

Australian Investment
Management
Survey 2006

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1. Foreword



Peter van Dongen
Partner
PricewaterhouseCoopers
Investment Management and
Real Estate Group

I am delighted to introduce the PricewaterhouseCoopers Investment Management Survey 2006.

We continue to enjoy the sponsorship of IFSA in this year's survey and are delighted to present a survey which builds on the results from last year. This year's survey also includes insights gained from the PricewaterhouseCoopers Global Investment Management Survey 2006, which was completed in a similar timeframe.

The survey comprised a questionnaire, initial discussions with CEOs and a chief executive roundtable meeting. The roundtable meeting was used to debate, challenge and expand the survey findings and was a key part of the process. In total we canvassed 30 investment management organisations of varying sizes and focus as well as being able to draw upon the results of our Global Survey.

Our survey highlights that the industry continues to experience good levels of growth and optimism. But this fast pace of growth comes with challenges. Meeting investor demands, creating sustainable alpha, exploring new distribution strategies as well as achieving an accepted standard for "clear and concise" disclosure are some of the issues that challenge the minds of our respondents. Successful organisations will be those that best manage these challenges on behalf of their investors while meeting the ever increasing needs of regulators and shareholders.

The PricewaterhouseCoopers investment management survey team would like to thank survey participants and in particular the executives who participated in our round table and one-on-one meetings. We appreciate their openness, insight and vision provided on key topics. I welcome feedback on the survey, particularly how it can be improved for the next edition. If you would like any further information regarding the survey, please do not hesitate to contact myself or your usual PricewaterhouseCoopers contact.

2. Executive summary – Key themes

Our survey indicates that CEOs continue to be optimistic about their businesses yet conscious that risks still need to be carefully managed. As firms are looking to adapt to meet increasing and evolving client demands, a new range of highlights and challenges have emerged:

Macro themes

- The industry has enjoyed a period of sustained growth – and continued optimism.
- Simpler mechanisms for rationalising product suites is needed.
- Rationalisation of platforms is expected as competition grows and margins decrease.

Business themes

- Investment managers, in order to meet the demands of increasingly sophisticated investors, need to develop avenues for sustainable alpha at the same time as managing capacity levels.
- Talent continues to be in high demand with star teams rather than individuals now in demand. The focus on retention strategies continues to intensify and needs to be more imaginative.
- Successful organisations will only drive growth by becoming more customer-centric; this requires a focus on measures more sophisticated than customer satisfaction.

Risk themes

- As innovation continues and new complex products are developed, industry participants need to ensure that the emerging risks are well managed simply disclosed and, ultimately, understood by advisors and end users.
- Organisations need to be more involved with their outsourced relationships to ensure processes are aligned.

3. About the survey

Figure 3.1: Size of organisations who responded to the survey

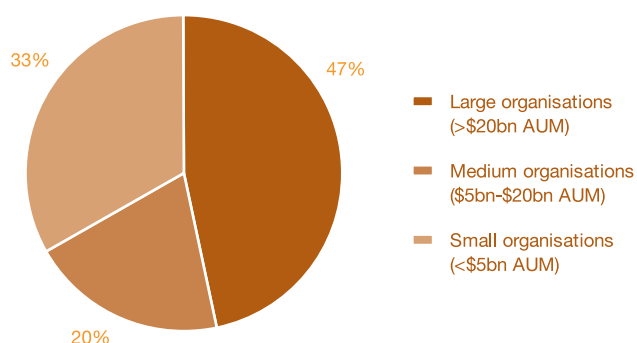
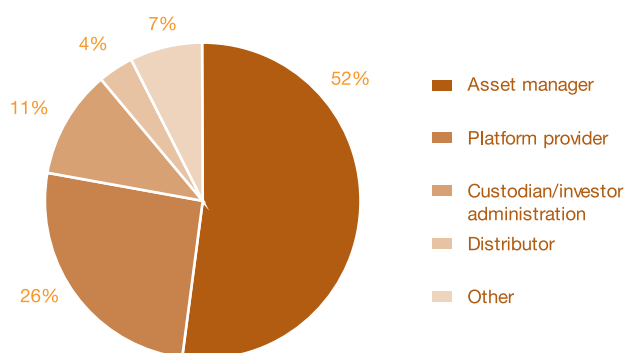


Fig 3.2: Primary focus of respondents to the survey



The PricewaterhouseCoopers Australian Investment Management Survey 2006 was conducted in May and June 2006.

30 investment management organisations, representing assets totalling more than \$700 billion, participated in the survey and/or the chief executives roundtable meeting. The survey was conducted by an in-depth online questionnaire targeting responses from the chief executive officer (CEO), chief operating officer and chief financial officer.

The survey covered seven main areas:

- organisational profile
- CEO views
- distribution and products
- investment process
- operational management
- finance function and management information
- governance, risk and compliance

A key part of the survey process was to hold a series of interviews with CEOs prior to the survey launch to better understand the issues facing the industry. The survey was designed following this important input.

A roundtable meeting with a number of CEOs followed the initial aggregation of the survey results. The roundtable meeting helped to consider those initial results and helped shape the analysis and interpretation. The meeting provided lively debate and extremely interesting and useful insights into the survey findings.

In addition to results from Australian organisations, we have incorporated results from the PricewaterhouseCoopers Global Investment Management Survey 2006, where meaningful comparison can be made. Our Global Survey included results from 81 investment management organisations, representing approximately \$12 trillion of assets under management.

This report provides an overview of the survey findings, together with our analysis and interpretation of the results of the survey and the PricewaterhouseCoopers point of view on some of the important issues facing the industry.

4. PricewaterhouseCoopers' point of view

A trillion reasons to be optimistic

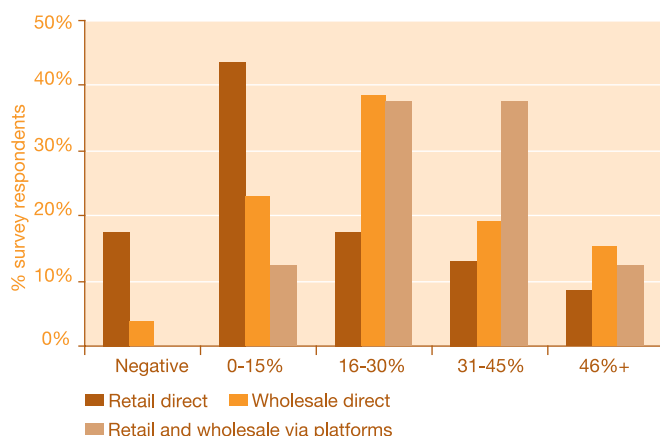
As we undertook this year's survey, external sources and reports confirmed that the Australian investment management industry had officially exceeded the trillion dollar mark¹, cementing its position as the fourth largest investment management market globally² and one in which, on a per capita basis, is the world's largest³.

In addition to the significant inflows that arrive through superannuation, funds under management have been boosted by strong investment markets. Respondents to our survey are buoyant and optimistic for the future.

It is clear that the Australian market is attractive to investors. While the industry may pause to celebrate the achievement of some great milestones and well deserved successes, equally it should be diligent to ensure it meets the many challenges that emerge from this fast-paced growth.

In this section of the report we explore the challenges of this fast-paced growth and the emergence of a "risk gap" – being the difference between actual investment risks (at one end of the investment management value chain) and the understanding of those risks by investors. Our report also looks into some other areas in investment management: talent, outsourcing, platform rationalisation, customers and most admired organisations.

Figure 4.1: Revenue – Expected three year growth

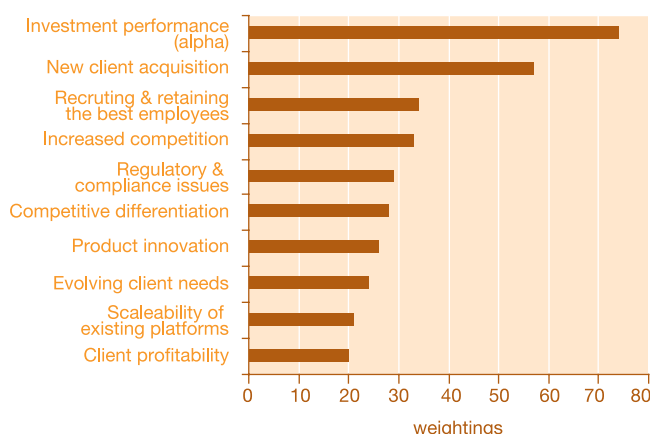


The challenges of fast-paced growth – is there an emerging “risk gap”?

Clearly individual entities will face their own challenges of growth – some of which are reflected in the Detailed Findings section of our survey. But the growth of the industry equally puts a systemic strain on all the links in the intricate value chain that makes up the Australian investment management industry.

