



Australian Investment Management Survey 2007

Important Notice

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1. Foreword



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I am delighted to introduce the annual PricewaterhouseCoopers Australian Investment Management Survey 2007 and welcome the continued sponsorship of this initiative by IFSA.

This research project gives us an opportunity to pause and reflect on the success, challenges and opportunities facing this dynamic industry.

Unsurprisingly, with over ten straight years of economic growth, senior investment managers are overwhelmingly focused on the search for continued growth and in particular, sustainable alpha. What is good for their investors is good for them.

The industry continues to be extraordinarily successful not just in taking advantage of a favourable market and capitalising on compulsory superannuation, but also in bringing innovative products to market. Assets under management in Australia continue to surge and are now well in excess of \$1.1 trillion.

Investors and superannuants have benefited enormously from the skill, innovation and integrity of the industry. Yet a small number of incidents have received a disproportionate share of the headlines this year for all the wrong reasons. Some investors have lost money through a combination of poor judgement, questionable sales practices and in some cases, alleged fraudulent management.

The learning point for the broader investment management industry is to remain alert that the search for alpha does not spawn products that have complex disclosure and risks that are not fully understood by advisors and end users.

This is particularly relevant as this year's survey touches on the growing importance of alternative investments. In the survey we asked senior executives about the importance of this asset class in their future portfolio mix. The results make

interesting reading.

The regulator has recently given notice to the industry – and specifically super funds – about the need for trustees to fully understand the risks associated with these assets, as well as those being sourced internationally.

In addition, the increasing attention being given by IFSA and others to furthering the investing community's understanding of investment fundamentals also appears well founded.

This year's survey also identifies the increasingly global nature of the industry; executives in the survey predict the amount of assets being sourced overseas will nearly double in the next three years. The Australian industry is strong, well managed and offers good opportunities domestically and abroad. The industry also looks poised to capitalise on significant growth expected in our local region.

We would like to thank survey participants and in particular the executives who took part in our round table and one-on-one meetings. We appreciate the openness, insight and vision provided. If you would like any further information regarding the survey or have any feedback please do not hesitate to contact myself or your usual PwC contact.

2. Executive Summary

– Key themes

Our survey highlights that CEOs are expecting continued success for their business but are aware of the challenges that lie ahead:

Macro themes

- The industry enjoyed another successful year benefiting from robust markets and superannuation fund flows.
- Organisations are experiencing pressure on margins and this has led to greater innovation and a move to alternative markets.
- The industry is increasingly recognising its export potential.

Business themes

- Finding and retaining key people is an increasingly complex challenge - and is very high on the list of issues concerning CEOs.
- In order to achieve aspirational growth, investment managers will need to become more customer centric by having well trained and responsive staff and quality interpersonal relationships.
- While managers are looking to leverage existing product suites, Treasury's contemplation of creating a more workable product rationalisation regime clearly remains a welcome initiative.
- The demand for investment vehicles that acknowledge the importance of environmental sustainability is growing.

Risk themes

- Despite growth and innovation, investment managers are aware of the operational risks of increasing their product suites.
- Managing conflicts of interest continues to be a challenging area.
- Lesson learned from overseas is to prepare early for the anti-money laundering requirements.
- The continued innovation and increasing number of alternative products is changing the risk landscape.

3. About the survey

Figure 3.1: Size of organisations who responded to the survey

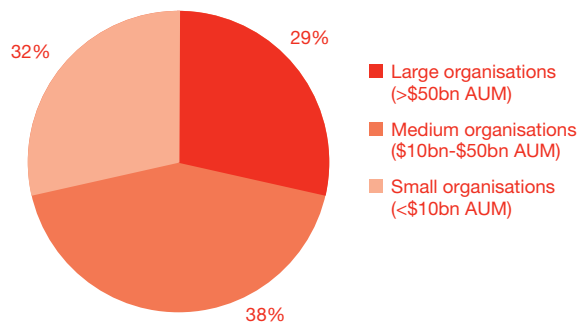
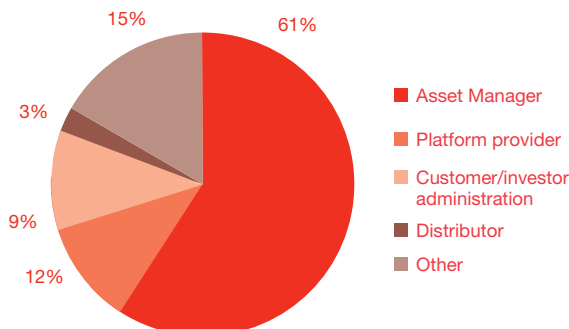


Figure 3.2: Please indicate the areas in which you primarily do business.



The PricewaterhouseCoopers Australian Investment Management Survey 2007 was conducted in May and June 2007.

34 investment management organisations, representing assets under management/administration of more than \$1 trillion¹, 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 investment officer, chief operating officer and chief financial officer.

In addition to information regarding the organisational profile of respondents, the survey addressed six main areas:

- 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 section 4 of the survey we set out the PricewaterhouseCoopers point of view on some of the important issues facing the industry. In section 5 we provide an overview of the survey findings, together with our analysis and interpretation of the results.

Survey participants will be provided with the complete survey results.

¹ In calculating this amount, we have not adjusted for assets under management in fund of funds structures or under the administration of other organisations that are managed in the first instance by another investment manager.

4. PricewaterhouseCoopers' point of view

The good times continue but what will define future success?

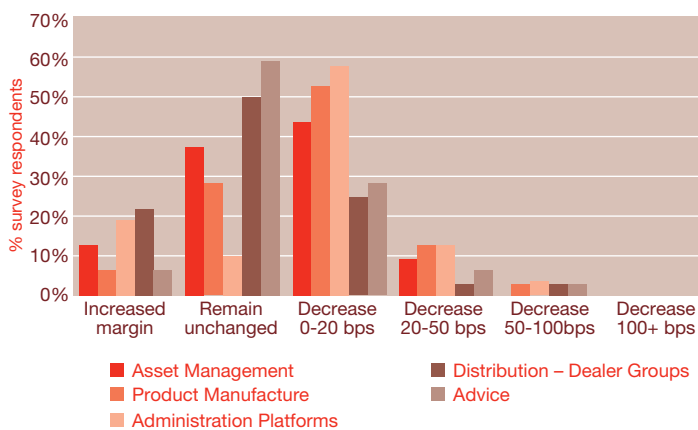
The investment management industry enjoyed a successful 2006/2007, benefiting from robust markets and a strong supply of investor funds, largely driven by compulsory superannuation – and aided by changes thereto.

The industry now has \$1.1 trillion of assets under management, making it the fourth largest global player. And there is no reason to suspect this asset growth will slow; indeed, respondents to the survey suggest, the pace of growth may quicken.

Our survey paints a picture of strong growth in the past year – and great optimism for the next three years.

Of course, industry growth is the good news. But investment managers are experiencing pressure on their margins (see Figure 4.1 below). Innovative managers with long-term strategies will still prosper, but growing competition will almost inevitably result in greater industry consolidation.

Figure 4.1: For each area of the value chain, please indicate the expected change in margins over the next three years.



Certainly investment managers are acutely aware of increasing competition and tighter margins particularly in traditional asset classes, and have responded by continuing to innovate with new products offering healthier margins. For example, the demand for alternative products (for example private equity vehicles, infrastructure assets) continues to grow; the survey shows 74% of respondents had 0-5% of their assets under management housed in alternative products but in three years time, 79% of respondents expect to have greater than 5% of the assets housed there.

At the same time there has been a proliferation of “absolute return” and other hedge fund products where increasingly, the standard fee has become 2% for funds under management and 20% for out-performance. The 2007 State Street Hedge Fund Research Study shows nearly two-thirds of institutional investors allocate more than 5% of their portfolio to hedge fund strategies and only 4% have no hedge fund allocation.

Increasingly, investors are seeking an index return (beta) at a lower fee, and are prepared to pay significantly higher fees for a smaller part of their portfolio – expecting in return to supplement their beta with a degree of out-performance (alpha) at a more efficient, blended fee rate.

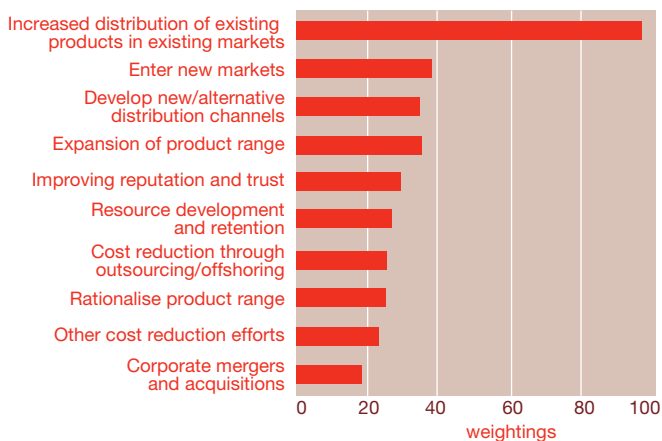
While the increase in absolute return and innovative new products is providing a lucrative adjunct to more traditional businesses, also some significant and successful businesses have been built to capitalise on this shift.

