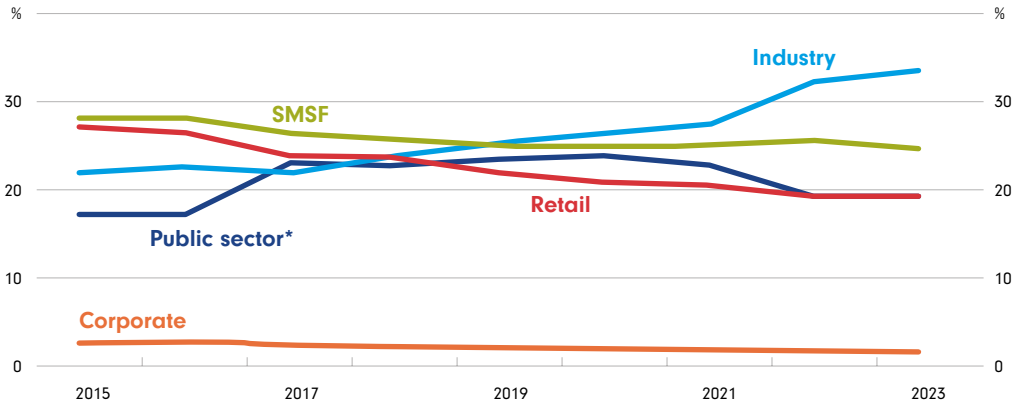
The top 10 APRA-regulated funds represent about 60% of total superannuation FUM and 40% of overall FUM. Other industry participants, such as IFM Investors (owned by 16 Australian pension funds), also play a critical role in managing investments.

A notable inclusion is the Australia Future Fund, a public-sector fund that is not regulated by APRA. The Future Fund has grown from A$60.6 billion in 2006, when it was established by the Australian government, to A$304.5 billion in December 2024 because of reinvestment of returns. The fund does not publish details of its investments.

Types of Australian Superannuation Funds

Many of the top 10 funds are 'industry' funds (asterisked in Table 2), which have seen the largest growth (see Chart 3).

Chart 3: Growth of FUM for Superannuation Fund Sectors



Source: APRA, Reserve Bank of Australia (RBA)

* The increase in public sector funds in 2016 reflects the launch of ADF Super. The 2022 decline reflects the merger of QSuper and SunSuper to create Australian Retirement Trust

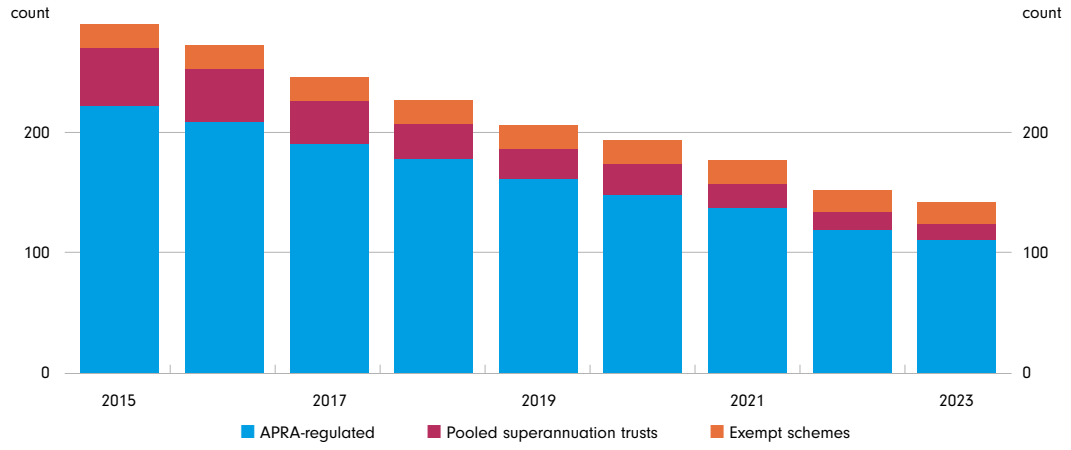
The funds are ranked in five categories:

- **Industry:** Funds that were formed from industry groups and/or trade unions, which have about 34% of total FUM.
- **SMSFs:** Small- and medium-sized funds formed by small groups of people (often family groups). There are currently over 625,000 SMSFs with approximately 25% of total FUM.
- **Retail:** For-profit entities, such as banks and retail funds, with about 19% of total FUM.
- **Public sector:** Consisting only of public-sector employees, with around 19% of total FUM.
- **Corporate:** Employer-sponsored funds with approximately 3% of total FUM.