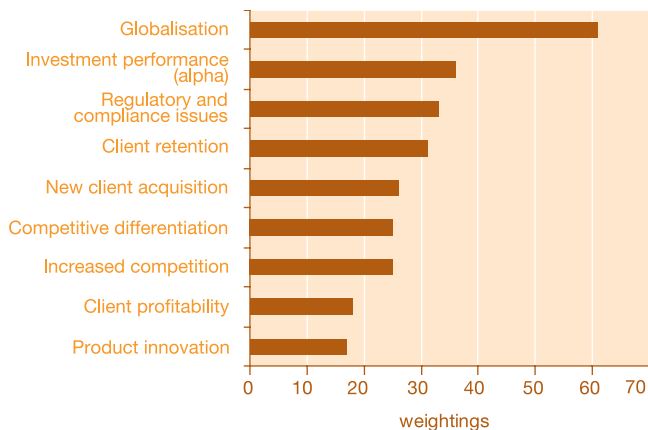
The most significant challenge for investment managers is being able to produce sustainable alpha (see Figures 4.2 and 4.3)

Figure 4.2: Top five challenges – Wholesale clients – Australian Survey



1. Australian Bureau of Statistics March 2006 quarterly report on the managed funds industry
 2. IFSA media release 14 June 2006
 3. The Australian Finance Group Global Funds Management Index

Figure 4.3: Top five challenges – Retail clients – Australian Survey



However, managing “capacity” has become a critical concern, especially with large investment managers whose fund size and buy and sell decisions are driving the market itself, thus eroding some of the potential gains that would otherwise have been available to their investors. Larger organisations may have the teams and processes to make the right calls more often, but sustainable alpha in traditional asset classes is proving to be increasingly elusive.

Some managers have reacted to this capacity issue by limiting or closing certain products to new investors.

But the needs of shareholders, in particular profit growth and appropriate shareholder returns, are not satisfied by closing your books to new investors.

Consequently, investment managers are continuing to innovate and develop new products in other asset

classes. In Australia, we have been leaders in packaging infrastructure assets, and followed global trends in increasing the range and diversity of private equity and hedge fund offerings. More innovative property vehicles have also flourished.

All industry participants have a vested interest in ensuring that the risks implied by the assets acquired and packaged by asset managers are understood throughout all links in the chain, right through to the end user. Recent events such as Westpoint are a reminder that a chain is only as strong as its weakest link. A widening of the “risk gap” between the investment risks at one end, and the understanding of those risks by the investors, will be detrimental to all links in the chain, not just those that seemingly break down.

The industry’s growth, and the drive to new innovative products, increases the inherent risk of a widening “risk gap”.

An important challenge for industry participants remains in the risks that emerge from such innovative products and growth. In particular, are the investment risks well understood by the end investors or by those they trust? Are the communications and disclosures relating to such risks articulated in a way that investors can truly understand the investment risks they take? Is the industry structured and regulated in a way that the end investor’s need for understanding of product risk is satisfied by the disclosure regime imposed on the product manufacturers and distributors?

Simply, is there an emerging risk gap? And who is warning you to “Mind the Gap”?

Who is “minding the gap”?

This particular issue has aspects for all participants to think about – and presents challenges and issues to explore.

Investment managers

Driven by a capacity-constrained, but fast-growing industry, Australian investment managers have proved to be at the very leading edge of innovation. Organisations such as Macquarie Bank and Babcock & Brown, increasingly asset managers, have shown the success that can be achieved by those who innovate. But all the large organisations are innovating and designing new investment opportunities for the unrelenting tide of investment dollars.

The Australian investing public has enjoyed many positives as a result of such innovation. Sophisticated investors in particular have enjoyed the availability of products that can be used to enhance strategies to maximise returns while managing risks.

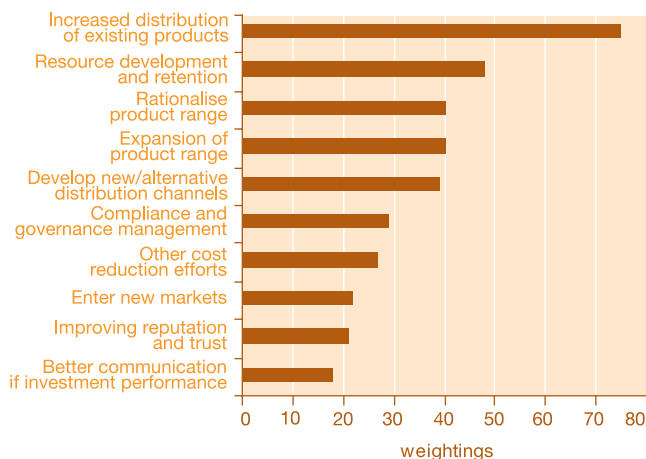
Investment managers are currently grappling with an increasingly complex dilemma. While the momentum for growth and innovation is required to stay ahead of the competition, investment managers must be mindful of their own risk appetite and capacity to manage such risks to ensure they can manage the changing operational risks that accompany innovative products.

Having the very best people and processes obviously helps deal with this issue; but risk management systems need to evolve with these trends. Senior management needs to ensure that resources and time are being used to consider and manage the complex risks arising from these new products.

Disclosures also need to be user friendly. Investment managers query whether the disclosure regime has obscured the important information; a better response would be to determine what the important information is and do their best to properly present it.

Our survey findings also show that while the expansion of the product range is an important priority, finding new/alternative distribution channels is also a top objective of CEOs:

Figure 4.4: Top five key objectives for your business – Now – Australian Survey



The quest for growth has seen new channels being considered – in particular in private client services. Finding the ability to differentiate the offering, particularly from those Australian banks who have a strong hold on private banking, is one of the significant challenges for investment managers.

Investment managers are, however, not looking to compete with the mainstream banking offerings – instead, they are looking to differentiate through products offered and best service. How does one maximise profitability from the innovative product suites being developed? Offer exclusivity to the customers prepared to pay the margins implied in private client services. This may achieve a more profitable outcome for investment managers, and help them manage the ‘risk gap’, by providing the more innovative, complex products more exclusively to those better able to comprehend them.

For both products and distribution, investment managers face an environment of rapid evolution. Organisations need to be able to innovate yet ensure they manage their own risk capacity by making disclosures that are user friendly. Distribution appears likely to become more challenging as tiered offerings and exclusivity of product is channelled to particular market segments.

Regulators and legislators

Clearly, new asset classes pose different, sometimes complex risks. Large infrastructure deals create a myriad of risks for those acquiring the assets – and indeed for those acquiring the interests in vehicles housing them. Similarly, it appears the investors in recent property schemes did not clearly understand the risks associated with their investments.

But the complexity of the disclosures and requirements tend to result in managers being driven by compliance and making administrative disclosures, rather than value-adding disclosure.

In the wash-up of Westpoint, there needs to be clarity about whether sufficient disclosure was made and whether it could have been simpler and more understandable for the investor. ASIC and Treasury have recently issued guidance on disclosures so it is clear that disclosure simplification remains on the agenda – and rightly so. Sophisticated investors do not want to read 80 pages to explain a product and neither does anybody else.

Another consequence of the rapid growth in the industry, and the innovation in product suites, is the proliferation of product and the growing number of unprofitable products. For every \$ of revenue, Australia prices 15 more unit prices than our US counterparts.

The current cocktail of superannuation inflows, capacity (and hence alpha) constrained asset classes, reasonable shareholder demands for profit growth and a proliferation of new and innovative products is a heady mix when combined with legislation that inhibits rationalisation. The new does not replace the old – it just adds to it. We understand that the legislators are looking at this important issue. Lets hope a solution arrives quickly.

Platforms

Along with the advisers/planners, the platform providers play an important role of gatekeepers between the product providers and the investing public. The platform providers have clearly created a blurring of lines between retail, mezzanine and wholesale product, creating a significant opportunity for retail investors to access wholesale product.

While the differentiation between wholesale and retail product has been predominantly fee based, the platform providers have been instrumental in creating access, without being an apparent contributor to managing the risk gap. But clearly their role has become more complex. There are literally thousands of products that could be offered at a platform's point of sale – yet they seek to offer a wide and diverse range, but in a discerning way. Accordingly, their offerings are in the hundreds, not thousands. The criteria for being accepted on a platform is being constantly reviewed; their investment committees are being increasingly challenged by the number and types of products being offered.

As manufacturers continue to address capacity and respond to demand for greater alpha by innovating and presenting more complex products, the challenge for the platforms will be to understand the more complex risks being presented, and satisfying themselves that such risks are being fairly presented, before providing shelf space for such products.