The challenge of the proliferation of these products is greater operational risk. While good managers can handle this increased risk, there are cautionary precedents emerging.

At the time of writing this report, there has been a down-turn in the US sub-prime market which could have ramifications for the alternative investment market here in Australia. Perhaps regulators will look at this industry further.

Yet for all of the growth stimulants and the drive to innovate, there are indications from the survey that investment managers are saying “enough is enough” with their product suites. Interestingly, when asked their key objectives for the business in three years time, the overwhelming response was to increase distribution of existing products in existing markets. Similarly, the main focus was on retaining clients, not winning new ones.

Figure 4.2: Please indicate the 5 key objectives for your business in 3 years time.¹



This is not altogether a surprise. Put simply, there are too many Australian products given the size of the market. Businesses have seen the impact that operational failures can exact on a business; having more products than is necessary is a sure way to increase the inherent risk of such events. Legislative relief for those wanting to rationalise their product suites is overdue. The recent Treasury discussion paper on product rationalisation is a step in the right direction. For the time being though, leveraging existing product suites seems to be the favoured strategy.

What will drive future success?

Investment managers are adamant that investment performance remains the key to retaining and winning business. But will strong returns suffice into the future? What will happen when the inevitable market downturn occurs?

In a cooler investment climate, some will prosper – indeed the absolute return managers look to the opportunity to demonstrate their differentiated offering. For many though it will be necessary to find other avenues for finding and retaining clients. In our view, enlightened organisations will be those that become more customer centric.

This means having well trained and responsive staff and quality interpersonal relationships.

As indicated in the following results, managers' first steps will be to improve the quality and timeliness of customer related metrics, and the systems used to derive such information. Organisations need to be able to understand customer needs and their risk appetite and meet these requirements by offering better-tailored solutions fitting individual risk horizons.

There is a school of thought that strategy is easily copied and that execution is the critical component of success. Maybe. But many strategies to improve customer centricity are being employed.

Figure 4.3: What of the following strategies will your organisation adopt over the next 12 months in order to make itself more customer-centric?



What does this mean in practice? Results from a recent PricewaterhouseCoopers briefing, *Winning the Battle for Growth Building the Customer-centric Financial Institution*, published in association with the Economist Intelligence Unit (EIU) in April 2006, isolated these factors as critical to enhancing client relationships:

- Refocusing the company culture on customers rather than products; valuing and developing the skills of customer relations staff.
- Giving customers a choice of channels through which to do business (the more business clients do, the more channels they tend to use).
- Breaking down the tendency to organise departments purely by product or product type, so that customers can be served effectively at their first point of contact with staff.
- Motivating staff based on customer-related outcomes as well as financial ones.

¹ This graph, and a number of subsequent graphs, indicate a 'weighting' response. A 'weighting' is used where respondents are asked to rank a number of options. Weightings are applied depending on the ranking given and then aggregated. The outcome demonstrates the relative importance of items.

- Avoiding concentration on financial performance metrics, such as customers' product histories, at the expense of data on their future value or their loyalty profile.
- Making sure a named individual takes direct responsibility for the quality of customers' experience, and represents the customer's point of view at a high level.

Who will drive future success?

The answer is obvious: employees. So how to find and keep key people will remain of paramount importance for all investment managers, irrespective of their size. On this front, the survey found that retaining key people was the most important issue facing CEOs – and not far behind as the third most important issue was finding key people. To absolutely drive home the point, the loss of key personnel was seen as the main threat to profits over the next three years.

Figure 4.4: How important will the following issues be for your organisation over the next 12 months?

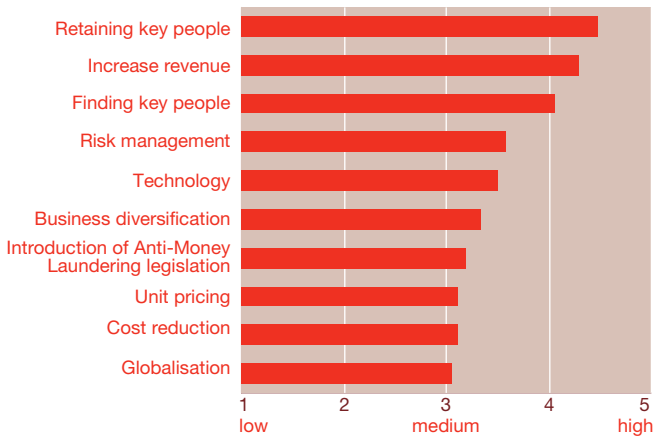
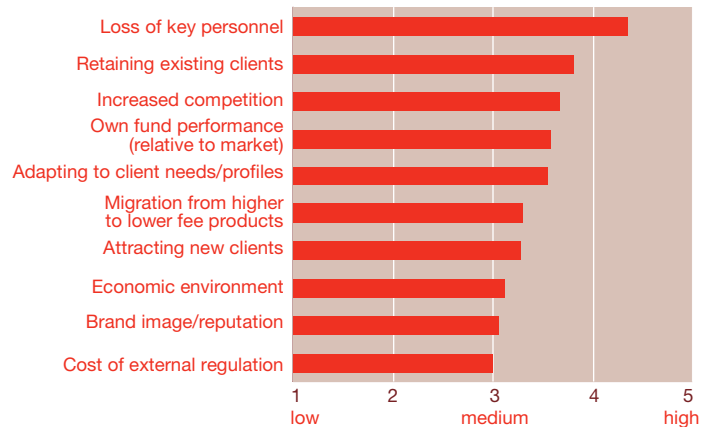


Figure 4.5: Rate the following factors that present the greatest THREAT to your organisation's profit objectives over the next three years?



There is no doubt; people management is the key issue troubling CEOs. Larger investment managers, in particular, are finding it increasingly difficult to win in this war for talent; they face the significant challenge of promise and hope. The promise of riches from the boutique strategy and the hope that it eventuates. In this year it is obvious that some do. But time will tell for how many the grass is truly greener.

The smaller players can offer greater levels of autonomy, lower levels of internal politics and the excitement of working for an embryonic organisation. The bigger players are looking at measures that replicate these workplace cultures. But it is difficult; workplace cultures are highly resistant to change, and replicating equity based remuneration incentives requires some thinking from outside the square.

In any discussion on employees, how they are remunerated is important. But it's not the only issue; research shows that Gen Y, for example, lists dollars and cents only sixth in importance when deciding to accept a job. The boutiques' ability to attract talent is further evidence of other factors at play in recruiting and keeping staff.

But interestingly, the boutiques are now starting to feel the pinch as well. Armed with a ready experience of getting a boutique up and running – and the heady experience of some notable success stories – those within boutiques but not getting the lion's share of equity, are spinning off.

And so the cycle and market economy will continue. While investors and shareholders will continue to find and create opportunities, for employees in this industry the continued high demand and low supply augers well.

Financial planners: the conflict remains

The role of financial planners in the industry has never been more critical. Yet the focus has been on conflicts of interest and (a small number) of failings, rather than the value that can and has been delivered.

The industry has always had to recognise and professionally handle conflicts; they have existed since the first advisor/client relationship. But with today's changes to the financial services landscape and business practices, the conflicts are more numerous, broader in dimension and greater in complexity. In an ideal world some of these conflicts may not exist. But equally, an ideal world is unlikely to start with \$1.1 trillion in the bank – and the industry architecture that comes with that.

That is not to say that more cannot be done. Respondents to the survey (note Figure 3.2) acknowledge this; many said the industry was not doing enough to manage conflicts of interest, although, interestingly, were confident in their personal handling of the issue.

Figure 4.6: How well does your organisation/the industry manage its conflicts of interest?



Most respondents to the survey use disclosure and documented policies and procedures to manage conflicts of interest.

In order to achieve an effective system to handle conflicts of interest, in our view, organisations who haven't already done so should think about adopting the following practices:

- Embrace evaluation of conflicts of interest – the culture of the organisation should encourage the study of underlying circumstances giving rise to potential conflicts.
- Develop objectives, dimensions and reporting protocols for a conflicts management process.
- Implement a conflicts management process – this should be a comprehensive and continuous process, effected by those charged with governance.

- Identify parties with responsibility for relationships and activities that could create potential conflicts.
- Use technology to help identify potential conflicts.

Distribution – a critical link in the chain

Not surprisingly, the survey highlighted the importance of distribution; when asked to rank the key business objectives in three years, increasing distribution of existing products in today's markets was the outright winner (refer Figure 4.2 above).

But at a time when there appears little room to move in traditional distribution channels, it remains a moot point how to achieve this goal.

Private banking is one preferred option although it should be stressed there are no quick wins in targeting high net worth individuals. The PwC 2007 Global Private Banking/Wealth management survey shows more than 80% of these individuals take at least six months to convert and a third are likely to take more than a year.

