Australian Managed Funds Industry

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Executive Summary

Australia's financial services industry is the largest contributor to the nation's economy, with a 9.0% share of Gross Value Added (GVA), (mining is the second-largest contributor, with 8.9%.[1]), and the employment of over 402,000 Australians[2]. Within this Australia has developed a sophisticated and growing managed funds industry totalling at December 2014, some A$2.5 trillion in funds under management. On the international stage, Australia has the third-largest pool of funds under management behind the United States and Luxembourg, and currently has the largest pool in the Asian region.[3]

The growth of the industry has been supported by a rigorous regulatory framework. The Australian Securities & Investments Commission (ASIC) is the principal regulator of fund managers. ASIC's responsibilities include the registration of managed investment schemes, licensing of investment managers and compliance monitoring. The regulator oversees 485 active responsible entities, 3,673 registered managed investment schemes, and 614 foreign financial service providers.[4]

This report provides analysis of trends in two main areas—total assets under management (data sourced from a survey of assets held by managers) and the managed funds industry (data collected by Morningstar's managed funds database).

The analysis reveals the below findings:

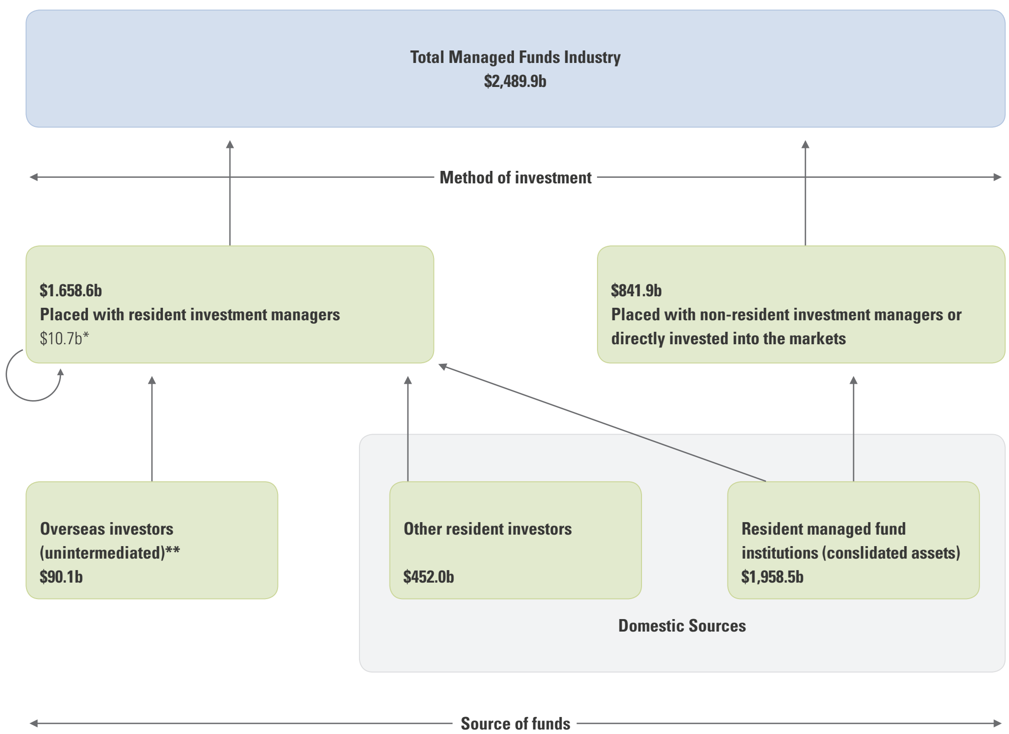
- Substantial growth of total assets under management, almost doubling since December 2004.
- Top ten ranking of managers by size continues to be competitive as market share and rankings change over time.
- Growth of discrete mandates assets from A$206.1 billion at December 2005 to A$719.3 billion at December 2014.
- Investment managers on aggregate have reduced exposure to Australian equities and increased international equities.
- Consolidation of managed funds since 2011, the number of funds has fallen, however, the overall level of assets has increased.
- Composition of funds has changed since 1994—growth in number of pension and annuity funds.
- Australia compares favourably at an international level for retail managed fund fees.

1 ABS cat No. 5204.0 Australian System of National Accounts, 2013–14
2 ABS, Labour Force, Australia, 6291.0.55.003, May 2015
3 Investment Company Institute, Worldwide Mutual Fund Assets and Flows
4 ASIC Annual Report, 2013–2014

Australian Managed Funds Industry

The managed funds industry comprises multiple components. Figure 1 illustrates how these funds are both sourced and managed. Of the total A$2.5 trillion, approximately A$1.6 trillion is managed by Australian resident investment managers, the balance is managed either by offshore managers or directly—for example, A$422.0 billion of the A$543.0 billion in self-managed superannuation fund ('SMSF') assets at 30 June 2014 were invested directly in cash, shares, or direct property. Figure 2 breaks down the managed funds industry by the type of institution managing the money and, in turn, by the structure of the superannuation sector, which accounts for approximately 75.0% of managed fund assets.

Figure 1 Breakdown of Australian Managed Funds Industry[5]



* Indicates funds invested by resident investment managers with other resident investment managers. These are deducted to derive the total managed fund industry.

** These funds do not include investments held by Australian nominees on behalf of overseas investors.

5 ABS, Managed Funds, 565 5.0, DEC 2014

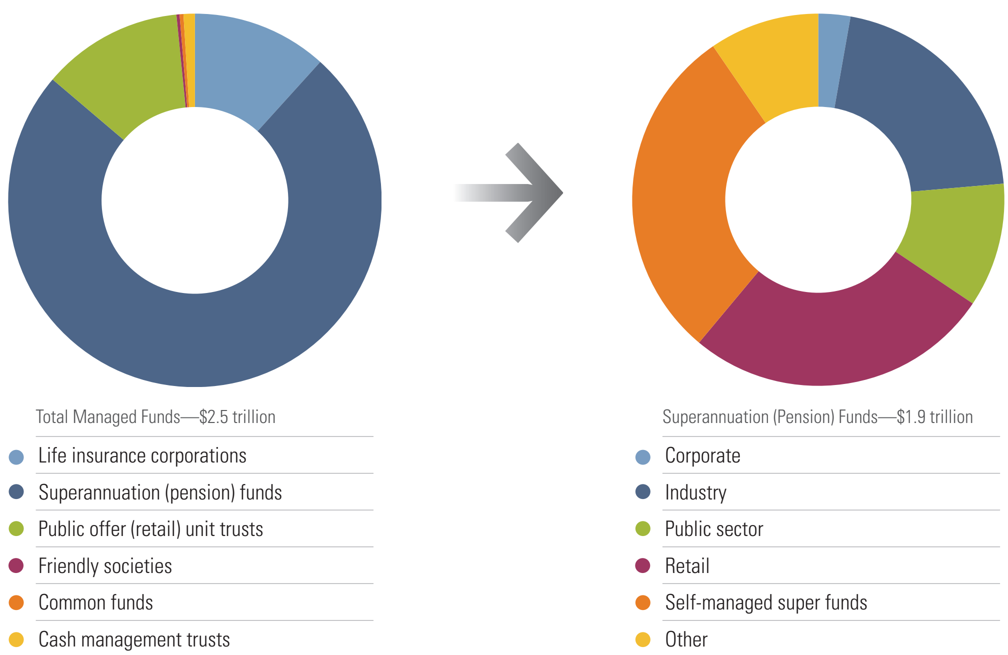
The balance of this paper discusses the A$1.6 trillion managed by Australian resident investment managers. As Figure 2 shows, the bulk of these assets are held by superannuation funds, life insurance companies, and public offer unit trusts.