The role of the platforms in responding to the risk gap is an interesting one. At this point, it would appear there is a higher reputational risk than direct legal risk if this risk is not managed well. Yet as we see elsewhere in our survey, there is an expectation of margin compression and consolidation of platform providers. Accordingly, reputations matter. It seems platform providers are alert to such risk and their investment committee's factor in all manner of issues, including product risks, before providing shelf space. As products continue to become increasingly complex, having the right people consider such issues, and maintaining their diligence, will be well worthwhile.

Advisers

It is alleged that certain planners who advised their clients into Westpoint did so to obtain the lucrative up-front commissions. If this argument is sustained, the many excellent planners of high integrity have been badly let down by their colleagues. But in the investment public's eye, the stain is spread to the wider industry.

Whether the advisers understood the investment risks they were recommending to the investors will play out. Clearly, they should have. Whether such risks were clearly and concisely explained to those who trusted them is also to be explored. However it falls, there are lessons to be learned.

In light of these recent events, the issue of adviser and planner fees and commissions has been re-explored, but seemingly to no outcome.

It is normally true that the highest margins achieved on particular products emerge when they are new and innovative. As replica and similar products emerge and compete, innovative products become yesterday's product – and the underlying margins reduce. While high margins prevail in this competitive market, the ability of the product manufacturers to assign up-front and lucrative trails to those that bring the dollars through the door will remain.

While many will argue the validity of commission-based fees, it is inescapable that such fees create a conflict of interest for the advisers/planners. And while newer, innovative products generate the higher margins, it may be fair to assume that some may seek to exploit that conflict by offering large incentives. The fear, and the apparent reality, is that the more unscrupulous are tempted. Who wins?

It is crucial that investment managers and advisers set in place a system that identifies and manages these conflicts to the point of having a better informed investor.

ASIC have recently issued guidance around these issues including a discussion paper on managing conflicts of interest.

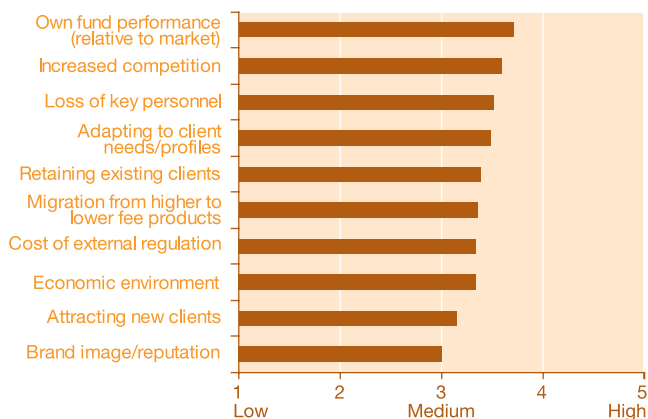
Adviser compensation remains a good debate, and one that deserves resolution.

Talent continues to be in high demand

Our survey shows that recruiting and retaining the best personnel is in the top three challenges facing wholesale clients (see Figure 4.2).

When asked to rank factors that present the greatest threat to organisations' profit objective over the next three years, the loss of key personnel was third in a list of 16 factors, with the top ten listed below.

Figure 4.5: What are the greatest threats to profit over the next three years? – Australian Survey

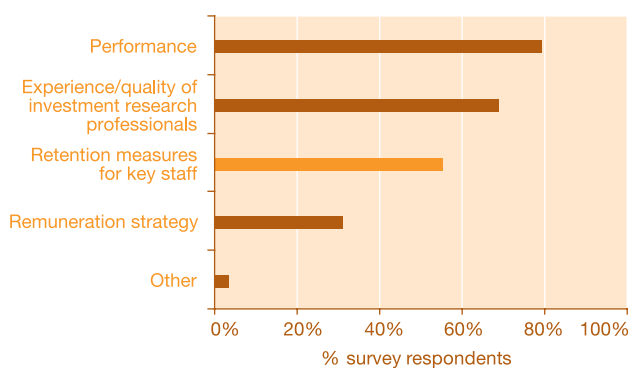


The growth in the industry has exposed a widening talent shortfall. With top talent in demand we are seeing considerable upward pressure on remuneration, with this starting to flow through to lower levels. Most of the change in remuneration is still being driven by large increases in cash bonus plans.

Interestingly, we are starting to see more examples of star teams being poached, rather than star individuals. This seems to be driven by two key factors - a need to grow the business by moving quickly into new product areas, best facilitated through recruiting a team with the necessary skills; and the realisation that it is quite common that a star individual will find it difficult to replicate their performance at another organisation.

When asked to select the most important measures to evaluate their investment performance of their business, 55% of survey respondents selected retention measures for key staff (up from 26% in the prior year).

Figure 4.6: What are the most important measures used to evaluate the performance of your business? – Investment process – Australian Survey



With many experiencing the considerable negative impacts of losing key talent we are starting to see more businesses introducing long-term strategies to retain their talent. Outlined in Figure 4.7 below is what we believe retention strategies should include.

Figure 4.7: PricewaterhouseCoopers Retention Strategy

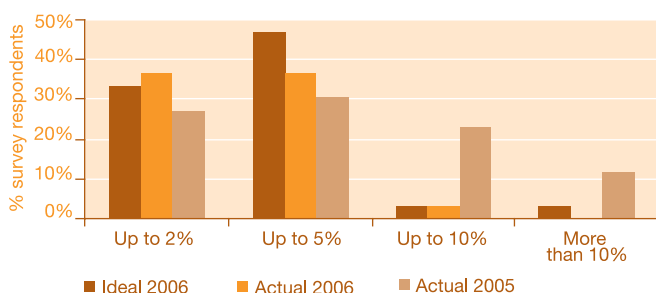
Leading edge retention strategies should focus on a number of key areas:

1. Identification of key talent and those most at risk of leaving;
2. Some tailoring of the reward offering to individual needs and wants;
3. Moving to a longer term remuneration framework – in some cases 5 years plus, ie using reward to lock-in key talent over the business planning cycle to provide business certainty;
4. More emphasis on long-term incentives, with considerable upside, typically well in excess of the reward available under cash bonus plans;
5. Negotiating with key teams and not just individuals; and
6. Thinking beyond just financial rewards, eg career development, training opportunities, secondments, non-cash benefits, extended leave etc.

Outsourcing monitoring costs fall

When asked to state the ideal and actual amount (as a percentage of contract value) spent on managing outsourced relationships, most respondents thought a spend of between 2% and 5% is ideal. Somewhat surprisingly, over 30% of respondents spend less than 2% of the contract value of their outsourcing relationship on monitoring and managing the performance of the outsourcer. About the same percentage thought such a level was ideal.

Figure 4.8: How much do you spend as a percentage of the total contract value managing the outsourced relationship? – Australian Survey



It seems everyone can quote the mantra of not being able to outsource responsibility, but it appears less are prepared to invest sensibly to work with the outsourcer to manage their own risk, instead relying on the power of contract law. Of course contracts and SLA's will not of themselves protect reputations.

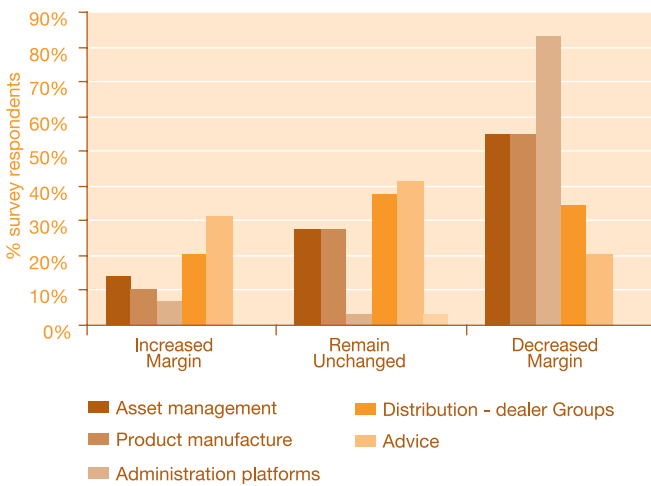
In our view, this continues to be an important issue. Investment managers do not tend to think about their outsourcer's capacity and ability to manage new products. Outsourcers are generally not heavily involved when new and innovative products are being developed, or when the PDS for such products is being prepared.

Outsourcing is a critical business issue for many investment managers. Each should satisfy themselves that they are working closely enough with their provider to give that provider every chance of helping their clients to get it right each and every time.

Platforms – rationalisation is expected

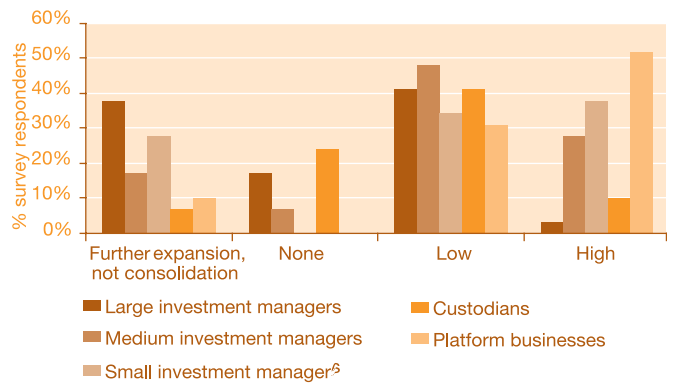
While our survey indicated that platforms were seen by CEOs as the area that has experienced (and will continue to experience) the highest levels of growth (see Figure 4.1), CEOs also indicated that platforms are the point on the value chain that will most experience decreasing margins.