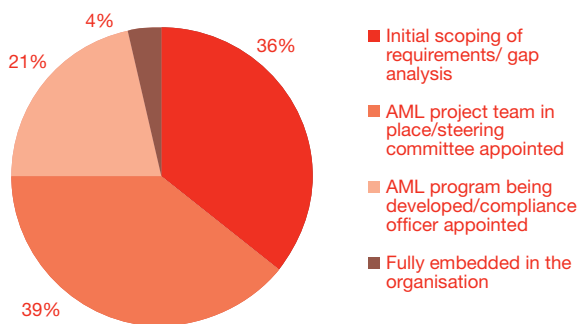
Given the time and investment required to bring on a new client, there needs to be real focus by organisations on understanding their clients needs and structuring the business accordingly.

Private bankers and wealth managers need to ensure they have the human resources and client relationship skills and capabilities to meet their private client needs. The PwC 2007 Global Private Banking/Wealth management survey highlights the difficulties of managing exceptional growth without compromising excellent client experience. This is particularly relevant in Australia where clients require increasingly complex solutions.

Anti-money laundering – don't leave it too late

Companies that delay meeting their anti-money laundering (AML) requirements under the recently issued Federal Government law will pay a high price. Although some parts of the legislation are not finalised, those projects that started early have a better control over costs by maximising the available planning and implementation time. Survey results suggest an opportunity to accelerate implementation.

Figure 4.7: What stage of implementation has your organisation achieved in meeting the anti-money laundering (AML) requirements?



This observation was confirmed in recent PricewaterhouseCoopers workshops for AML practitioners in the financial services sector; however participants are finding it's taking more time and resources than expected to get the fundamentals right (e.g. identifying products and services, gaps in investment processes). It also involves a major change management program, as well as work time, to meet their legal requirements.

Overseas experience shows that while it is important not to complicate implementation, it's critical to get it right the first time and that costs can be greater than anticipated. In the US, for example, costs in similar programs have doubled original estimates.

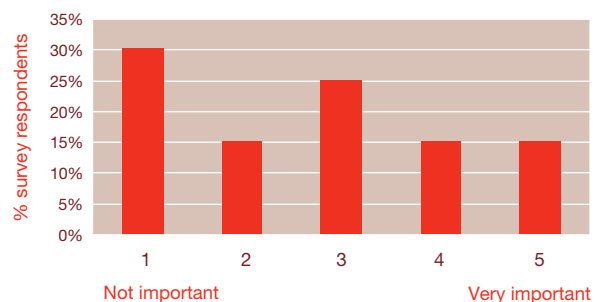
The industry will obviously want to avoid regulatory/legislation deficiency. But equally, it should avoid unnecessary cost. The time to act is now.

The drive for sustainability

Demand for investment vehicles that explicitly acknowledge the importance of environmental sustainability is growing apace as institutional investors "reward" companies perceived to be addressing this issue. Today, nearly 200 institutions managing about \$11 trillion have signed the UN Principles of Responsible Investment (PRI) that require companies to provide more information on Environmental, Social and Governance (ESG) issues.

Australia is part of this trend (see Figure 4.8 below), and it will have significant consequences for financial planners. Concepts such as triple bottom line (TBL) reporting and markets such as the Dow Jones Sustainability Group Indexes and the Financial Times FTSE4GOOD Index will have to become part of their financial language. Almost inevitably the concept of TBL will become an intrinsic part of corporate life.

Figure 4.8 How much importance has your organisation (asset managers only) placed on incorporating the United Nations Principles for Responsible Investment in your investment offerings?



More specifically, financial planners will need to understand products that use a "sustainable alpha" investment process, integrating environmental, social and governance analysis with financial analyses that differ from the traditional financial indicators.

To date, retail investors are not queuing up to buy these products. However, new similar products are emerging indicating a nascent demand for funds that pay more than lip service to environmental sustainability.

Certainly superannuation funds understand the potency of this combination and, armed with long-term investment horizons, are beginning to direct their capital accordingly.

That demand will not simply be a product of broad public concern about environmental sustainability, although undoubtedly that will play a role. What will prove critical will be data that begins showing that businesses behaving in an environmentally, socially and economically responsible manner outperform companies only paying lip service to anything but the profit-and-loss statement.

The jury is still out on whether companies addressing ESG issues are outperforming the broad market. Perhaps the fact that the timing of the sustainability fuelled increase in consumer interest and spending has been matched by the current bull market has masked the impact. The better question is whether the structural shift in public sentiment on environmental sustainability will result in a more discernible difference in a market downturn.

Final comments...

The investment management industry has enjoyed another stellar year and all indications suggest it will continue apace. Its growth is being fuelled by a strong economy, near full employment, rising wages in a tight labour market, and, most significantly,

a compulsory superannuation scheme that enjoys bipartisan political support.

But growth attracts competition. The industry found in 2007 that margins contracted as more players – especially at the boutique end and from overseas – competed to offer an enormous array of product.

PwC does not see this trend changing and investment managers will have to become adept at developing product that differentiates them from the pack. Even then they may find that their window of opportunity to enjoy bigger margins will get smaller.

Most admired organisation

Lastly, in keeping with prior years, this survey asks who were your most admired competitors and why. This is what you told us:

Organisation	Main reasons given
Platinum	Focus on their value proposition and performance
AllianceBernstein	Global philosophy and investment approach
Barclays Global Investors	Product offering and innovation
Colonial First State	Distribution capabilities and partnering with manufacturers
Perpetual	Long term success
Macquarie	Innovation and performance culture

5. Detailed survey findings

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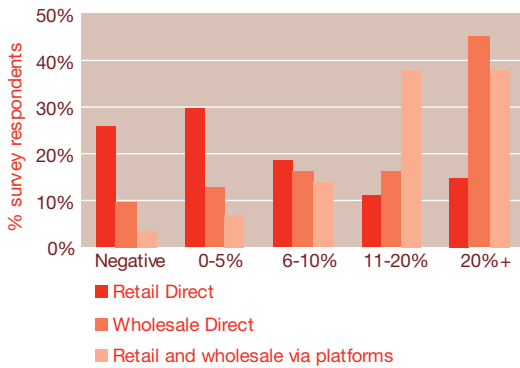
In this section we provide a summary of findings from our survey in the following areas:

CEO Views

Growth and growth expectations

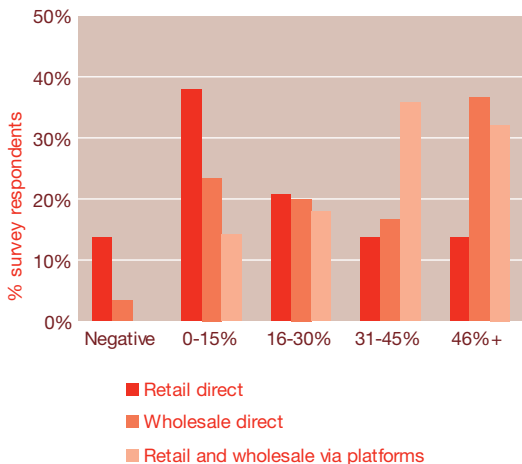
The investment management industry grew by approximately 15% in the year to 31 March 2007 and now totals \$1.157 trillion of assets under management². More significant growth is expected in the quarter to 30 June as investors rushed the superannuation window – and investment managers opened their shops like weekend retailers.

Figure 5.1: Assets under management – Growth for the year to 31 December 2006



While significant, such growth was consistent with the 18% witnessed globally, with global assets under management rising to \$26.9 trillion³. The outlook for the next 3 years is also optimistic, particularly in the wholesale direct channel and for platforms, where over 30% of respondents expect growth in excess of 46%.

Figure 5.2: Assets under management - Growth in 3 years time



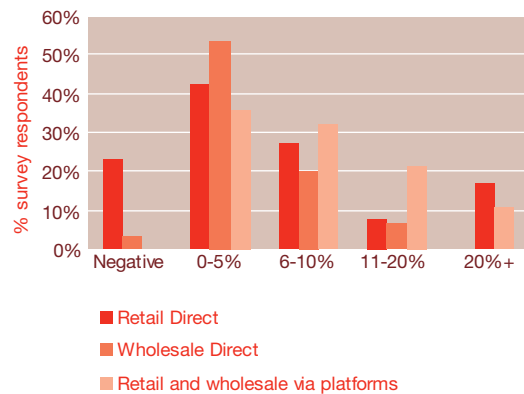
Yet, when asked for their best guess expectation of the Australian All Ordinaries Index at 30 June 2008, the average response from the CEOs surveyed was 6,618, an increase of only 5% over the 30 June 2007 close.

One interpretation of this is that the markets will either have a strong 2009 and 2010 after a modest next year, or fund flows will continue apace – or that the All Ordinaries is a less important indicator of a multi-faceted industry than in the past. Or perhaps an element of all three.

In any event, the three year projection is, other than for the retail direct channel, very optimistic.