This report draws on data compiled by Morningstar to examine the growth of assets, changes in asset placement by managers, top managers by size, sources of investments, growth of the number of funds by investment structure, and fees. The data is based on a direct survey of over 150 investment managers. Two main data sets are used:

- **Total Assets Under Management**, a top-down survey of assets held by managers participating in the survey broken down between various metrics. This is a representative sample of the entire industry, with total assets of A$1.27 trillion accounting for 76.5% of the A$1.66 trillion reported by the Australian Bureau of Statistics at 31 December 2014; and

- **Morningstar's managed funds database**, which tracks individual managed investment schemes, the data from which has been aggregated for presentation in this report.

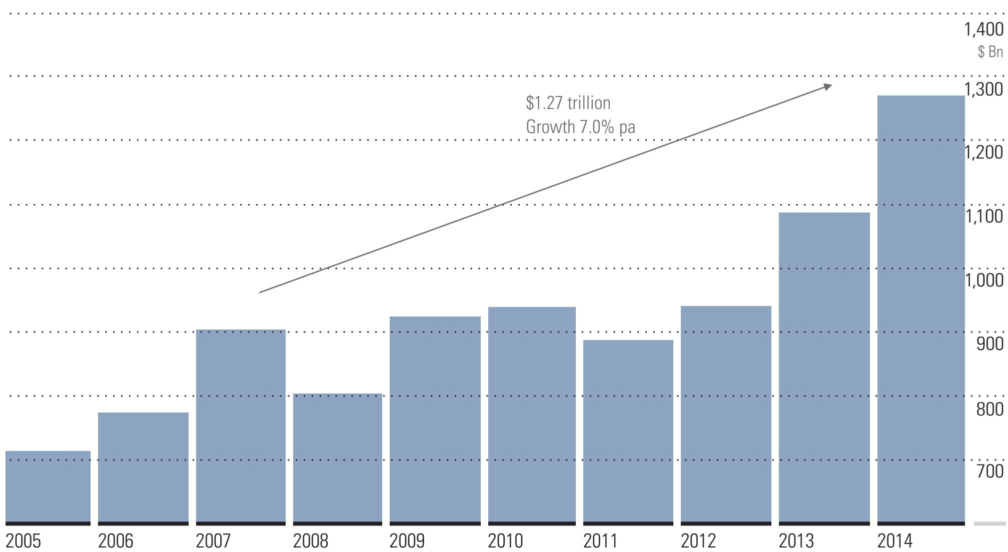
Figure 2 Superannuation — The Core of the Australian Managed Funds Industry



Source: Morningstar

Industry Overview

Figure 3.1 Assets Under Management



Changes in AUM reflect a combination of market returns and cash flows.

Figure 3.2 Changes in Allocation 2009–2014

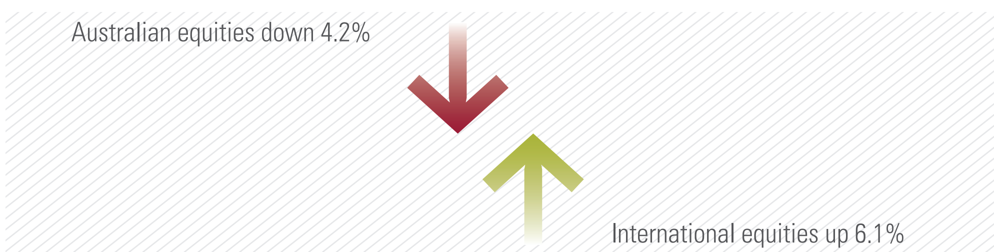


Figure 3.3 Fee Movement 2010–2014

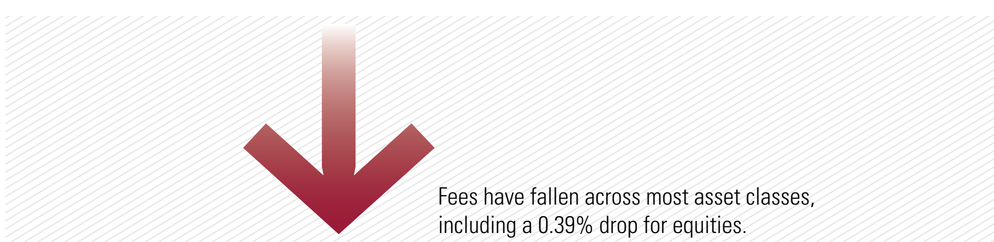


Figure 3.4 Investment Source 2014

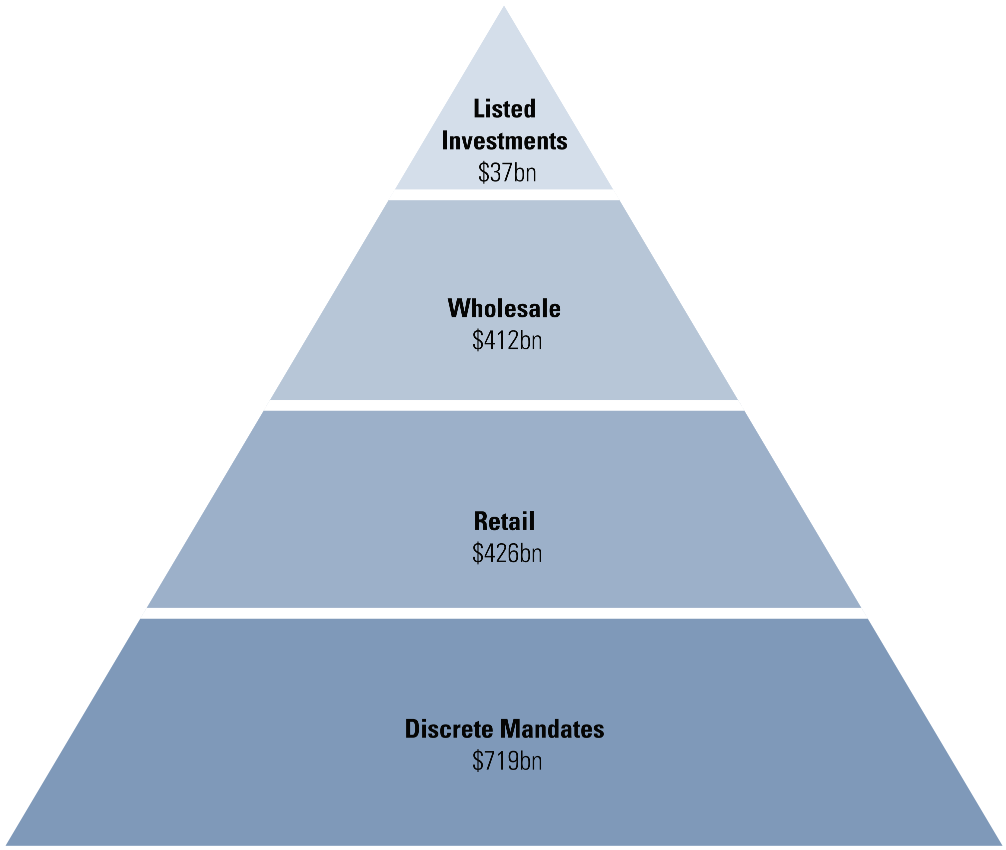
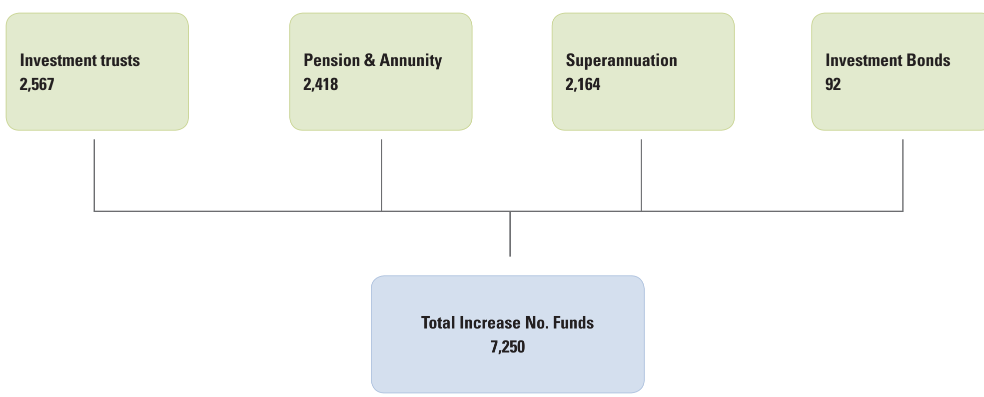