Figure 4.9: Expected change in margin over three years – Australian Survey



With a high number of platform providers competing for market share, we believe continued pressure on margins will force consolidation in this area, favouring the larger players who have the scale to survive.

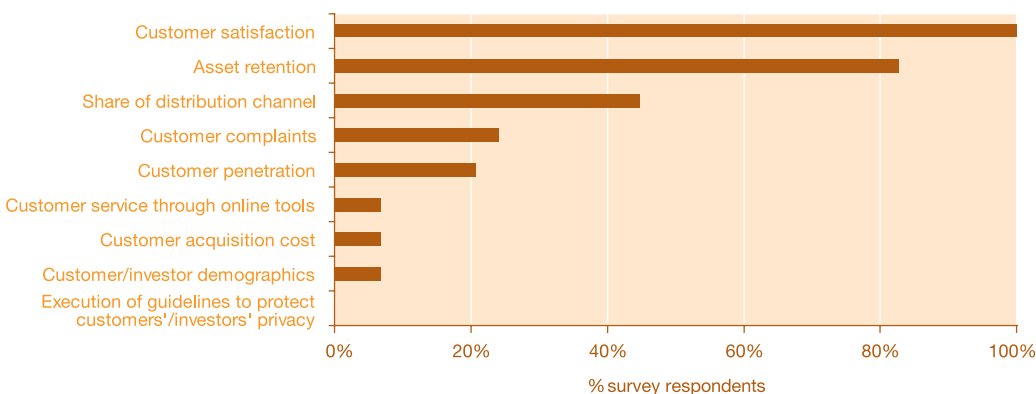
Figure 4.10: Consolidation expected over the next three years – Australian Survey



Are your customers directing your strategy?

Our survey asked respondents to identify the most important measures used to evaluate the performance of their business. 100% of respondents indicated that customer satisfaction was an important metric, yet only one quarter indicated customer complaints.

Figure 4.11: What are the most important measures used to evaluate the performance of your business. – Client relationship management – Australian Survey



We believe that successful organisations will only drive growth performance by becoming more customer-centric through placing the customer at the heart of every decision. This requires a focus on customer-centric measures beyond customer satisfaction. In our view, customer satisfaction is of itself a poor indicator of a customer's likelihood to provide future value. Consider how many products and services you are currently satisfied with, and yet would change with very little thought; such as restaurants, shoe brands or credit cards. And how your loyalty would change should you have to make a complaint. Many consider retail financial services to be "stickier" with respect to customer retention. But times change - consider the churn in the home loan market for instance.

Customer and staff engagement should be high on the executive agenda, because just meeting expectations isn't always enough. Exceeding customer expectations and engaging them to build long-lasting relationships is at the heart of increasing a customer's discretionary (and investment) spend with your business. To achieve this,

knowing the current and future value of customers is critical. Our recent PricewaterhouseCoopers Customer-centric Growth Survey with the Economist Intelligence Unit revealed a strong global trend towards collecting data on future customer value; but to be truly effective, forward looking metrics must go beyond direct cash flows and include predictive measures of advocacy and loyalty.

Measuring the strength of your future relationship with customers, rather than their previous satisfaction, requires measuring complaints, their propensity to stay and buy future products and, most valuable of all, their propensity to proactively advocate your company to other people. Through measuring this, a moderate value customer who recommends three additional customers of the same value is often worth more to a company's growth performance than a single high value customer. Measuring the impact of these customers, along with the customer information and staff engagement behind them, will be a much better measure of future performance than knowing how satisfied your customers have been.

Most admired organisations

Our survey asked respondents to list which of their competitors they most admired and why. The results highlighted the following organisations:

| Organisation | Main reasons given |
|----------------------|---|
| Macquarie | Investment innovation and distribution capability |
| Colonial First State | Investment performance and scale |
| AMP | Successful long term performance |
| BGI | Profitability and focus on service |
| Perpetual Trustees | Marketing and sales focus |

Other organisations prominently mentioned included Maple-Brown Abbot, Platinum, UBS and Wellington.

5. Detailed survey findings

Contents

In this section we provide a summary of findings from our survey in the following areas:

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CEO Views

Growth and growth expectations

Our survey results show that the investment management industry continues to experience good levels of growth. Assets under management grew by 17%⁴ in the current year (10%⁵ globally) and the outlook for future growth is also optimistic. Approximately 40% of survey respondents expected growth of more than 30% in three years time.

These results are consistent with our Global Investment Management Survey 2006 (Global Survey) which also showed optimism and increased growth expectations.

Figure 5.1: Assets under management – three year growth – Australian Survey

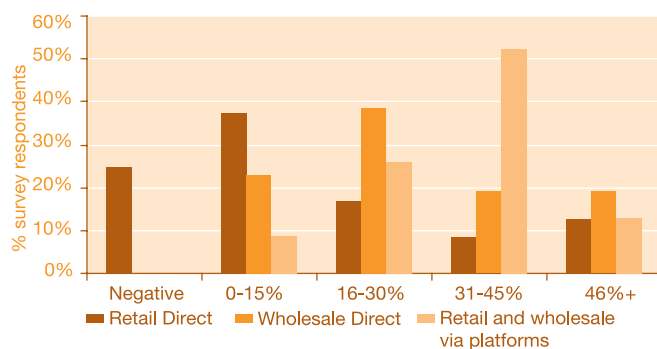
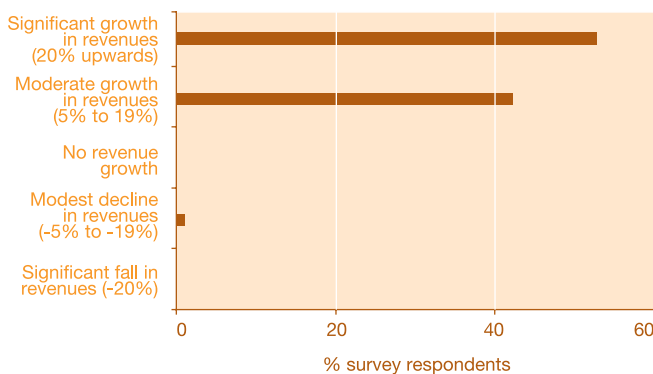


Figure 5.2: Which of the following statements best describes how you expect your business to perform over the next three years? – Global Survey



The continued dominance of product via platforms is a feature of the growth expectations, while the expectation of many is for below average or negative growth in directly available retail products.

Several good years of market performance have contributed to these growth levels, which is being translated into strong revenue growth amongst participants. In addition, other than for direct retail, optimism prevails with significant growth expected over the next three years. Indeed, the growth expected in wholesale and via platforms more than counters the expected slow down in direct retail. Our discussions with CEOs confirmed their optimism to achieve these growth forecasts. However, since the survey and the discussions, stock markets have declined and world events are impacting the markets. The markets currently look skittish and uncertain. Optimism may need to be tempered.

Our research and discussions with CEOs highlight this growth is expected to be fuelled by several factors. A leading factor will be increased saving levels especially with changes to superannuation presented in the May 2006 budget. In particular abolishment of tax on superannuation benefits for the over 60's, changes to reasonable benefits limits on lump sum payments and relaxation of time limits when superannuation balances must be drawn, will mean that superannuation funds are the best choice for retirement assets (if they haven't already been).

In addition, as the many years of compulsory superannuation are having its desired effect, the level of disinvestment by those retired is declining. People are working longer and the size of savings and superannuation balances have grown such that retirees are more able to live off income generated from their savings without eroding capital balances.

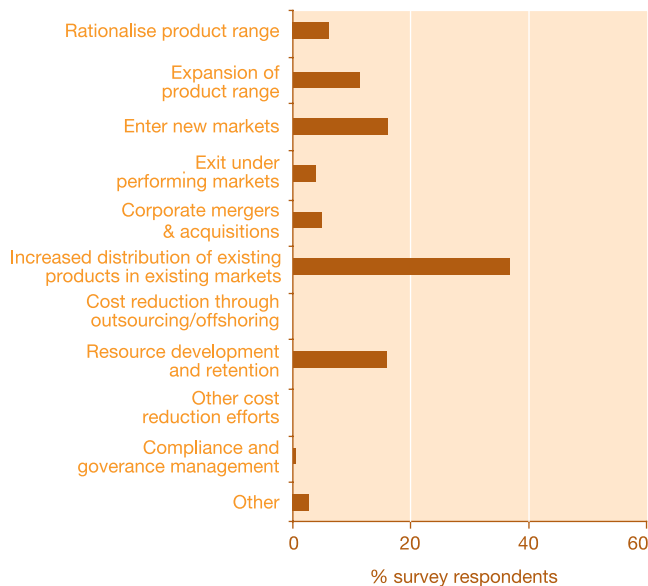
The focus of Chief Executives when asked to list their top five key objectives for their business in three years time showed increasing distribution of their existing products in existing markets as well as developing new/alternative distributions channels and entering new markets as the main areas. By contrast cost reduction was not seen as a priority.