APRA regulates 'large' funds and covers all categories except SMSFs and some exempt public-sector funds. The Australian Taxation Office regulates SMSFs. The RBA does not regulate funds but does oversee any impact on the monetary system from funds' activities.

Chart 4 shows the total number of APRA-regulated funds, which has been falling consistently. Given growing FUM, this suggests the large funds are becoming larger and more systemically important.

Chart 4: Drop in the Number of APRA-regulated Funds



Source: APRA, RBA

* APRA-regulated funds with six or less members have not been included

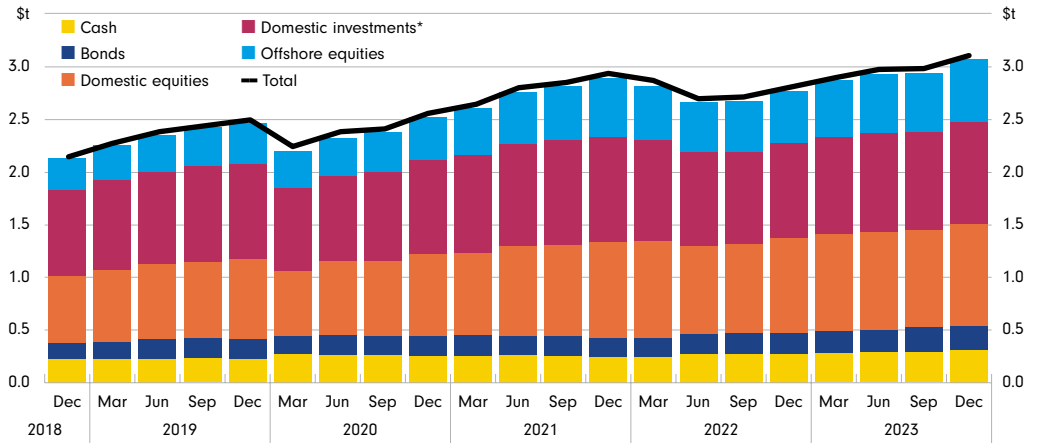
In summary:

- The FUM of Australian superannuation funds has grown substantially over the past 10 years (see Chart 1).
- This growth is expected to continue, with FUM predicted by the RBA to double over the next 10 years.
- The top 10 APRA-regulated funds represent 60% of superannuation FUM and 40% of overall FUM (Table 2).
- The total number of funds is falling, and the larger funds are growing.
- Fewer funds with growing assets are attracting the attention of APRA and the RBA.

ANNEX 2: ASSET ALLOCATIONS TO OFFSHORE INVESTMENTS

Australian funds have had non-AUD investments for many years, but the rapid growth of FUM has meant funds have become increasingly constrained by limited domestic investment opportunities and a lack of diversity in the Australian market, which has led them to increase their offshore investments (see Chart 5). The proportion of offshore investments is expected to grow as FUM continues to increase.

Chart 5: Allocation of Assets by Large Superannuation Funds (AUD trillion)