Figure 3.5 Increase in Number of Funds 1994 –2014



Industry Trends

- **Continued increase in the size of assets**—the value of assets under management has increased by 7.0% per annum on average since 2005. This growth has been fuelled predominantly by mandatory superannuation savings, a trend set to continue as Superannuation Guarantee entitlements are legislated to increase from the current level of 9.5% to reach 12.0% by 2025.

- **Demographic shifts**—baby boomers currently make up the largest age cohort. As boomers reach retirement, there will be a resultant shift to income-based products—already seen in the growth in the number of pension fund options available to retirees.

- **Continued pressure on fees**—greater transparency and increasing scale benefits have seen fees fall.

- **Flows**—movement of assets out of Australian shares and into international shares.

Trends in Assets Under Management

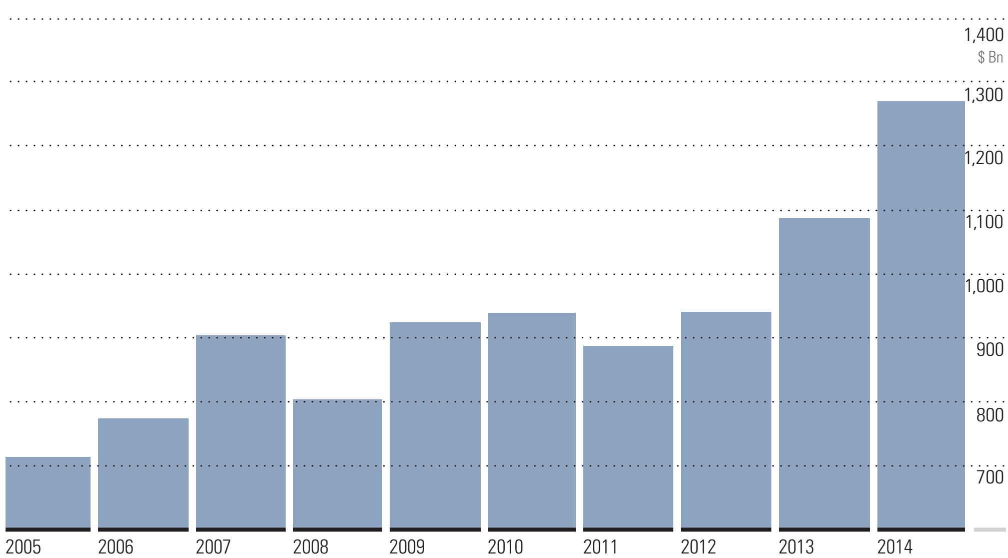
Analysis in this section is measured by Total Assets Under Management (TAUM). This is the total net money managed by the investment manager. It is net of all borrowings and outsourced investment managed monies. Double counting is removed as only the underlying investment manager reports the amounts.

Growth in Assets Under Management

- Australia's investment management industry has experienced substantial growth over the past 10 years. TAUM has almost doubled from A$654.4 billion at 31 December 2004 to more than A$1270.1 billion at 31 December 2014.

- Total assets have fallen twice over this 10-year period (Figure 4). The most significant decline occurred over 2008 against the backdrop of the global financial crisis ('GFC'). There was another smaller fall in 2011 as shares fell again. The table of asset class returns in Figure 5 illustrates the impact of investment performance on industry asset levels.

Figure 4 Growth of Australian Managed Fund Assets, 2005–14



Source: Morningstar Total Assets Under Management

Figure 5 Annual Returns % from Major Asset Classes, 2005–14

Asset Class Returns	2005 %	2006%	2007 %	2008 %	2009%	2010%	2011 %	2012 %	2013 %	2014 %
Australian shares	22.45	24.51	16.22	–38.92	37.59	1.90	–10.98	19.74	19.68	5.30
International shares	16.84	11.49	–2.60	–24.92	–0.30	–2.04	–5.34	14.14	48.03	15.01
Australian listed property	12.70	34.05	–8.36	–55.31	9.56	–0.68	–1.56	32.79	7.27	26.79
International fixed interest (H)	3.81	5.40	6.63	9.23	8.03	9.28	10.51	9.66	2.27	10.37
Australian fixed interest	5.79	3.12	3.50	14.95	1.73	6.04	11.37	7.70	1.99	9.81
Morningstar Multisector Growth	14.98	14.55	4.51	–25.62	17.93	2.68	–4.1	13.88	17.56	7.76

Asset class return sources (indexes): Australian shares—S&P/ASX 300 TR; International shares—MSCI World Ex Australia NR AUD; Australian Listed Property—S&P/ASX 300 A-REIT TR; International fixed interest (H)—Barclays Global Aggregate TR Hdg AUD; Australian fixed interest— Bloomberg AusBond Composite 0+Y TR AUD, AUD/USD, positive movement represents appreciating AUD currency.

Morningstar Multisector Growth index represents the average return of Investment Trusts with an exposure to growth assets between 60% and 80% and is after fund fees but before tax.

Top Ten Managers by Size

- The top 10 managers held a combined A$757.5 billion in assets at the end of 2014, equivalent to a 58.9% share of the market from our survey. The industry remains competitive, however, the top 10 positions continuing to change both by constituents and market share. Four managers have broken into the top 10 from significantly lower rankings in 2009. (Figure 6)
- The same set of managers held A$457.5 billion in assets at the end of 2009.
- Market share held by the top 10 managers increased by 2.0 percentage points from 2009.