Interestingly our survey results indicate that the asset under management growth will come mainly from existing customers. Indeed customer growth has been strong – a long and sustained campaign to improve voluntary penetration appears to be paying off.

Figure 5.3: Customer numbers - Growth for the year to 31 December 2006

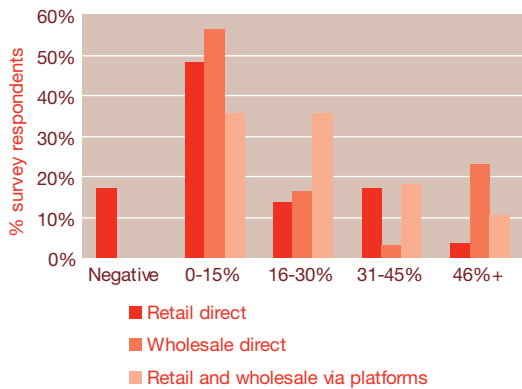


And the growth looks set to continue - especially through platforms.

² Australian Bureau of Statistics March 2007 quarterly report on the managed funds industry

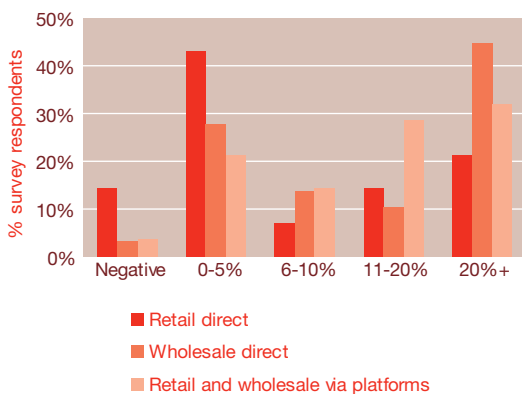
³ IFSA report on Policy options to increase Australia's export of fund management services, May 2007

Figure 5.4: Customer numbers - Growth in 3 years time



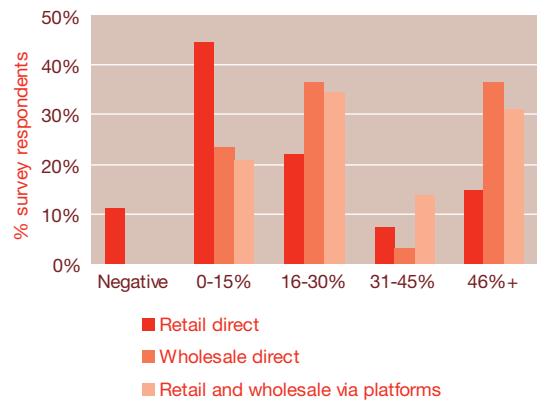
When we look at profit growth, the results show that the majority of retail direct respondents had static or low levels of growth, but the wholesale direct and platform businesses were more successful in improving their profit results.

Figure 5.5: Profit - Growth for the year to 31 December 2006



The three year profit growth expectation is also optimistic, especially in the wholesale direct and platform businesses.

Figure 5.6: Profit - Growth in 3 years time



Costs

There is a large spread of results when respondents were asked to indicate their cost to income ratio (measured as operating expenses/operating income).

When we further analysed these results by size of company, as we expected, the larger investment managers had lower cost to income ratios compared to the smaller players. The average response for large investment managers was 31%-40% whereas the smaller managers averaged 56%-70%.

Figure 5.7: Cost to income ratio – current year

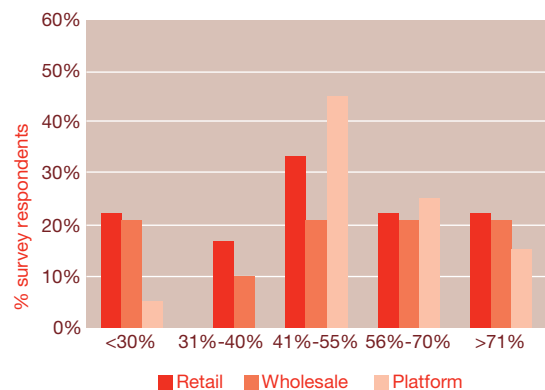
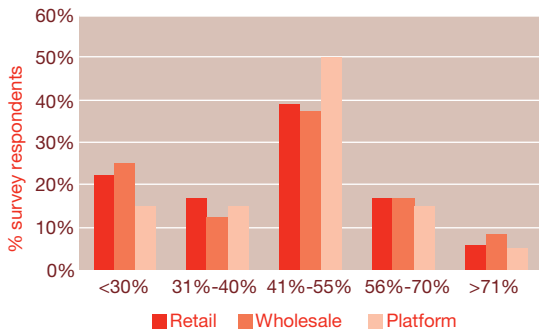


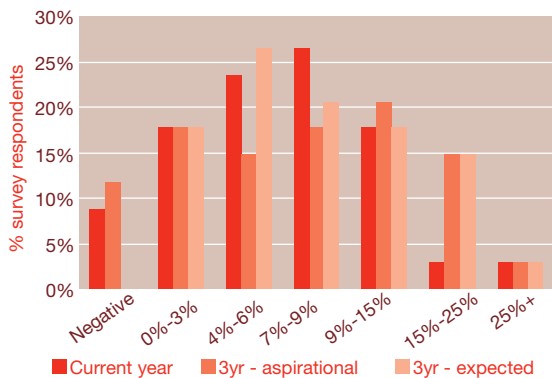
Figure 5.8: Cost to income ratio – three years time



Our analysis of the cost base increases over the current year indicate that the largest increases are in asset and portfolio management, and risk and compliance. These results are consistent with the expectations for the next three years, as well as an expected increase in business development expenses, particularly in distribution.

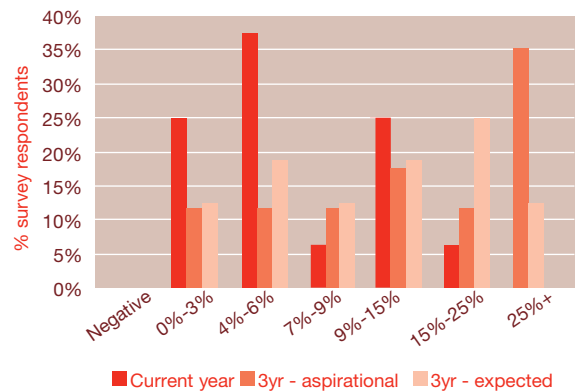
Our survey shows that employee numbers are expected to continue to grow, with the majority of respondents expecting growth in excess of 7% in 3 years time.

Figure 5.9: Expectations of annual growth: Employees



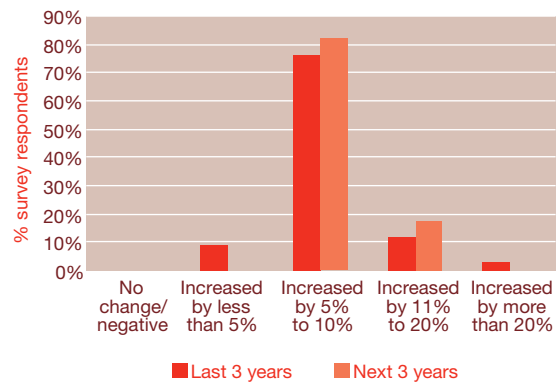
When looking at the growth in financial planners numbers, there are also increases expected. But a skills shortage looms; 35% of respondents aspired to growth in financial planner numbers in excess of 25% in 3 years time but only 13% expected to attain this level.

Figure 5.10: Expectations of annual growth: Financial planners



When looking at salary levels, the results indicate that salary levels increased between 5%-10% and those levels are expected for the next three years. In today's climate where resources appear to be scarce, it may be a significant management challenge to constrain salaries to such levels.

Figure 5.11: How have your salaries changed over the last three years/next three years



Salary and short term incentives (mainly bonuses) are the main ways organisations remunerate asset/portfolio managers. This is consistent with findings from PricewaterhouseCoopers publication "Executive Remuneration – Fit for the Future?" which also expects the use of Short-Term Incentive (STI) to increase. This is predominantly because many companies are facing "line of sight" difficulties with their Long Term Incentive hurdles, whereas STI metrics are often perceived as more relevant to management.

Figure 5.12: Please indicate the 3 most important measures you consider in relation to recruiting, retaining and incentivising asset/portfolio managers



Industry trends and drivers

The most significant challenge facing investment managers continues to be able to produce sustainable alpha (see Figures 5.13 and 5.14), but recruiting and retaining the best employees has risen in importance and is now seen as a significant challenge for both retail and wholesale investment managers. New client acquisition has decreased in its significance as a challenge when compared to last year and cost reduction, particularly with wholesale managers, is relatively unimportant compared with the other challenges managers now face. Regulatory and compliance issues have also fallen in importance for retail investment managers.