4. Australian Bureau of Statistics March 2006 quarterly report on the managed funds industry

5. Global mutual fund assets growth, 2006 Investment Company Fact Book, Investment Company Institute

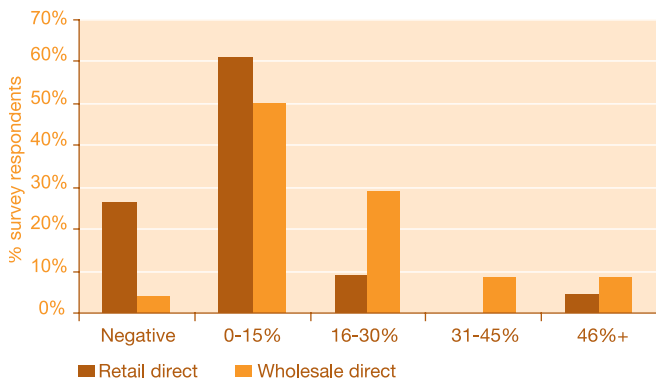
These results were consistent with our Global Survey as highlighted in Figure 5.3 below.

Figure 5.3: Please indicate the top three key objectives for your business in three years time – Global Survey



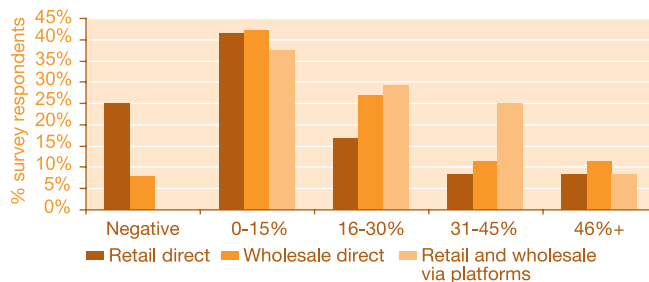
One CEO commented to us that such is the demand for investment opportunities, just by the strength of his brand he can put on new products and get reasonable fund flows. This growth is also reflected in the graph below that showed that the number of funds offered is still expected to increase in three years time.

Figure 5.4: Increase in number of funds offered – Three years time – Australian Survey



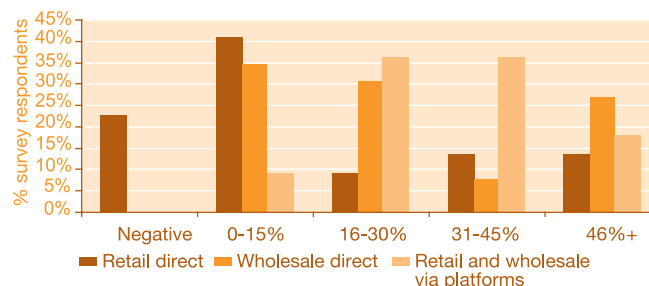
Customer numbers have remained stable in the year for retail direct and wholesale direct clients but have increased for platforms, with increases in three years time expected across the board particularly via platforms.

Figure 5.5: Customer numbers – Three year growth – Australian Survey



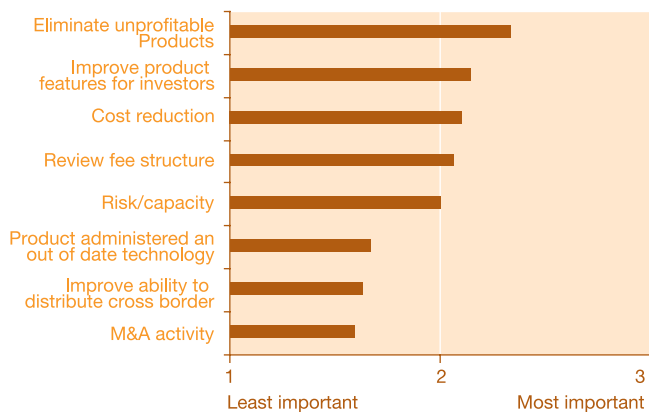
Profit growth has also been strong, with approximately 30% of survey respondents experiencing growth in excess of 11% in the current year (slightly down on last years survey) and over 50% of respondents expecting growth in excess of 16% in three years time, particularly from wholesale direct and platforms.

Figure 5.6: Profit growth – Three year – Australian Survey



It is also clear that in order to achieve this growth, product suites need to be managed appropriately. CEOs listed rationalisation of product range in their top 3 key objectives for their business now and in three years time (see Figure 4.4). While tax and legislative change is needed to simplify a process that currently deters rationalisation, it is evident the drive for product rationalisation continues and is needed to eliminate unprofitable products, improve product features for investors and for risk/capacity reasons.

Figure 5.7: Key drivers for product rationalisation – Australian Survey



Costs

While a high proportion of respondents have indicated a cost to income ratio (measured as operating expenses/operating income) of less than 30%, there continues to be a large spread of results with over 30% of respondents indicating a cost to income ratio of greater than 55% in the current year.

The expectation of those surveyed is that this ratio will decrease over the next three years. Given the revenue expectations, this alone might drive better performance on this measure.

Figure 5.8: Cost to income ratio – Current year – Australian Survey

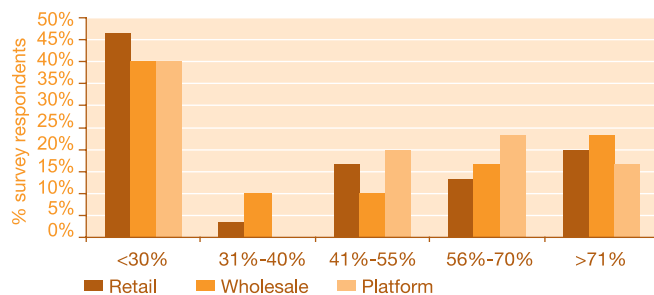
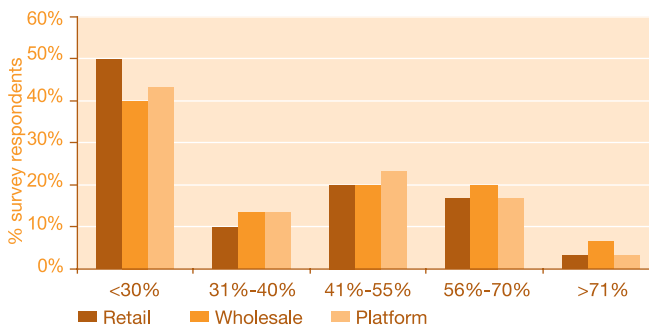


Figure 5.9: Cost to income ratio – Three years time – Australian Survey



When asked in what areas of their business are most likely to achieve significant cost efficiencies, CEOs highlighted back office administration, straight through processing and product rationalisation as the three main areas. CEOs also said that the industry could better work to get cost efficiencies in such areas as information technology, reduction of regulation and disclosures and more standardisation and consistency across the industry to aid straight through processing.

The question certain to be posed to CEOs is how do you achieve back office administrative cost reductions and straight through processing when product growth is high and getting increasingly complicated?

Our survey shows that employee numbers will grow in the next three years and financial planners numbers are also expected to rise.