Figure 6 Top 10 Australian Investment Managers by Size at 31 December 2014 and 31 December 2009

	2014			2009		
Investment Manager	**Rank**	**A$ Bn**	**Mkt Share %**	**Rank**	**A$ Bn**	**Mkt Share %**
State Street Global Advisors (Aus) Ltd	1	152.3	11.9	5	53.6	5.8
Commonwealth/Colonial Group	2	117.1	9.2	1	105.1	11.4
AMP Group	3	93.9	7.4	4	57.0	6.2
Vanguard Investments Australia Ltd	4	72.5	5.7	3	60.5	6.5
Macquarie Bank Group	5	59.3	4.6	2	75.6	8.2
BlackRock Investment Mgmt (AUS) Ltd	6	59.2	4.6	17	15.8	1.7
BT Financial Group Ltd	7	58.0	4.5	7	40.9	4.4
IFM Investors Ltd	8	53.8	4.2	12	20.7	2.2
Schroder Investment Management Australia Limited	9	51.8	4.1	19	14.5	1.6
UBS Global Asset Management (Aus) Ltd	10	39.8	3.1	20	13.7	1.5
					457.5	**49.5**
Top 10		**757.5**	**58.9**		**525.9**	**56.9**
Top 20		**1,017.6**	**79.1**		**699.2**	**75.7**
Top 30		**1,143.1**	**88.8**		**804.6**	**87.1**

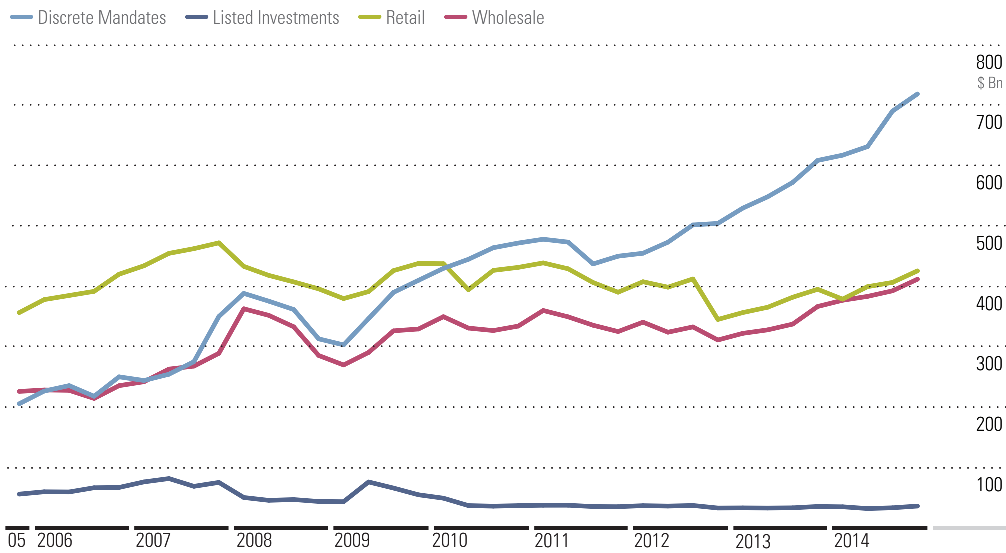
Source: Morningstar

Source of Investments

Figure 7 shows how these investments are being sourced. There are four main sources with the following definitions:

- **Retail** is money sourced from retail investors and generally placed in public offer unit trusts (or funds) offered by a manger with a minimum investment of less than A$50,000.
- **Wholesale** comprises money sourced from funds with a minimum investment of more than A$50,000. Once again this money may come from an individual, but is more likely to come from an institution, including platforms that aggregate assets on behalf of investors.
- **Discrete mandates** represent money managed on behalf of one particular client, typically a superannuation fund, but instead of investing through a fund, the investor retains ownership of the underlying securities being managed on their behalf. For example, the trustee of a superannuation fund will delegate the investment management process to an external manager and an independent custodian is appointed on behalf of the trustee and is responsible for physical custody, corporate actions, and record-keeping, while the external manager directs the day-to-day trading of the account.
- **Listed investments** include exchange-traded funds, real estate investment trusts, infrastructure, and listed investment companies.

Figure 7 Relative Growth in Dollar Value (A$bn) of Sources of Managed Fund Assets, 2005–14



Source: Morningstar

- Discrete mandates have increased by almost 249.1% from 2005–14 to reach A$719.3 billion at 31 December 2014. The superannuation funds that tend to use discrete mandates have continued to benefit from compulsory superannuation contributions, while at the same time consolidation among superannuation funds has seen more assets transition to discrete mandates because of associated scale benefits.

- Wholesale also experienced significant growth, increasing 82.1%, helped by a trend away from direct to retail funds to wholesale funds held on administration platforms. This also explains the relatively low 19.4% growth for the retail category over the same period.

Asset Allocation

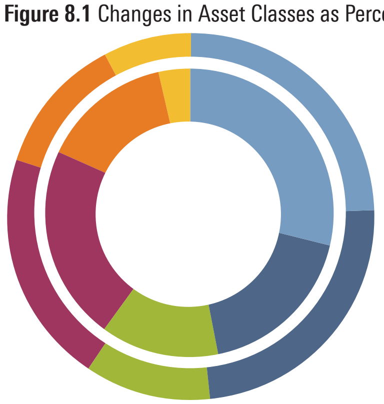
- Investment managers held 48.6% of assets under management in equities at 31 December 2014, split between domestic (24.6%) and international (24.0%). This represented a total dollar amount of A$617.4 billion.

- There has been a convergence between international and Australian equities since 2009. The difference between allocations to international and Australian equities has narrowed considerably, from 11.0% in 2009 to 0.6% in 2014.

- In dollar terms, the overall allocation to international equities increased A$140.9 billion from 2009–14, followed by fixed interest (up A$59.7 billion), Australian equities (A$48.7 billion), cash (A$21.6 billion), and property and infrastructure (up A$18.7 billion in assets over the past five years).

- 'Other' assets include private equity, commodities, and alternatives.

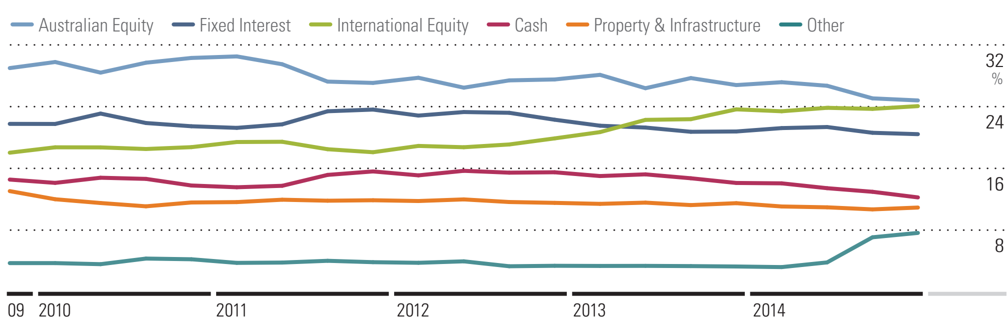
Figure 8.1 Changes in Asset Classes as Percentages of Overall Australian Managed Fund Assets, 2009 and 2014



Asset Class	2014 (%)	2009 (%)
Aust Equities	24.6	29.0
Intl Equities	24.0	18.0
Property & Infrastructure	10.9	13.0
Fixed Interest	20.6	21.8
Cash	12.3	14.5
Other	7.6	3.6

Source: Morningstar

Figure 8.2 Changes in Asset Classes as Percentages of Overall Australian Managed Fund Assets, 2009 and 2014



Source: Morningstar

Trends in the Managed Funds Industry

Investment Structures

Public offer funds available in Australia can be broken down into the following principal legal types on the Morningstar database. These are all types of collective investment vehicles.