Figure 5.13: Please indicate your top 5 challenges in relation to your wholesale clients

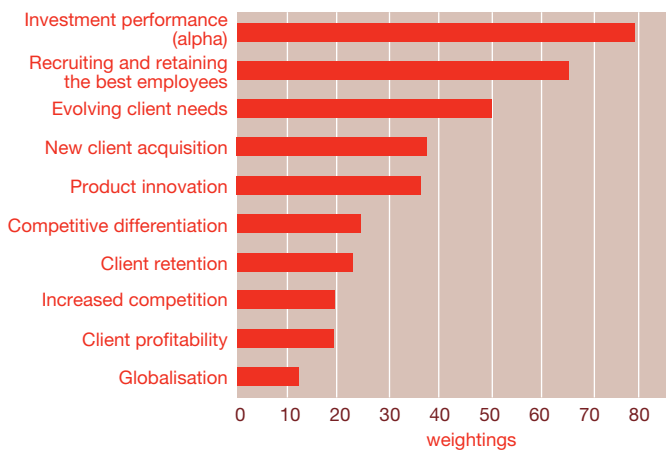
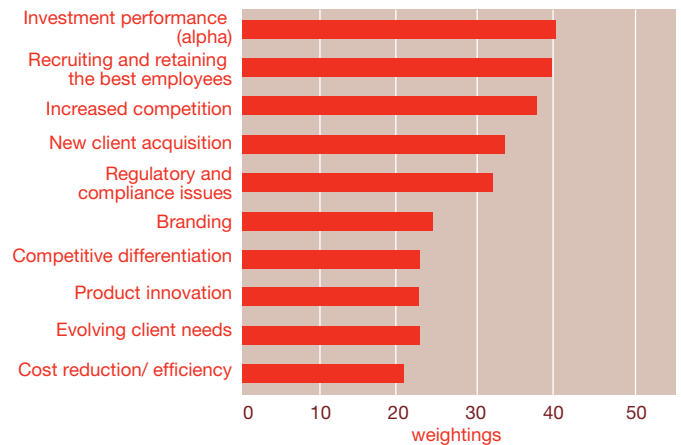
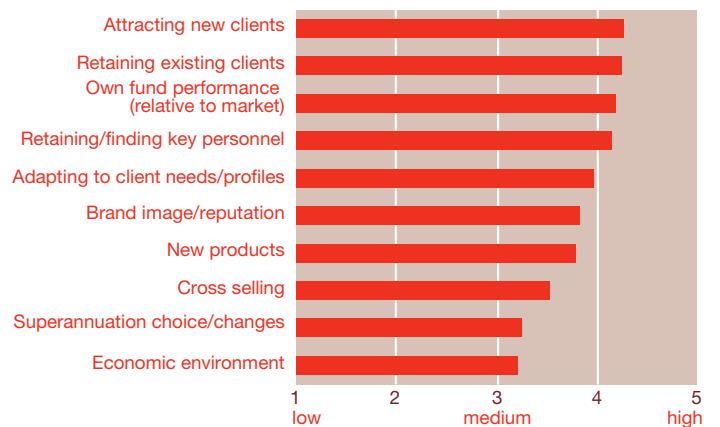


Figure 5.14: Please indicate your top 5 challenges in relation to your retail clients



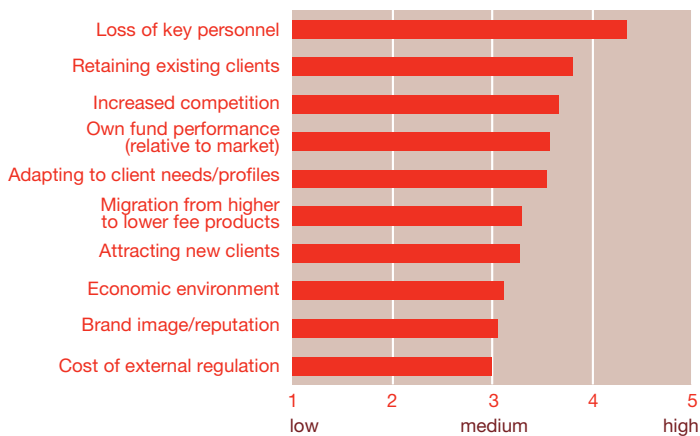
Our survey highlights that attracting new clients and retaining existing ones continue to be the main opportunities to improve profitability. Retaining and finding key personnel has risen slightly in prominence indicating the greater importance organisations are placing on keeping talented people. Interestingly capitalising on superannuation choices/changes did not figure prominently as an opportunity for profit.

Figure 5.15: Greatest opportunities to your organisation's profit objectives over the next three years?



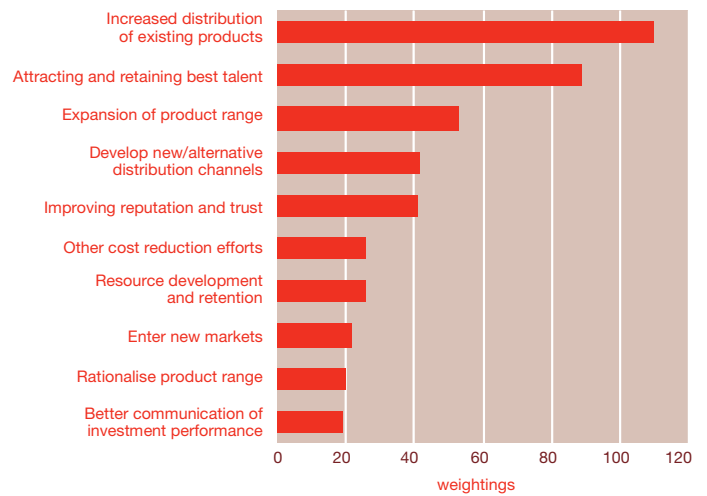
When asked to rank the greatest threats to their organisation, loss of key personnel was rated as the top response, with retaining existing clients as the second. These responses show a shift from prior year with own funds performance and increased competition rated as the top two responses. These results are indicative of several good years of stock market performance and a noticeable uplift in the importance that key personnel play, as well as the rising concern of being able to manage the deficiency of skilled supply.

Figure 5.16: Greatest threat to your organisation's profit objectives over the next three years?



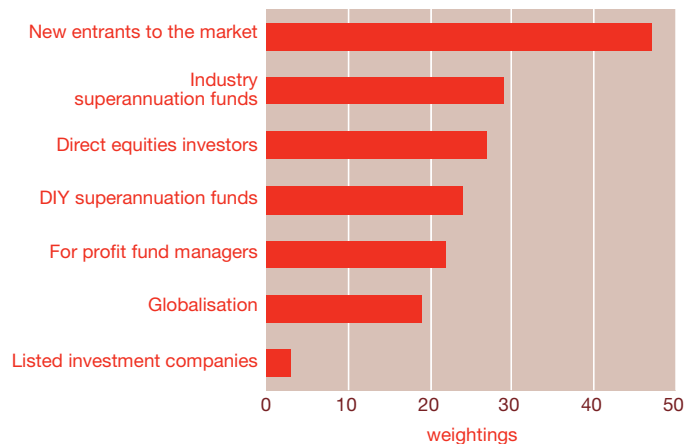
Increasing distribution of existing products in existing markets continues to be the key objectives for business now but attracting and retaining the best talent is also important and further emphasises the war on talent. Conversely rationalising the product range, in the top three objectives last year, has dropped down in importance this year.

Figure 5.17: Please indicate the 5 key objectives for your business now.



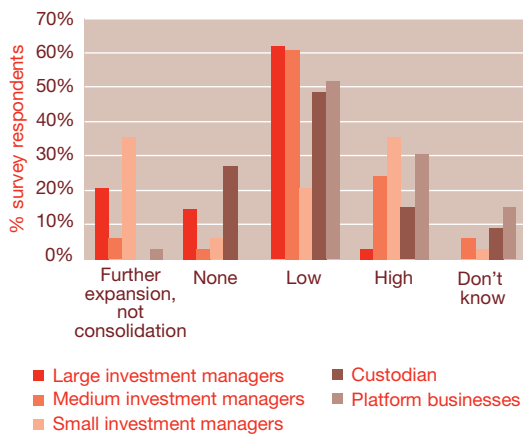
When asked to list the top three competitive issues that will most impact their businesses, industry superannuation funds was the top response last year, and by a clear margin. Results this year indicate that while industry superannuation funds are still seen as a threat, new entrants to the market pose the bigger competitive challenge. Clearly the Australian market, fourth largest in the world and with a compulsory superannuation regime, is an attractive proposition for international conglomerates and capital is being directed accordingly. Others, who had hitherto not been directly in the investment management space, are also broadening their horizons.

Figure 5.18: Top 3 competitive issues that will most impact on your business



More merger and acquisition activity is expected over the next three years, with continued consolidation expected for the smaller investment managers and platform businesses.

Figure 5.19: Over the next 3 years, how much consolidation, if any, do you expect within the following areas of the Investment Management industry?



When asked the percentage of assets under management sourced from outside Australia, just under half of respondents indicated that less than 5% were sourced from outside Australia and 33% have greater than 10%. In three years time at the bottom end, those expecting less than 5% drops to 24%, while 42% of respondents expected greater than 10% of their assets will be sourced from outside Australia.

