Super funds' insourcing strategy: The role of...

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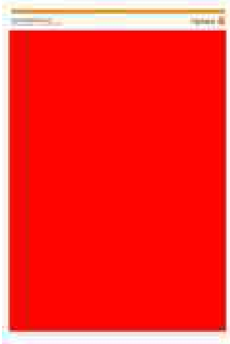

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Super funds' insourcing strategy: The role of outsourced trading

Insourcing is a great strategy, but funds still need support

Australia's superannuation fund industry is booming with approximately AU$3.9 trillion in assets as at 31 March 2024, up from AU$2.6 trillion in 2018.[1] It is one of the leading pension systems worldwide, with approximately 23 million member accounts.[2]

While the superannuation fund industry is continuing to grow, the demographics in Australia are shifting due to an ageing workforce population. The Australian Bureau of Statistics highlight how quickly the population is ageing, which could result in changes to the super fund sector.[3]

Superannuation funds are facing continued pressure to deliver consistent and reliable income streams to pay out pensions for retirees who were among the first adopters into their schemes. In addition to this shift in demographics, market performance in certain asset classes continues to be impacted by fluctuating interest rates.

As superannuation funds grapple with changing demographics and the interest rate environment, they are also navigating an evolving regulatory landscape and market change. One key development under consideration is the shift from a trade date plus two (T+2) to a trade date plus one (T+1) securities settlement cycle.

While intended to increase efficiency, this transition introduces additional complexities for Australia, particularly the distinct time zone challenges and technological adaptations required.[4]

Taken together, these pressures are prompting some super funds to look at ways to become more efficient and exert greater control over their cost structures. Larger funds have turned to insourcing the investment management of equities and fixed income, seeing it as a way to manage these changes.

The wave of insourcing

By bringing the management of equity and fixed income in-house, the largest super funds may gain more control over investment decisions, reduce costs and enhance efficiency.

In a May 2024 survey of global asset managers by Northern Trust, nearly 67% of Australian-based respondents selected 'insourcing investment management' as an investor trend impacting their distribution strategy.[5] This trend is exemplified by superannuation funds, with leading funds like UniSuper now managing 70% of their assets internally, reflecting the growing shift toward insourcing investment management.[6]

The shift to in-house management highlights a broader industry focus on improving operational efficiency and maximising value, as internal teams can understand the unique needs of their funds and can respond quickly to market changes.

How outsourced trading can play a pivotal role

While many large superannuation funds are bringing their investment management in-house, the effectiveness of this approach relies heavily on the fund's ability to maintain the expertise and performance that was achieved with external asset managers.

Without the right combination of in-house capabilities, insourcing may fall short of its potential advantages. This is particularly relevant for complex areas of the business, like trading, where managing asset classes such as fixed income, entering new global markets, or adapting to regulatory changes such as shortening trade settlement cycles to T+1, can present unique challenges.

Increasingly, fund managers are seeking to create orchestrated ecosystems of expertise, delivering an optimal balance of fixed cost and variable cost solutions. As a result, some funds are looking for external expertise from an outsourced service provider.

To maximise value, investment teams need market access, relationships and networks, scale, technology, expertise and governance. Yet these capabilities are often not readily available to a fund that has chosen to move their investment responsibilities in-house.

For example, they may not be able to leverage the most sophisticated technology or have the necessary scale to access new asset classes or to begin trading in new global markets. An outsourced service provider can offer global trading capability from desks in multiple regions with access to numerous exchanges across asset classes. And while an in-house team may maintain a limited number of broker relationships on their own, a scaled trading desk can offer access to a significant roster of global counterparties.

Outsourced providers have also invested in leading-edge technology needed to maximise their trade activity, such as algorithmic trading. And because trading is their primary business, they have a well-developed governance structure to support their operations. Crucially, outsourcing the trading function can enhance a super fund's governance and compliance, creating a separation of duties between investment manager and trader.

In addition to these benefits, an outsourced provider offers specialised traders who bring deep industry knowledge. With fixed income, for example, which is the second largest asset class in superannuation portfolios, accounting for approximately 20% of assets,[7] having designated fixed income traders who understand how to effectively utilise resources and optimise processes is paramount.

With their exclusive focus, fixed income traders continuously monitor market flows and are knowledgeable of key counterparties and market makers. During the pricing process, a fixed income trader is better equipped to set an accurate price that aligns with current market trends. They also have the ability to apply the most optimal trading strategy to each situation, which can increase a portfolio's potential returns. This deep expertise enables the trading desk to navigate a broader range of fixed income assets, helping to increase efficiency and opportunity.

The quote

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Looking ahead

As superannuation funds navigate a more challenging and dynamic investment landscape, strategies like insourcing can help them maintain their competitive edge and allow them to achieve sustainable growth for their aging member demographic.

Yet as the insourced management trend grows, many realise that they still need support in certain areas – trading being a primary one. Outsourced traders, with their specialised expertise and advanced technology, can help super funds reduce operational friction and navigate time zone and technological hurdles, attributes that will be particularly valuable as more global markets move to a T+1 trading environment.

Superannuation funds that bring investment management in-house and look to partner with an outsourced service provider will be well positioned to thrive. **FS**

1. Super Statistics - ASFA The Voice of Superannuation since 1962
2. Annual superannuation bulletin - highlights | APRA
3. Why the Government will continue to target super and the pension (morningstar.com.au)
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5. Driving Growth in Asset Management 2024 | Northern Trust
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7. Superannuation Asset Allocation Trends in Australia (marketmaven.com.au)