Legal Type Name	Description of Legal Structure	Taxation Structure
Unit Trusts (also known as Investment Trusts)	Unit trusts are registered managed investment schemes administered by a Responsible Entity.	Distributes all income and realised capital gains to be taxed in the hands of the unitholder. The unit trust is not taxed. Capital gains are assessed at the time of the sale of units in the unit trust.
Superannuation Funds (including multiple investment options offered by one Superannuation Entity)	Superannuation funds are tax-concessional savings vehicles used to save for retirement. They receive contributions from either an individual or an employer. The trustee of the fund holds assets on the member's behalf until transfer to another fund, retirement, or another prescribed condition of release.	Assessable fund income is taxed at a maximum of 15%, with capital gains on assets held for at least 12 months assessed on two-thirds of the gain, i.e. at 10%. Tax is assessed and paid within the fund and not distributed. The actual tax rate may be lower than 15%, depending on what deductions or imputation credits are utilised. *https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/tax-and-super* has a full description of tax on superannuation.
Allocated Pensions (including Term Allocated Pensions)	Allocated Pensions are a form of account-based pensions which are designed to pay a regular income stream to those in retirement. An allocated pension may be set up as a segregated account within a Superannuation Fund.	Income generated from assets in an Allocated Pension is free of income tax at the fund level. While pension payments are made, no investment income is distributed with these payments. Imputation credits are collected within the fund.
Allocated Annuities (including Term Allocated Annuities)	This is an insurance policy income stream. The vehicle provides a guaranteed income over a specified term, generally either a lifetime or a set number of years.	Income generated from segregated pension assets is free of income tax at the fund level.
Investment Bonds (also known as Insurance Bonds)	Investment bonds are life insurance policies and can be issued by life insurers and friendly societies. These policies originally had a life insurance component, but today are predominantly investment vehicles.	Assessable fund income is taxed at the corporate rate of 30% provided the bond is held for 10 years—more limited benefits are available if the bond is held for a minimum of eight years. The bond does not distribute income during this period and no additional income or capital gains tax is payable on withdrawal after 10 years.

Number of Funds

The following analysis is based on all discrete classes of a fund appearing on the Morningstar database across the following legal types: superannuation, investment trusts, pension and annuity, and investment bonds. These numbers include multiple investment options offered by the same legal entity. For example, at 31 December 2014 APRA reported 252 Registrable Superannuation Entities (RSEs), but these RSEs issue several thousand investment options for both superannuation and allocated pensions.

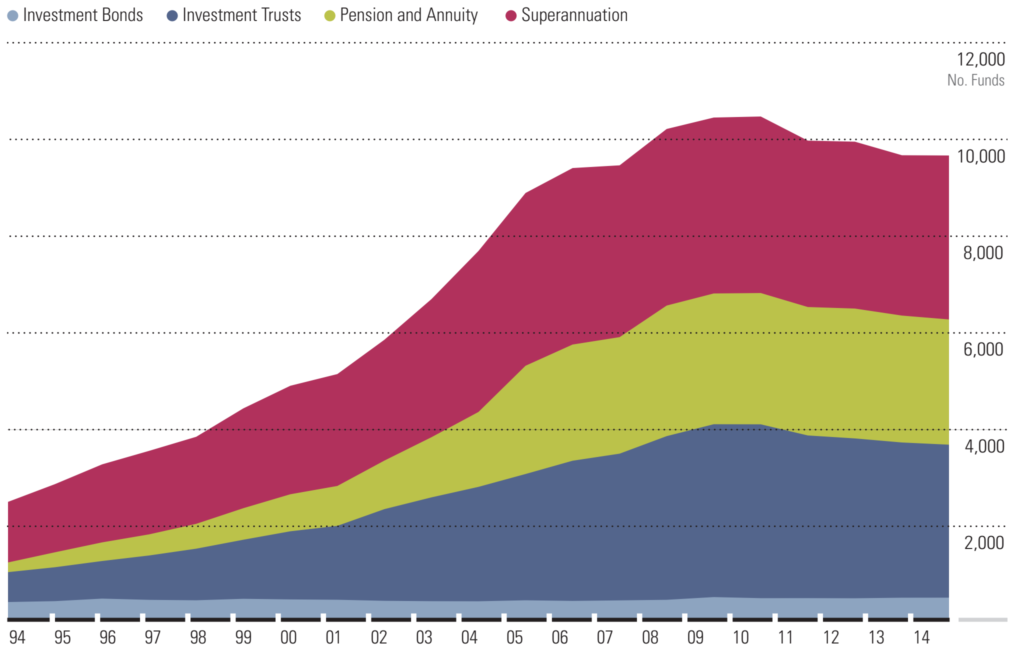
- Morningstar tracked 9,297 active share classes at 31 December 2014. Over the course of 2014, 344 funds were created and 393 liquidated or merged. The majority of mergers and liquidations were pension/annuities and superannuation funds. Investment trusts accounted for 42.0% of newly-created funds in 2014.

- 16,431 funds were created and 8,090 liquidated from 1989–2014, resulting in a net increase of 8,341 funds. The greatest number of liquidations occurred over 2010, with 1,312. (The majority of these were related to the consolidation of funds following an acquisition.)

- There has been a clear period of consolidation since 2011, with net decreases in the number of active funds—fund terminations on the Morningstar database have consistently exceeded fund additions. Much of this has been driven by consolidation following previous merger and acquisition activity.

- The industry continues to provide a diverse set of investment options and tax structures to meet the varying needs of investors.

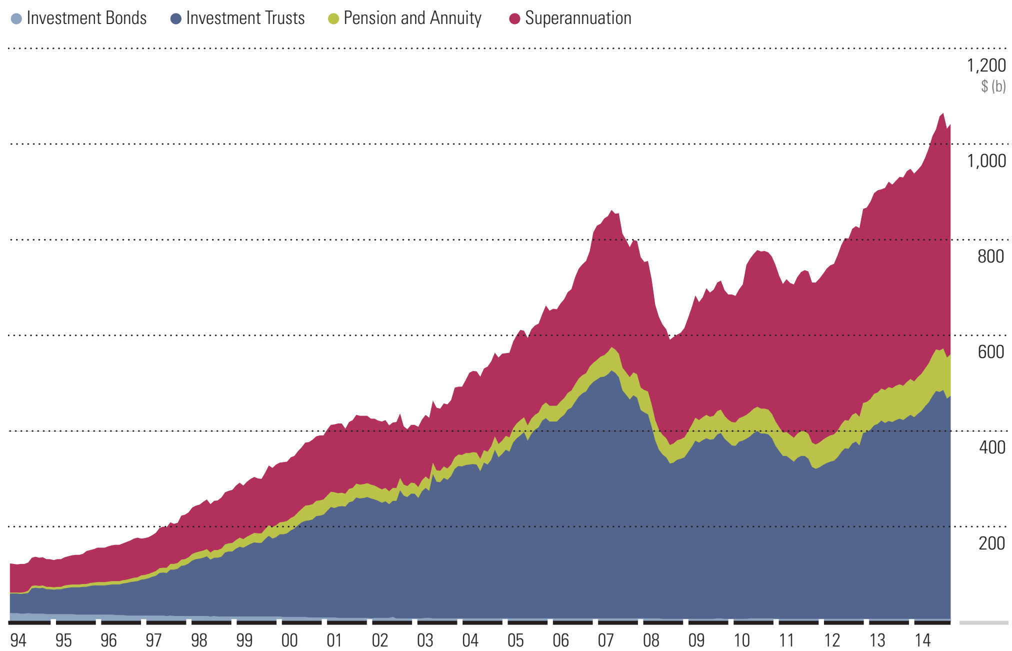
Figure 9 Changes in Number of Australian Managed Funds by Legal Type, 1994–2014