Figure 5.20: What percentage of your assets under management is sourced from outside Australia – Now?

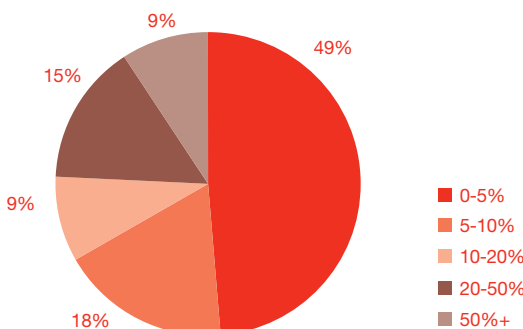
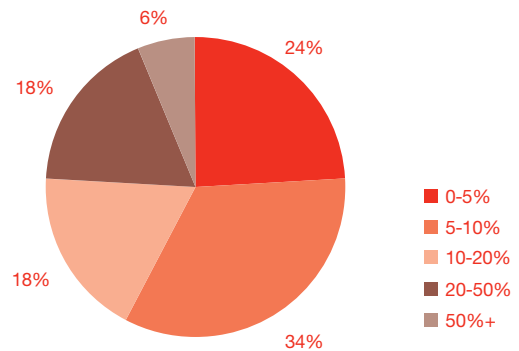
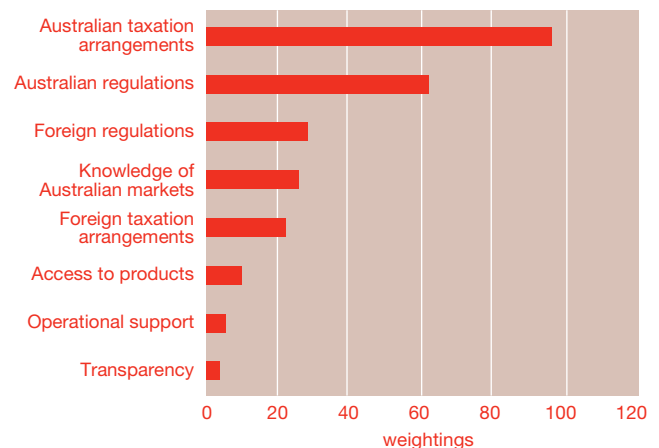


Figure 5.21: What percentage of assets under management do you expect to be sourced from outside Australia - 3 years time?



Results from the survey also show that, overwhelmingly, these funds are expected to come from Asia. While it is clear there is a push for further globalisation, there are still barriers in attracting overseas investors; Australian tax arrangements and regulations being the main ones.

Figure 5.22: What are the main barriers for attracting overseas investors of your products?



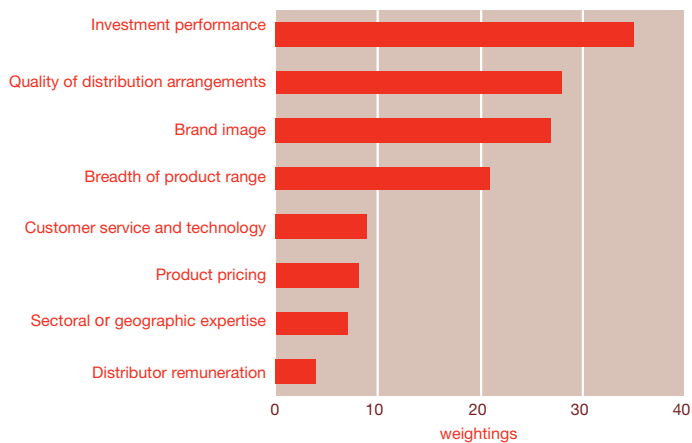
Following IFSA's work to highlight the export potential for the investment management industry, a recent report by the House of Representatives Standing Committee on Economics, Finance And Public Administration, concluded that the Australian government can aid this process of expansion by continuing to simplify the taxation system; encouraging regulatory harmonisation with major trading partners; and by placing a higher priority on the non-tariff barriers facing the financial services industry in trade negotiations.

Provided these measures are put in place, the industry can look to further opportunities to bring foreign investment to Australian managers as an increasingly viable avenue to generate the levels of growth hoped for.

Distribution and products

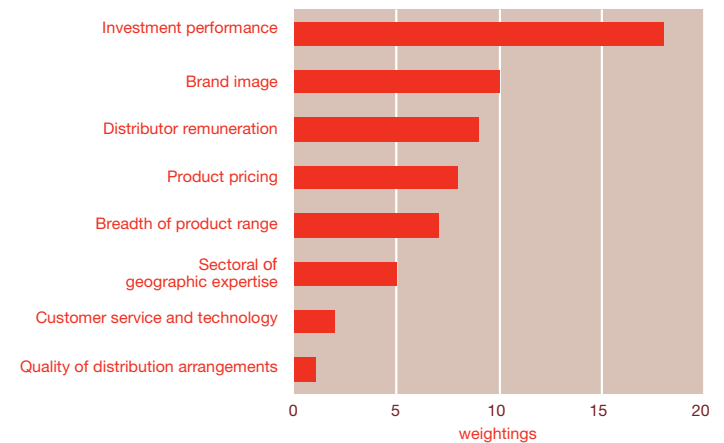
Investment performance continues to be the most important factor in increasing retail sales, albeit that other factors are increasingly prominent. When compared to last years results, the importance of distribution arrangements, brand image and breadth of product range have risen in importance, probably highlighting several good years of market performance and the need to differentiate from competitors in other ways.

Figure 5.23: Top 3 reasons why you have increased your sales in retail markets?



When asked for the reasons for a decrease in sales, investment performance has again the main reason with brand image and distributor arrangements the next two options. Interestingly product pricing was only the fourth option as a reason for decrease in sales. This view would support those who have passed on platform fees (and other costs) through increasing fee rates on certain products.

Figure 5.24: Top 3 reasons why you have decreased your sales in retail markets?



Our survey results show clear principle barriers preventing Australian fund managers from becoming more customer-centric. There is a lack of good information on customer satisfaction and expectation, shortcomings in IT infrastructure and a dependency on others (eg financial planners) that are hard to manage.

Figure 5.25: What are the principle barriers in the way of turning your organisation into a more customer-centric organisation?



Results from the survey continue to show the importance of actively managed products to the revenue of an organisation, with approximately 80% of respondents receiving over 80% of their revenues from such products. This level of importance is suggested to continue - at least for the next three years.

Intermediaries (eg financial planners) and call centres are the two main distribution channels investment management firms currently use but in three years time interactive web sites will grow in importance. This probably reflects a desire to cut costs through greater straight through processing and increased knowledge of the use of the internet by investors. It is, however, not the first time the industry considered the internet a looming distribution force.

Figure 5.26: What distribution channels do you offer to customers? Now

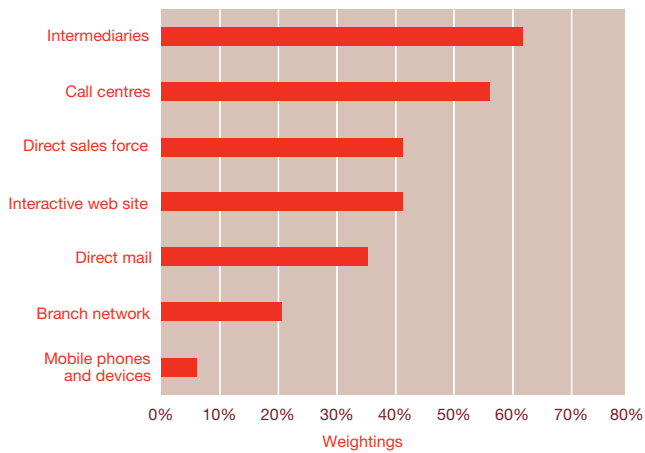
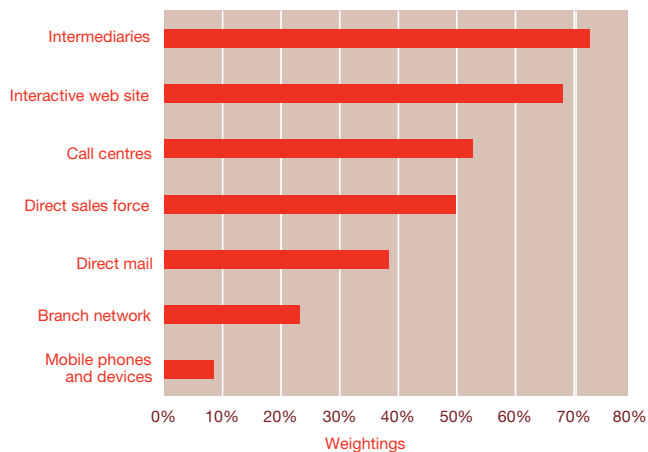


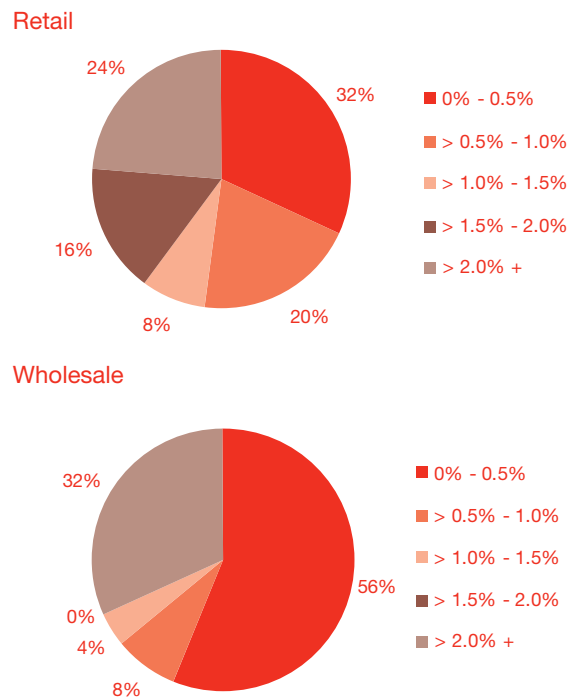
Figure 5.27: What distribution channels do you offer to customers? 3 years time



Aggregate management fees show a good spread through the retail space.

