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Super Fund Mergers: How do you maximise value and avoid pitfalls?

Asset management insight

How do you maximise value and avoid pitfalls for superannuation funds?

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What would you like to grow?

If you are considering a fund merger, maximising value for members is paramount. You also need to be aware of and avoid potential pitfalls.

To merge or not to merge? That has been the question at the forefront of the minds of superannuation fund trustees around Australia in recent years. Increasingly over the last 12 months, the answer has been "yes", followed by, "but we had better make it quick". This question will remain an important consideration for trustees in coming years, even as time runs out on the Federal Government's tax loss rollover relief.

Whilst we observe the Federal Government (through its response to the Cooper Review and the "Stronger Super" initiatives) seeking to encourage trustees to identify opportunities for better scale and efficiency in their funds, the focus of the industry should continue to be to take a reasoned and pragmatic approach and consider if the *"Bigger is better"* mantra applies to their circumstances.

Fundamentally, trustees have to undertake a realistic assessment of the member benefits of a merger whilst knowing what the intrinsic challenges are in realising those benefits. The application of the tax rollover relief may have made the case for a merger easier, however, there are a number of factors that need to be carefully considered if real benefits are to flow to members as a result of a merger.

So how do trustees determine which funds to merge with? And how do they provide the most benefits for their members and realise those benefits?

A merger which merely replicates all aspects of a target fund in a separate division of the merged fund is a merger in name only and is unlikely to provide significant benefits for members. It requires much more: the melding of policy and strategy, structure and process, culture and behaviour.

From a transferee fund perspective, trustees need to ensure existing members will benefit from any newly merged fund, both financially and otherwise. Target fund trustees should consider how to ensure their members receive not just equivalent rights as legally required by successor fund transfer rules, but enhanced benefits.

Comparing our experiences from mergers across a range of industries, super fund mergers need to consider implementation considerations as early as possible to ensure that they have realistic synergy and timeline expectations. For example, legal obligations for trustees and member communication are considerations which may not feature in other industries but are vital for a super fund merger. Also, simple synergy estimates (e.g. adoption of the lower of the respective fund's administration cost per member for the merged fund) may overlook implementation challenges like whether the funds to be merged are outsourced to the same or different fund administrators. A generic merger integration approach won't deliver the benefits that the Trustee is responsible for.

Before any detailed planning for a merger occurs, it is critical for the trustees and executives of the two funds to perform a high-level assessment, or "pre-due diligence" of the benefits to members of both merging funds and any potential implementation issues that could cause the merger to fail.

"Pre-due diligence" may include:

- Identification of long term merger benefits (both member and product) through high level understanding of each entity;
- Potential for economies of scale in investment management, administration, service delivery and costs;
- Current income tax or stamp duty opportunities and risks;
- Agreement on composition, or process to agree composition of the merged board;
- Agreement on process for appointing key executives in the merger entity e.g. Agreed CEO of spill of positions;
- Member alignment and branding issues;
- Legal impediments that may exist e.g. Governing rules, constitutions or other legislation;
- Time period over which due diligence and transition are planned and any exclusivity agreements in dealing with each other over this time;
- Agreement on conflict resolution procedures through the merger.

Once both trustees reach agreement of potential benefits for their funds and members from merging, appropriate legal advice should be sought along with consideration of the following 7 key areas as part of a more formal merger due diligence process.

Key Areas	Considerations
High–level review	What are the short and medium-term benefits to members and products? Are there economies of scale in investment management? Are there economies of scale in administration, service delivery and costs? What are the costs/benefits of improved benefit options? Will a merged board and secretariat better manage governance and oversight? Where should savings be invested?
Investment due diligence	Are there material differences between the asset allocation structures of the two funds' investment options? Have all the possible implementation issues (e.g. Transferability of assets, valuation of assets, uncalled capital commitments) been considered?
Group life insurance	How do the target fund's insurance benefits compare to those of your fund? Who will be the insurer for the merged fund? What will the member takeover terms be?
Financial due diligence	What are the key drivers for the potential merger (one-off merger costs, ongoing cost savings and the payback period to recoup these on-off costs)? Has investment and contribution income been analysed for trends and the impacts of those trends? Has the cost base been analysed for potential synergies and adjustments and have realistic assumptions been made?
Governance and risk management	How will governance and risk management be addressed in the merged entity e.g. Function, risk management framework, protocols, consolidated risk profile? Are the risk committee and senior management aware of the key risks facing the merged entity? Are strategies in place to resource and manage risks?
Product consolidation	Is management addressing the key factors that will influence the success or otherwise of the data conversion and migration program? How will administration "black out" periods be managed and communicated to members?
Tax considerations	Has all the information relevant to stamp duty been obtained for each investment (including assets held indirectly through unit trusts operated by third parties)? Do the two funds have different levels of deferred tax assets? If so, have the implications of this been considered? Have the implications of the franking credit "45 day" holding rule and present entitlement of trust distributions been considered? Have the implications of the deductibility of the mergers costs been considered?