Source: Morningstar

While the overall number of fund options has fallen since 2011, the overall level of Australian managed fund assets has increased (Figure 10). Fund managers are clearly achieving efficiency gains, as a growing pool of assets is being managed within a smaller number of options. Figure 10 also shows the importance of investment trusts and superannuation fund options as the favoured investment types. Importantly, investment trusts can be held by superannuation entities, so the source of assets attributable to superannuation and allocated pensions is even greater than that shown.

Figure 10 Changes in Australian Managed Fund Assets by Legal Type, 1994–2014



Assets calculate as the sum of the assets held in funds listed on the Morningstar database. Figures are unconsolidated and double-count some assets. They should be considered for trend purposes only.
Source: Morningstar

Percentage of Funds

Another way to look at the Australian managed funds industry is by the percentage of funds within each legal type. There have been distinct changes to the composition of the funds industry since 1994.

- Superannuation funds have contracted from 51.8% of all funds at 31 December 1994 to 35.4% at 31 December 2014. This is mirrored by the number of RSEs reported by APRA falling from 1,245 in 2004 to 258 at the end of 2014.

- Pension and annuity funds have increased from 8.3% to 27.0% of managed fund options. The expected growth of post-retirement assets will mean that these products will continue to remain a focus.

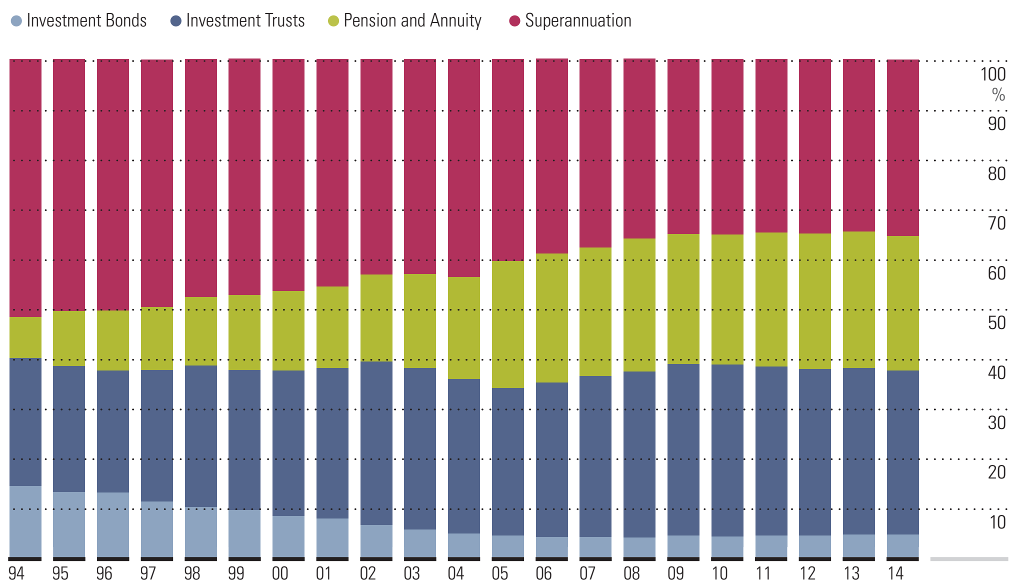
- Over the same period, investment trusts' share of all managed fund options has grown from 25.6% to 33.0%.

- These trends are unsurprising given that industry consolidation has affected superannuation products more than investment trusts, and the existence of the trend to using wholesale investment trusts as investment options within umbrella superannuation arrangements.

- The average fund size for investment trusts at 31 December 2014 was A$145.5 million, followed by superannuation options at A$117.0 million, and pension and annuities A$34.3 million.

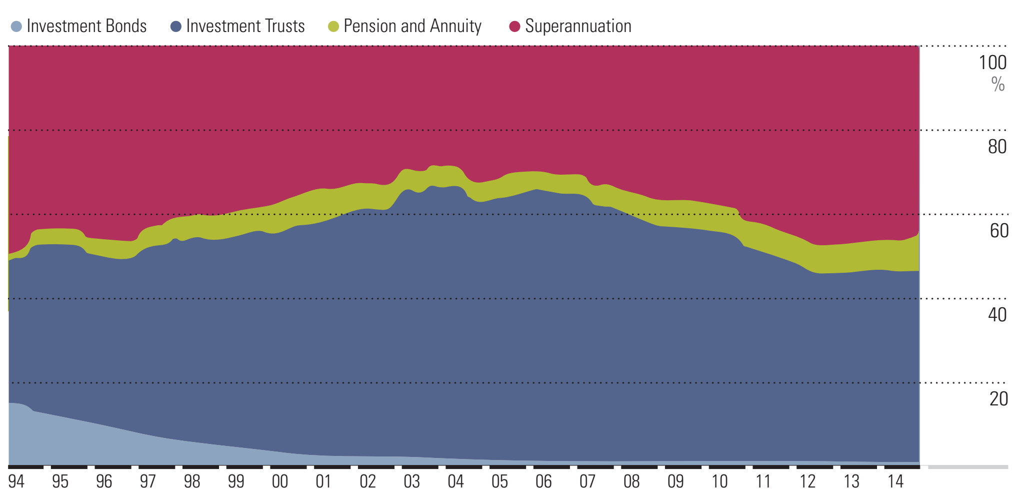
- The median fund size for investment trusts at 31 December 2014 was A$17.5 million, followed by superannuation options at A$8.1 million, and pension and annuities A$2.8 million.