An intriguing statistic is the 'barbell effect' of fees for wholesale managers; 56% of responses indicated fees of between 0 and 50bps, while at the other end of the spectrum, 32% of respondents were receiving fees greater than 2% of their assets under management. This appears to be a reflection of traditional asset classes compared with alternative assets - and the speciality nature of businesses offering, in particular, such alternative assets.

Figure 5.28: Please indicate your aggregate management fees as a percentage of assets under management



When asked what the average length of their PDSs were, only 3% said they were less than 20 pages and over 75% said that this was the ideal length.

This continues to be an area of concern and one that regulators and industry bodies are liaising closely on. The concerns raised in Australia are echoed elsewhere; at the US Investment Companies Institute conference in March 2007 a major concern of those attending was how to reduce disclosure documents to 10 pages.

Figure 5.29: What is the average length of your PDSs?

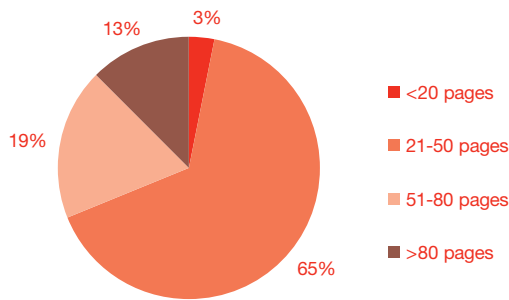
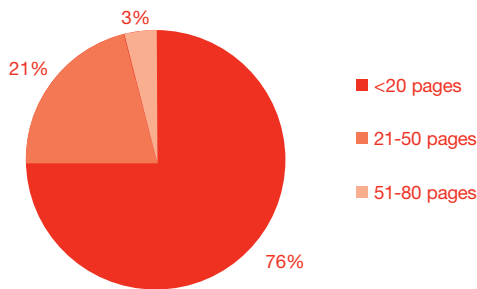


Figure 5.30: What do you think the ideal length should be?



While the industry obviously has its view, IFSA have undertaken a consumer study to understand the investor experience and be better informed about an investor's needs. This appears to be a sensible step. In time, let's hope there is a convergence of views.

The desire to eliminate unprofitable products and improve product features continues to be the main drivers for product rationalisation. The cost of implementation is still seen as the major challenge in rationalisation but operations and technology impact is also seen as important.

Figure 5.31: If you have, or are considering, rationalising your product range, please indicate the 3 key drivers for this.

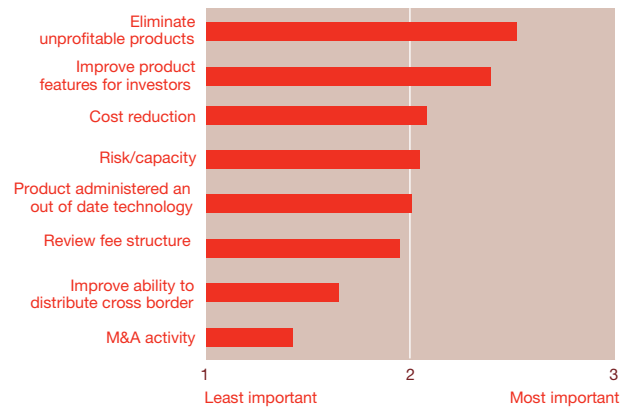
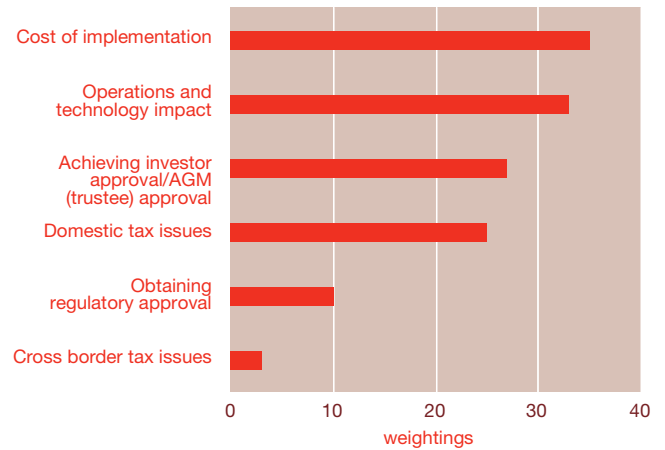


Figure 5.32: Please rank the top challenges in rationalising your product range.



The Treasury department has recently released an issues paper titled "Product Rationalisation" which will serve as a basis for consulting stakeholders about a product rationalisation mechanism in the managed funds sector. The purpose of the paper is to explore the main issues involved in developing a product rationalisation mechanism and to provide guidance to stakeholders interested in submitting their views on this matter. The closing date for submissions on this paper is 21 September 2007.

Investment process

The survey asked Chief Investment Officers for their best estimate of the Australian All Ordinaries Index at 30 June 2008. The average response was 6,693 (compared to the CEO response of 6,618).

It is clear from the survey results that part of this growth will come from alternative products and emerging markets. 37% of respondents expect to have over 10% of their assets under management housed in alternative products in three years time (up from 8% this year) and over 50% of respondents expect that between 5-20% of their assets under management will come from emerging markets in three years time compared with only 17% this year.

Figure 5.33: What percentage of your assets under management is housed in alternative products? 3 years time

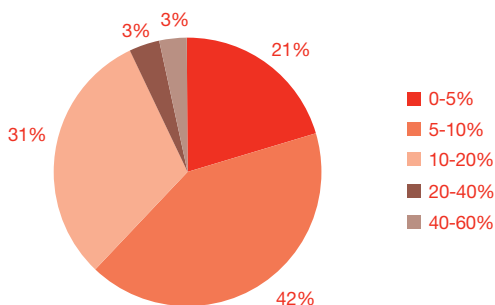
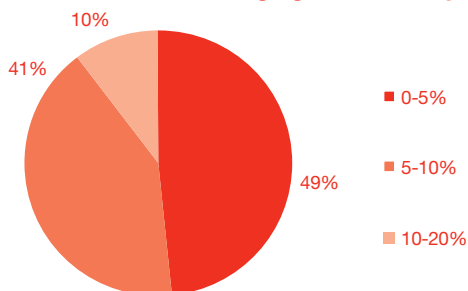


Figure 5.34: What percentage of your assets under management is housed in emerging markets? 3 years time



Recent times have seen the rise of private equity transactions in the market place and our survey results show that investment management organisations are playing an active role in these transactions - 44% of respondents indicated they “always” exercise their shareholder voting rights when the opportunity arises and this has not changed significantly in the last 3 years. Only a small number never exercised their voting rights. Quite a significant number have had a change on this front – seemingly to become more active.

Figure 5.35: How often do you exercise shareholder voting rights when the opportunity arises (asset managers only)?