Figure 5.10: Expectations of annual growth – Employees – Australian Survey

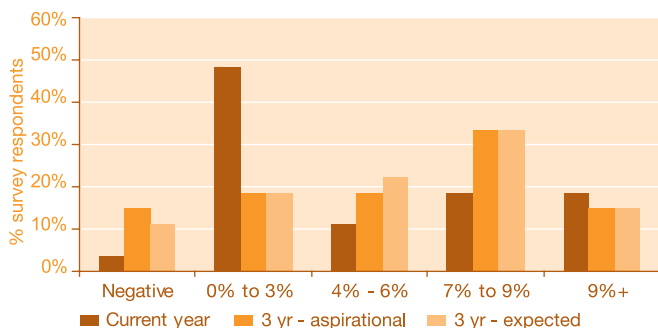
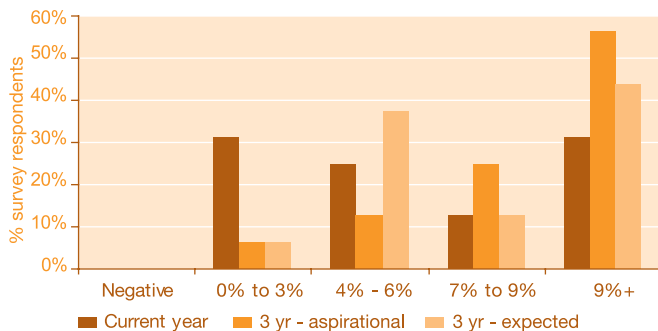
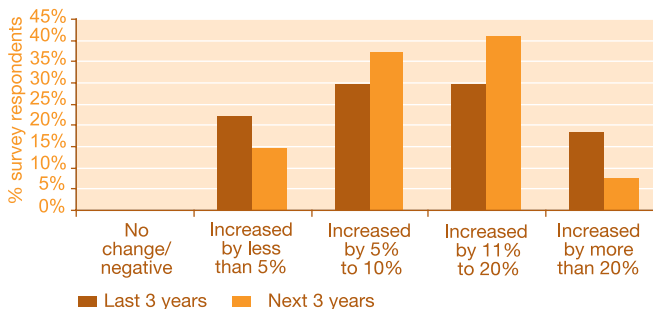


Figure 5.11: Expectations of annual growth – Financial planners – Australian Survey



Salaries have also increased in the current year with nearly 50% of respondents experiencing salary growth levels of over 11% in the last three years. In line with the increase in staff numbers, salaries are expected to increase by a similar level over the next three years.

Figure 5.12: How have salaries changed over the last three years/next three years – Australian Survey

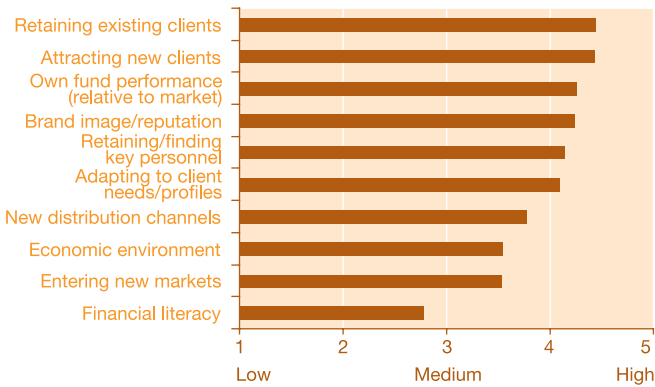


The driving question remains; notwithstanding expected salary increases in this industry, where are the talented staff and qualified financial planners going to come from?

Industry trends and drivers

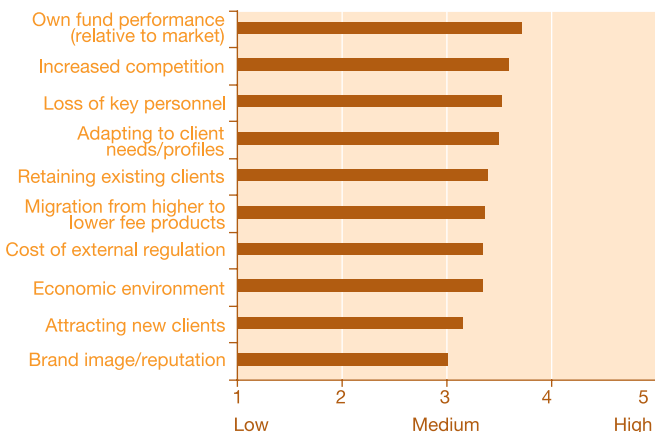
Our survey highlights that client retention and gaining new clients are the top two profit opportunities over the next three years. It is interesting to note that own funds performance was only third this year compared to the top response in last years survey, probably highlighting several good years of market performance. Brand and reputation continue to be key areas as well as the need to keep and hire talented people. Our survey asked the industry to rate a selection of 15 opportunities with the top 10 challenges highlighted below.

Figure 5.13: What are the greatest opportunities to organisations profit objectives over the next three years? – Australian Survey



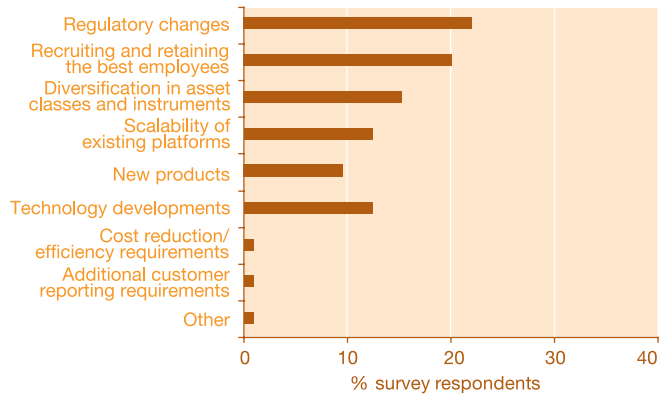
When asked to rank the greatest threats to profit objectives, CEOs highlighted own funds performance and increased competition as the top two responses. Our survey asked the industry to rate a selection of 15 opportunities with the top 10 challenges highlighted below.

Figure 5.14: What are the greatest threats to organisations profit objectives over the next three years? – Australian Survey



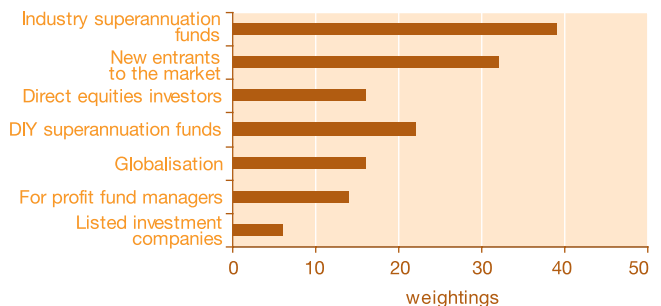
Some of the threats highlighted above are similar to the challenges facing the industry from our Global Survey. In particular recruiting and retaining best employees is a key issue for both Australian and global organisations.

Figure 5.15: What do you see as the major challenges facing the industry that will impact on your operations? – Global Survey



When asked to list the top three key competitive issues that will most impact their business, CEOs highlighted industry super funds and new entrants to the market as the top two issues. The sustained marketing and profiling of what the industry funds see as their differentiating factors is clearly being noticed.

Figure 5.16: Top three competitive issues that will most impact your business? – Australian Survey



Distribution and products

When asked to list the top three reasons why sales have increased in relation to retail clients, investment performance is a clear winner. However quality of distribution arrangements and brand/image also figure highly. These results are consistent with the Global Survey (see Figures 5.17 and 5.18).

Figure 5.17: In relation to retail sales, what are the top three reasons why you have increased your sales in retail markets? – Australian Survey

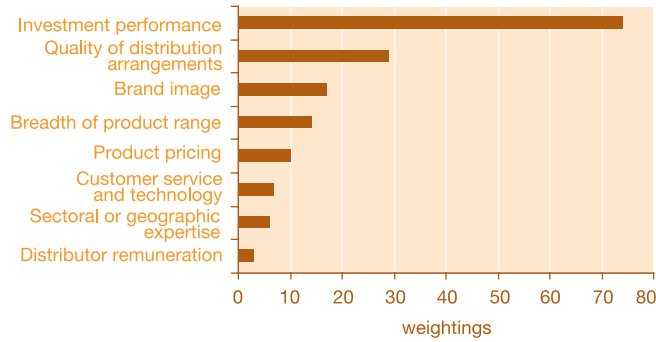
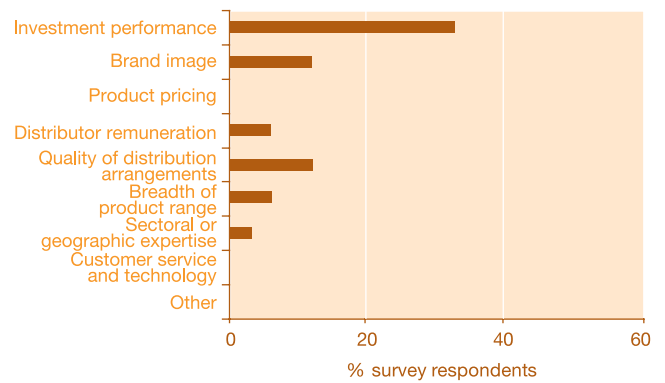


Figure 5.18: In relation to retail sales, what are the top three reasons why you have increased your sales in retail markets? – Global Survey

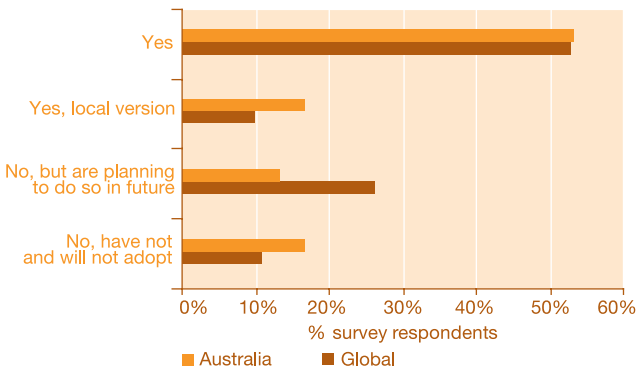


Results from our survey also showed that actively managed products dominate revenue at investment management organisations with approximately 80% of revenues derived from these strategies.