Figure 11.1 Changes in Percentages of Australian Managed Fund Options by Legal Type, 1994–2014



Source: Morningstar

Figure 11.2 Asset Size

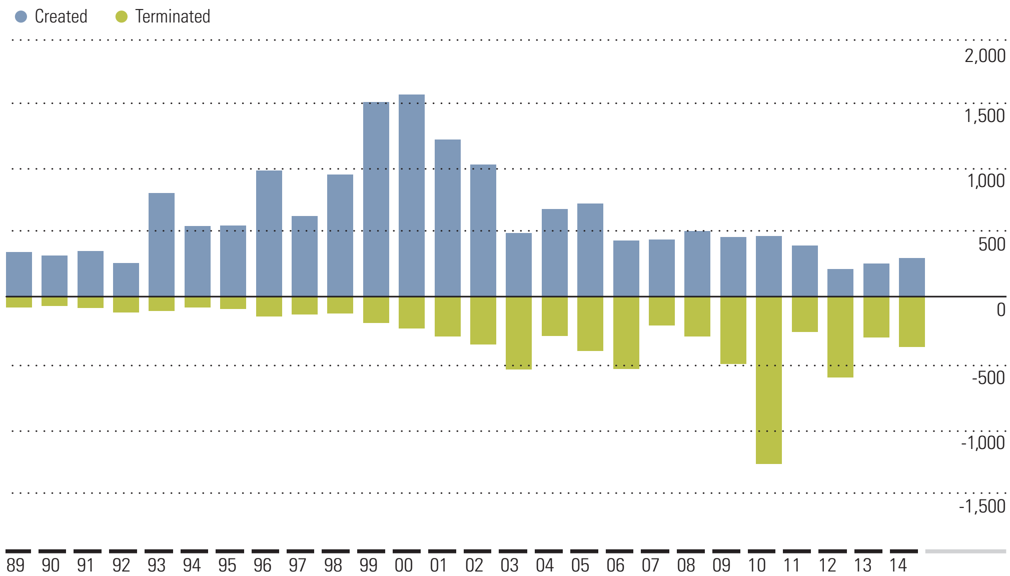


Source: Morningstar

Fund Lifecycles

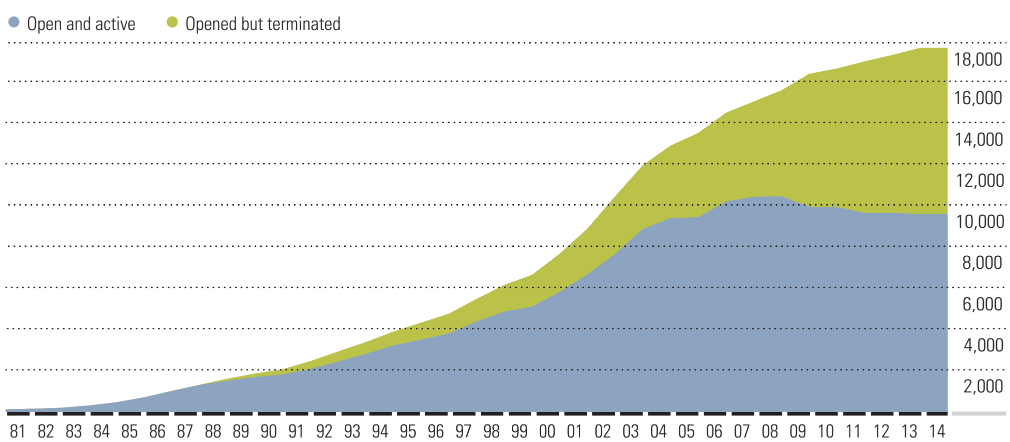
The following charts show the activity happening beneath the surface, with funds being created and terminated on a regular basis. Industry consolidation and product reviews continue to drive fund liquidations, while a combination of new managers and product offerings have continued to produce a steady stream of new funds coming to market.

Figure 12 Changes in Numbers of Australian Managed Fund Creations/Terminations, 1990–2014



Source: Morningstar

Figure 13 Aggregated Changes in Number of Australian Managed Fund Creations/Terminations, 1981–2015



Source: Morningstar

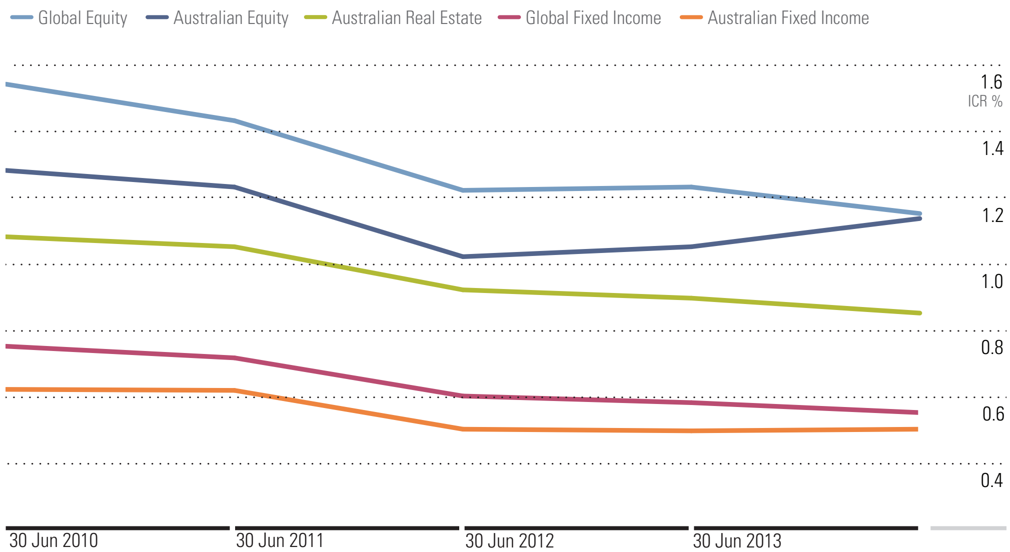
Fees

- This analysis uses the Indirect Cost Ratio ('ICR') measure to analyse changes in median fees over time. The ICR is the sum of the expenses incurred expressed as a percentage of the average net assets throughout the year. The ICR includes management and performance fees as well as legal, accounting, auditing, and other operational fees. This report uses published ICRs available in product disclosure statements.

- Figure 14 tracks the median ICR of investment trusts on the Morningstar database segmented by the major asset classes. The graph shows that median ICRs have generally been trending down for investment trusts. This is across the board for the major asset classes. The median ICR for global equity trusts fell 0.39% over the period 30 June 2010–30 June 2014, and fell 0.15% for Australian equity trusts over the same period. The cost of investing in domestic compared to global assets has converged to be on par in 2014. Median fees for global equities and global fixed income trusts were more expensive in 2010 than their domestic counterparts, this had all but disappeared by 2014.

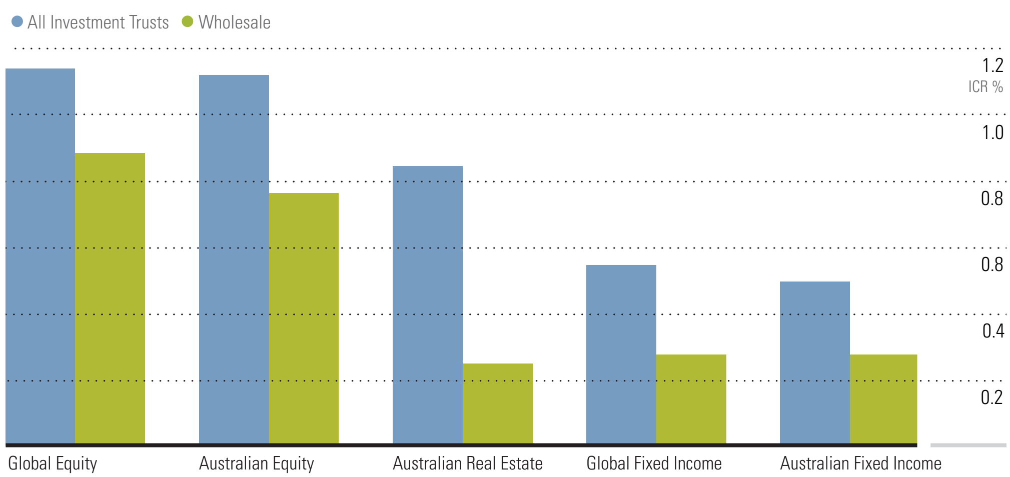
- Importantly, these are published fee rates. They do not include the impact of any fee rebates, which would reduce the stated figures. These figures are for investment trust vehicles only, and do not include individual mandates, which are typically managed at lower fee rates than the wholesale rates shown in Figure 15.