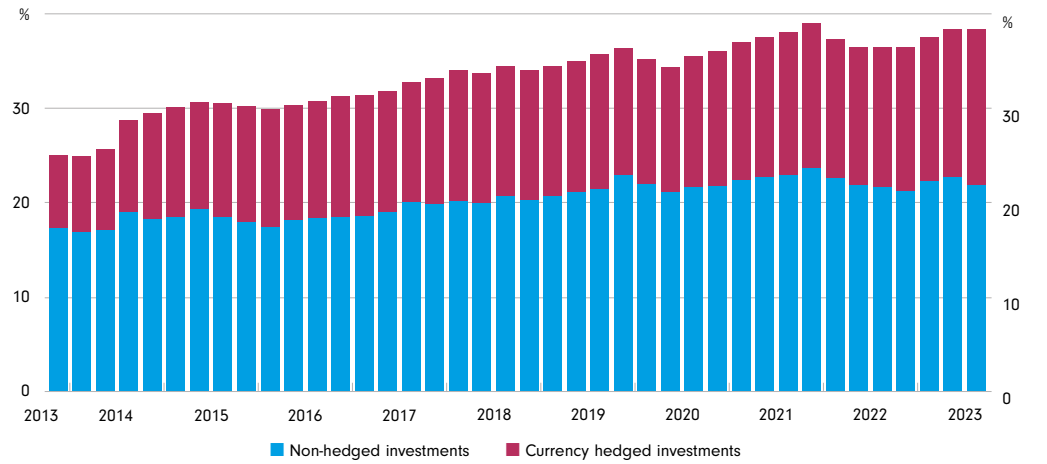
Source: APRA, RBA

* Latest observation December 2023

Chart 6 shows the proportion of superannuation funds' overseas investments that are currently hedged. The term 'currency hedged' refers to an investment in which the full notional (and often the return) is hedged at a certain AUD exchange rate when purchased. The RBA estimates that superannuation funds have around A$900 billion in derivatives notional outstanding.

For the 'unhedged' portion, the investment is fully revalued according to movements in the AUD exchange rate. In both cases, the returns are converted from foreign currency into AUD because member returns are reported in AUD.

Chart 6: The Proportion of Hedged and Non-hedged Offshore Investments*

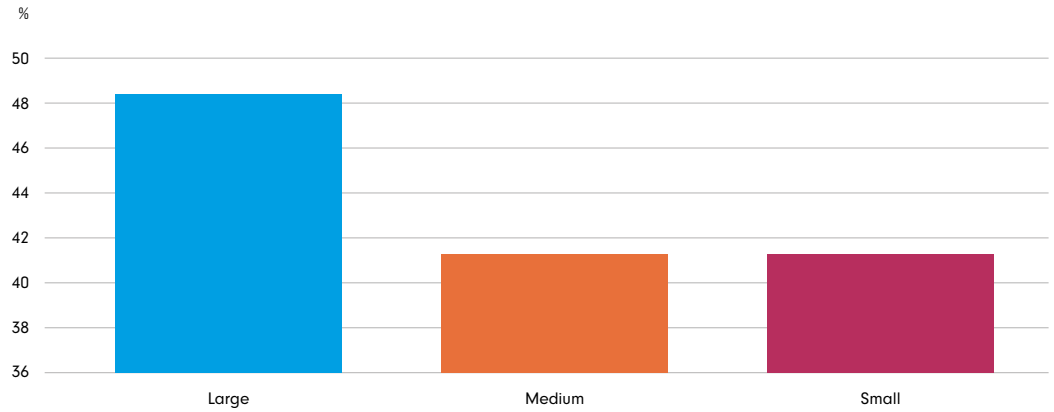


Source: APRA, RBA * APRA-regulated funds, does not include international investments in cash, unlisted equity, property and listed infrastructure

National Australia Bank (NAB) conducts a biennial survey[26] of 41 superannuation funds, which shows:

- There is a clear trend towards the internationalization of investment portfolios.
- The proportion of offshore investments has grown from 41% in 2019 to 46.8% in 2021 and reached 47.8% in 2023.
- Large funds have greater offshore investments compared with medium and small funds, due to their need to diversify their portfolios and their ability to access derivatives markets to transfer the returns into AUD.
- A substantial proportion of large funds (71%) plan to further increase their offshore investments in the future.
- Funds typically hedge fixed income, property and infrastructure investments fully against currency risk, and hedge around a third of their equity investments.

Chart 7: NAB Survey Responses for Offshore FUM Allocation Per Fund Size



Source: National Australia Bank

JP Morgan[27] also runs an annual survey that identifies current focus areas for funds. The 2023 edition notes that some of the largest funds with assets above A$100 billion are using this scale to increase their offshore investments across a range of asset classes and have/will set up global offices to explore new opportunities.

In summary:

- Industry surveys show close to 50% of the assets of large superannuation funds are invested in non-AUD assets and this percentage is increasing.
- Large funds plan to further increase their investments in offshore assets.

[26] National Australia Bank, NAB Super Insights Report 2023, https://business.nab.com.au/wp-content/uploads/2023/11/NAB-Super-Insights-November-2023.pdf

[27] JP Morgan, Optimising Outcomes Through Global Investment and Unlisted Assets, www.jpmorgan.com/content/dam/jpm/cib/complex/content/markets/futue-of-superannuation/Optimising-outcomes-through-global-investment-and-unlisted-assets.pdf

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