Investment process

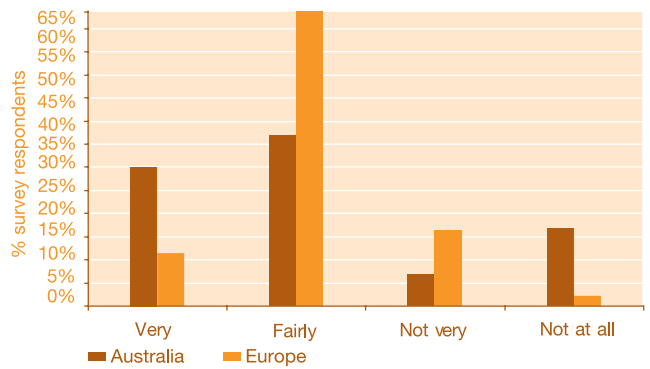
From our survey, standards of reporting compare favourably with those globally. 70% of respondents had adopted Global Investment Performance Standards (GIPS) with most that had not planning to do so.

Figure 5.19: Have you adopted GIPS within your organisation?



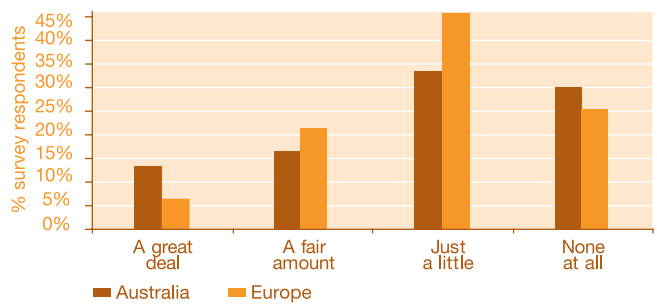
The survey showed that asset managers/analysts have a good understanding of International Financial Reporting Standards (IFRS) with over 60% very confident in the understanding of the impact of IFRS on the companies they were investing in and over 65% rated the information presented in interim reports and IFRS restatements as understandable. This result contrasts with the PricewaterhouseCoopers/Ipsos MORI survey conducted in February 2006 of investment managers across Europe, with only 12% of respondents very confident in the understanding of the impact of IFRS.

Figure 5.20: How clear and understandable would you say the information presented by companies in their interim reports and IFRS restatements have been?



However survey respondents indicated that IFRS has had little effect on investment decisions made. Over 85% of respondents stated that IFRS had no influence on their investment decision (compared with 48% in the European survey) and over 60% said IFRS had little impact on the perception of individual companies value.

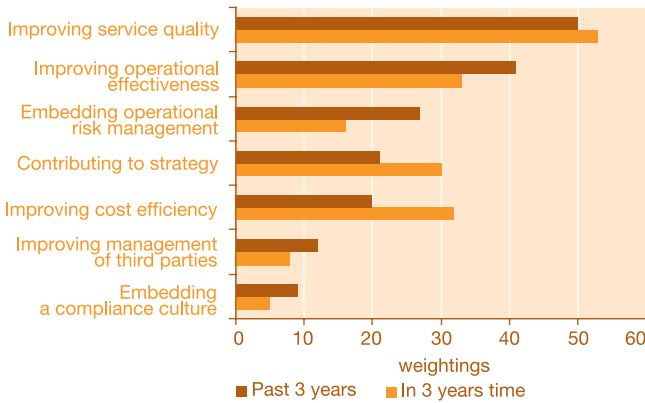
Figure 5.21: How much of an impact has IFRS had on your perception of individual companies' value?



Operational management

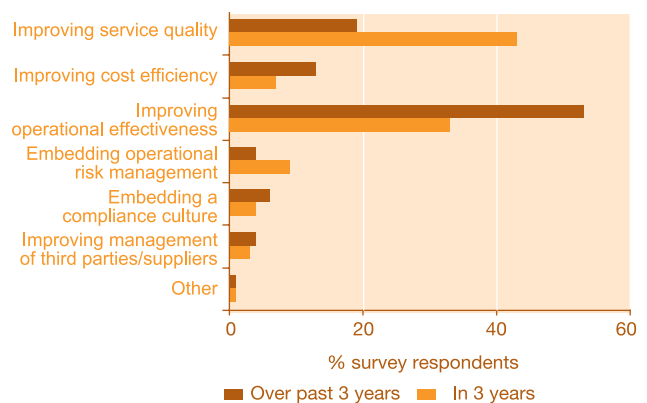
When Chief Operating Officers (COOs) were asked where they have added value over the past three years, the top two responses were improving service quality and improving operational effectiveness. The next challenge is to improve cost efficiency. Our Global Survey suggested that improving operational effectiveness was the most important with the next challenge to improve service quality.

Figure 5.22: Where do you believe you have added value to your organisation as COO? – Australian Survey



When asked to rank options where value would be added in 3 years time, improving cost efficiency and contributing to strategy rated higher in the Australian survey but there was still a focus on operational efficiency and service quality. However from the Global Survey the results suggested there was more focus on service quality, with cost efficiency not figuring as highly.

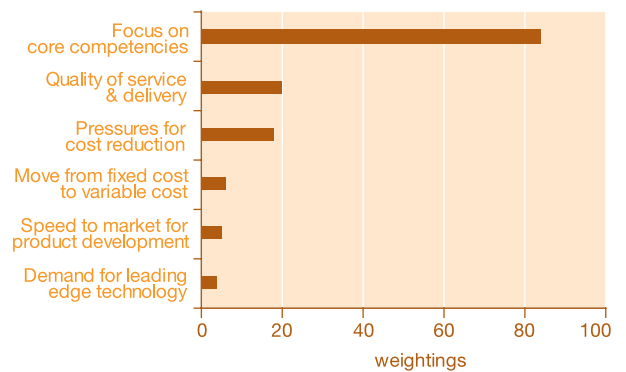
Figure 5.23: Where do you believe you have added value to your organisation as COO? – Global Survey



Outsourcing and offshoring

Our survey results show a general trend to increase outsourced operations mainly around custody, registry and unit pricing. As organisations seek to focus on core competencies, outsourcing providers, in particular the custodians, continue to play an important role in the middle and back office processes.

Figure 5.24: What are the drivers for outsourcing and / or offshoring? – Australian Survey



Our survey highlighted that there is little appetite for offshoring in the next 3 years, with only investment operations and IT being considered. This compares with the experience noted from respondents to the Global Survey where offshoring was not a popular option and there were few plans for expansion over the next three years.

Figure 5.25: What functions are performed in-house, or outsourced or offshored to a significant extent (i) now and (ii) your expectations for the next three years? – Global Survey



Finance function and management information

We asked respondents to indicate their level of understanding of profitability by organisation, by product and by customer.

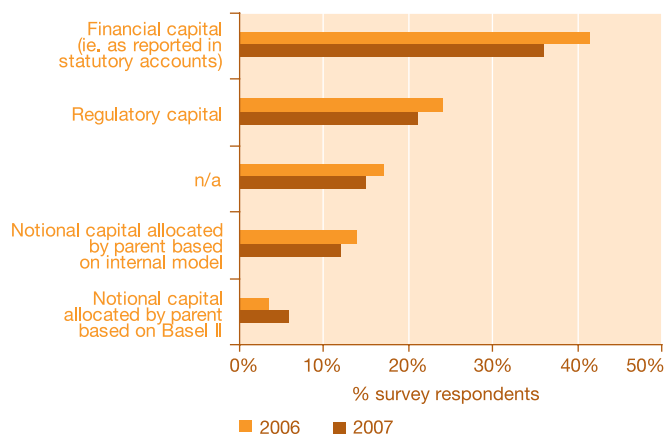
Not surprisingly, organisational profitability is reasonably well understood.

Over 50% of respondents claim to have an in depth understanding of product profitability. This will remain a challenge for larger organisations, particularly those with extensive, and often duplicative, product suites. If and when product rationalisation becomes a more feasible strategic choice, knowledge of the profitability by product will be increasingly important.

The lowest response related to having a meaningful understanding of customer profitability with less than 30% of respondents having such analysis. As segmenting and channel choices are important strategic imperatives of the CEOs, we might expect an improvement in this area.