Figure 14 Changes in Australian Investment Trust Median Fees by Major Asset Class, 2010–14



Source: Morningstar

Figure 15 Median Fees for Wholesale Versus All Investment Trusts, 2014



Source: Morningstar

International Comparison

Australia continues to compare favourably at an international level for retail managed fund fees. In the 2015 Morningstar Global Fund Investor Experience Report, which examines the experiences of investors in investment trusts across 25 different countries, Australia ranked equal highest (providing the best experience for fund investors) in the Fees and Expenses category, with the United States and the Netherlands.

Figure 16 Morningstar Global Fund Investor Experience Report: Overall Grades for Fees and Expenses

A	A–	B+	B	B–	C+
↑ Australia		↑ Korea	↑ Denmark	✶ Finland	↓ France
↑ Netherlands			↑ New Zealand	↓ India	↓ Thailand
= United States			↑ South Africa	↓ Norway	
			= Sweden	= Spain	
			↑ United Kingdom	= Switzerland	

C	C–	D+	D	D–	F
= Belgium	↓ Singapore	↓ China		↑ Canada	
↓ Germany		↓ Hong Kong			
↑ Italy		= Japan			
		↓ Taiwan			

↑ Improved ↓ Declined = No Change ✶ New

The report included an assessment of ongoing expense ratios, upfront loads or commissions, performance fees and the availability of funds without commissions. Figure 17 looks specifically at how ongoing expense ratios in Australia for four major fund groupings compared to the average of fund fees across the 25 countries in the survey.

Figure 17 Asset weighted annual median expense ratios for locally Domiciled and Available for Sale ("AFS") funds (%)

	Fixed-Income	Equity	Allocation	Money Market
Australia (Domiciled)	0.58	1.18	0.82	0.40
Overall Average (Domiciled)	0.78	1.64	1.39	0.39
Overall Average (AFS)	1.17	1.81	1.53	0.22

Source: 2015 Morningstar Global Fund Investor Experience Report

At the institutional level, research undertaken by the Financial Services Council ('FSC') to ascertain the relative level of fees charged in Australia compared to other parts of the world indicated a similar level of competiveness. Specifically, the FSC conducted a survey of several large global fund managers on their fees charged for the same products in Australia and other jurisdictions. The surveyed managers' funds under management in Australia totalled approximately A$110.0 billion and A$7.1 trillion globally.

The methodology was as follows. To achieve a meaningful comparison, the FSC collected the actual fees charged (and not the published rates) on products sold in multiple jurisdictions—comparisons were made on the same product sold around the world. The products surveyed were global equities, global property securities, emerging markets equities, and global bonds. The jurisdictions compared were Australia, the US, Europe ex-United Kingdom, the UK, Asia ex-Japan, and Japan. As fee levels can vary on the basis of the size of the investment, the fee rates collected were based on a $100.0 million mandate.

The results showed that:

- fee rates for global equities trusts were almost 11 basis points (or 20.0%) lower on average in Australia than the other jurisdictions;

- fee rates for global property securities trusts were six basis points (or 12.0%) lower on average in Australia than the other jurisdictions;

- fee rates for emerging markets equities trusts were 13 basis points (or 17.0%) lower on average in Australia than the other jurisdictions; and

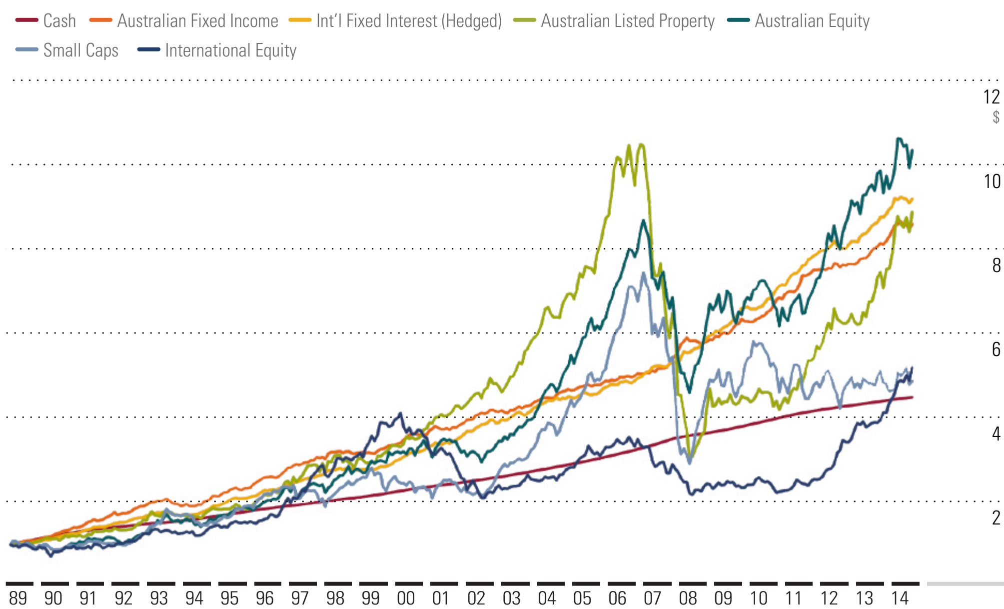
- fee rates for global bond trusts were on average about equal to other jurisdictions.

These results, comprising data from some of the world's largest fund managers, show that investment management fees charged in Australia are among the world's lowest (if not the lowest). Anecdotally, the FSC heard from several fund managers that on most occasions, approval had to be sought on a regular basis from head office to lower the fees charged in Australia in order to win business. While reaffirming Morningstar's results, the FSC survey shows that Australia has lower fees than even the United States on average based on a $100.0 million mandate.

Further, if the fees charged to Australian investors are lowered significantly further (with a wider gap between Australia and overseas jurisdictions), there is a risk of these global managers removing their products and investment capabilities from Australia. This would reduce competition and potentially adversely affect investors.

Appendix

Figure 18 Long-Term Growth of Major Asset Classes, 1989–2015



Source: Morningstar

Cash—RBA Bank accepted Bills 90 Days; Aust. Fixed Interest—Bloomberg AusBond Composite 0+ Yr TR AUD; Intl. Fixed Interest (H)—BarCap Global Aggregate TR Hdg AUD; Australian Listed Property—S&P/ASX 300 A-REIT TR; Aust. Equity—S&P/ASX 200 TR; Small Caps—S&P/ASX Small Ordinaries TR; Intl. Equity—MSCI World Ex Australia NR AUD