Consistent with the findings from the 2005 survey, most organisations still manage their capital based on statutory requirements and there has been little change in the use of capital management models such as Basel II.

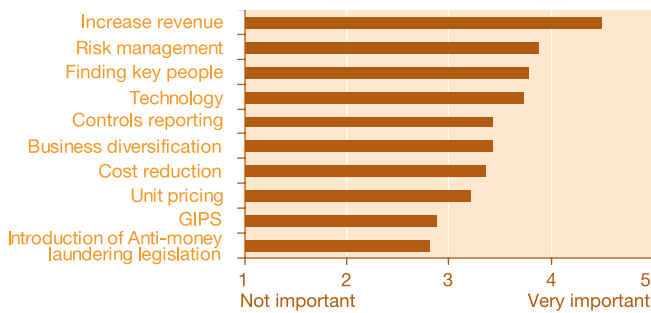
Figure 5.27: What capital is your performance measures against? – Australian Survey



Governance, risk and compliance

Governance, risk and compliance continue to be challenging areas due to growing levels of regulation as well as the changing nature of investment products. Regulatory and compliance issues are rated by CEOs in the top five challenges facing retail clients. The survey respondents also rated risk management as the second most important issue facing them over the next 12 months.

Figure 5.28: How important will the following issues be over the next 12 months? – Australian Survey



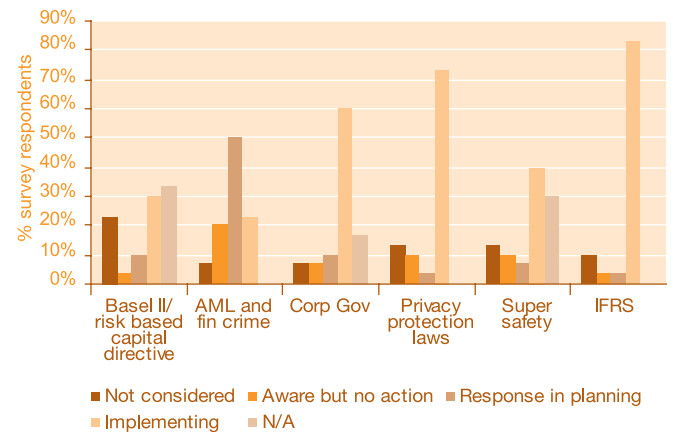
When survey respondents were asked to rate the biggest risk management issues facing their organisation, it was not surprising to see unit pricing errors and breaches of FSR legislation as the top two issues.

Figure 5.29: What are the biggest risk management issues facing your organisation? – Australian Survey



The above graph also shows that organisations have also to deal with new regulatory changes such as the introduction of anti-money laundering legislation. When asked to what extent the impact of certain regulatory requirements have had on the business and their level of readiness, survey respondents highlighted that there is still some work to do around newer pieces of regulatory change such as Basel II and anti-money laundering. CEOs in our round table highlighted that the response by the industry to protect against money laundering and, increasingly, organised crime are areas that need a continued focus.

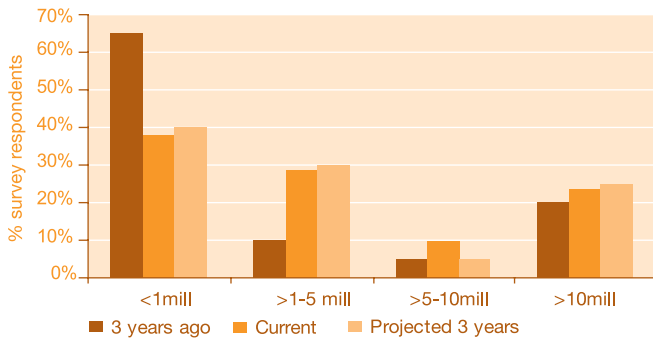
Figure 5.30: Impact of regulatory requirements and level of readiness – Australian Survey



It is clear that the pace of regulation continues and with it pressure on risk management and compliance functions. Regulators are becoming tougher and while risk management systems continue to improve, these need to be continually assessed in light of new developments.

Our survey results showed that the level of spend on risk and compliance programs has increased significantly and is expected to continue to increase (see Figure 5.31). This trend was particularly noticeable with large investment managers.

Figure 5.31: Estimate of total spend on risk and compliance programs – Australian Survey



Our survey also showed a move towards an automated enterprise risk management system in the future and away from a non-technology based review. This compares favourably with the Global Survey.

Figure 5.32: What does/will your firm use to monitor risk? – Australian Survey

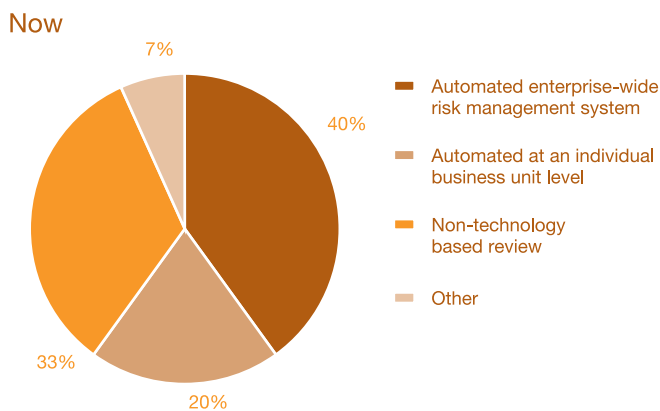
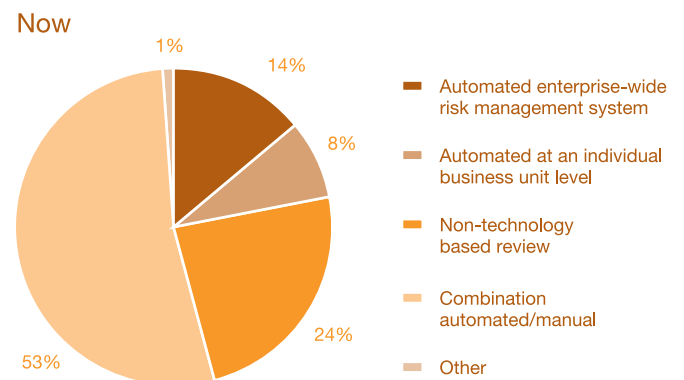
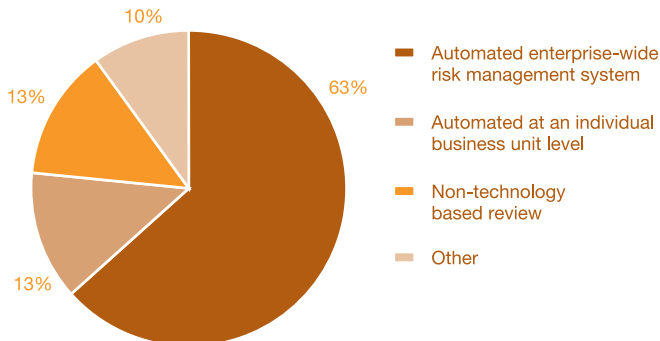


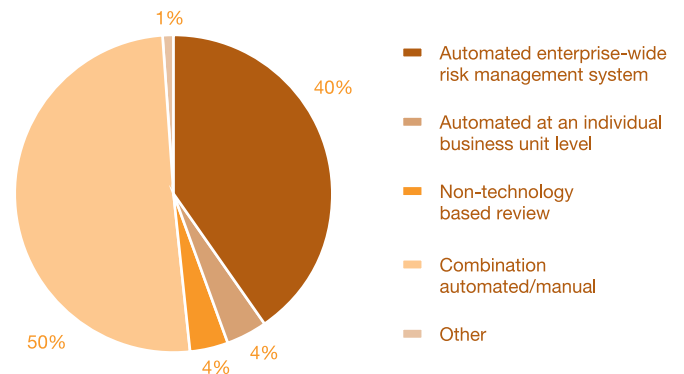
Figure 5.33: What does/will your firm use to monitor risk? – Global Survey



In the next three years



In the next three years



PricewaterhouseCoopers

In addition to this survey, PricewaterhouseCoopers regularly produces surveys, newsletters, white papers and brochures on industry issues. Recent publications include:

- Investment Management Perspectives (Global publication – July 2006)
- Global Investment Management Survey 2006
- Going for growth: The outlook for M&A in the financial services sector in Asia
- Winning the battle for growth: building the customer-centric financial institution
- IM Perspectives: Market reporting

If you would like to receive any of these publications, please contact Emma Barrett, Australian Financial Services Marketing Manager on 02 8266 1331 or emma.barrett@au.pwc.com



Who to contact

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Please go to www.pwc.com/au for electronic copies of the survey. For further information about the survey or to request a hard copy please contact Emma Barrett, Australian Financial Services Marketing Manager on 02 8266 1331 or emma.barrett@au.pwc.com.

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