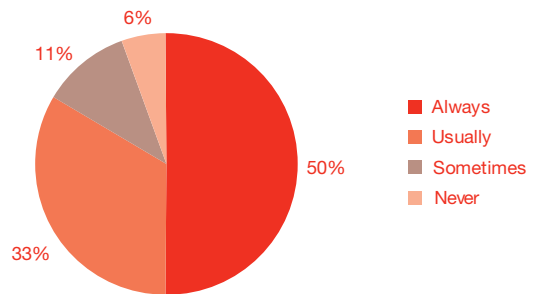
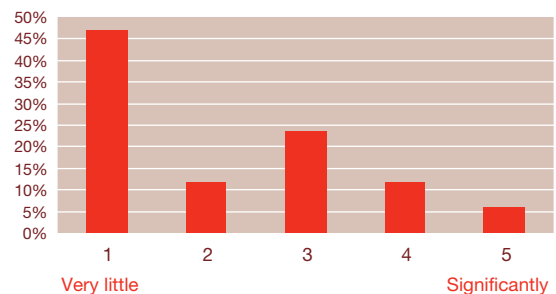
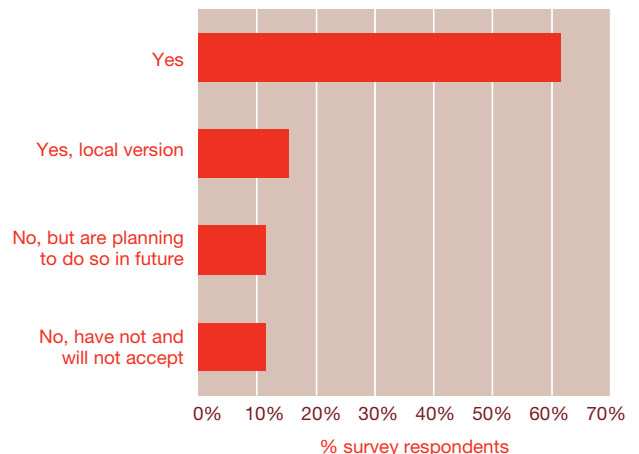


Figure 5.36: How much has this changed over the last 3 years (asset managers only)?



Our survey indicates that the take up of General Investment Performance Standards (GIPS) continues to grow, with over 60% of respondents saying they had adopted the standards, compared with approximately 50% in the prior year.

Figure 5.37: Have you adopted GIPS within your organisation?



Operational management

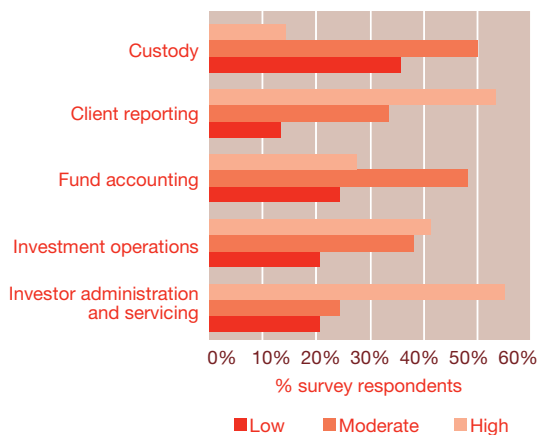
When Chief Operating Officers (COO) were asked where they have added value over the past three years, improving operational effectiveness was the top response, replacing improving service quality, which had been the top response from last year's survey. Clearly service quality remains an important priority, but in a year when the planets have aligned to deliver great growth – a shift in emphasis to ensure long term efficiency and effectiveness may be easy to rationalise.

Figure 5.38: Where do you believe you have added value over the past 3 years / 3 years time to your organisation as COO?



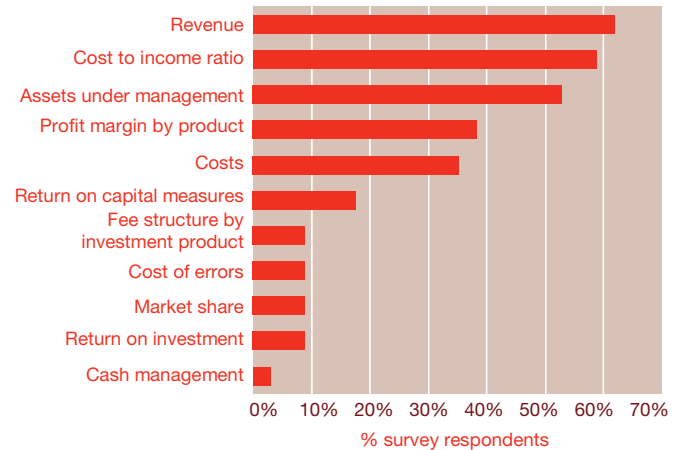
COOs have suggested that this emphasis, as well as improving client reporting, appears assured over the next three years as well.

Figure 5.39: What is your planned level of priority for operational improvement in 3 years time in the following areas



Revenue and cost to income ratios were reported by COOs to be the two most important financial metrics to measure the performance of their businesses. The raw measure of assets under management, has fallen in prominence - perhaps reflecting the good supply of funds available in the market, and possibly a shift to ensure businesses are in good shape to capitalise on what they have, if the markets turn.

Figure 5.40: What are the most important measures used to evaluate the performance of your business: Financial



Consistent with other findings in our report, employee retention is now seen as the most important measure in relation to management issues but asset growth, while still important, has fallen in significance.

Figure 5.41: What are the most important measures used to evaluate the performance of your business: Management issues



Outsourcing and offshoring

Our survey shows that there are some functions that are steadfastly protected as services to be retained in-house, such as marketing (which was and appears to remain exclusively in-house), HR (including remuneration strategies), finance and legal. Preferred functions to outsource continue to include custody, unit pricing, investment operations, registry and fund accounting. In the next three years, we can expect to see more unit pricing and registry moved to outsourced models – and a significant shift in moving investment operations and client reporting to outside providers, in particular to leverage talented, but potentially cheaper, workforces in offshore locations.

Interestingly, investment operations and client reporting also featured as the most significant priority areas over the next three years.

Figure 5.42: What functions are performed in-house, or outsourced or offshore: Now?

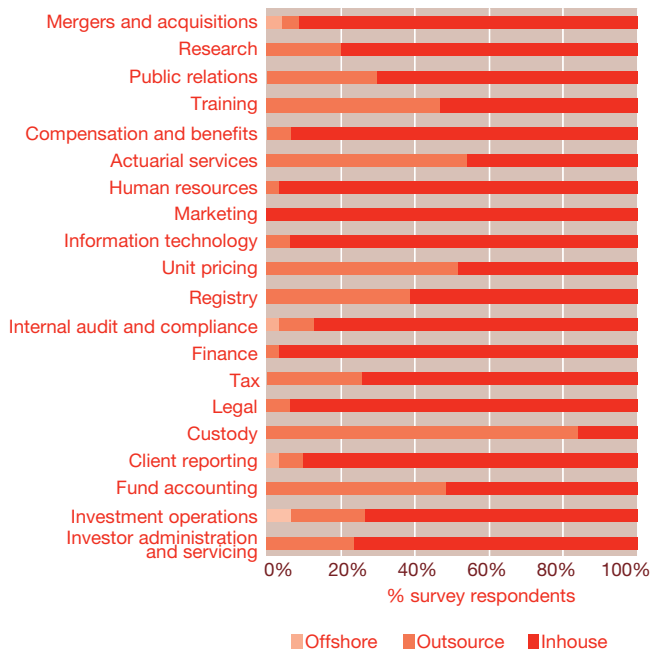
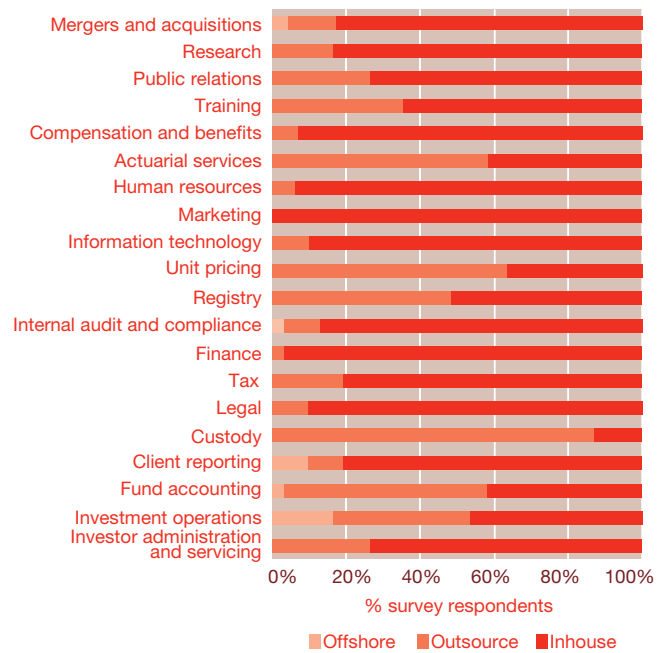


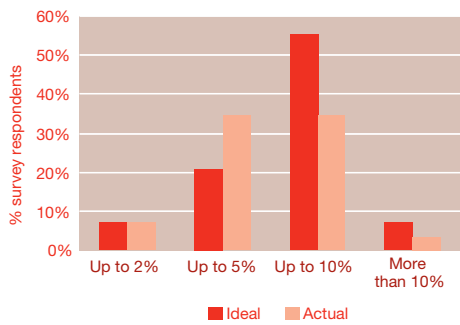
Figure 5.43: What functions are performed in house, or outsourced or offshore: Next 3 years?



We also surveyed the quality of service of the main outsourced functions – relative to prior in-house experience. For most functions, the results of the survey show that the quality of service received from outsourced/off-shored functions are the same as the in-house experience, or marginally better. The exceptions are in custody and fund accounting - where the full range of experiences are reported, but being significantly superior.

We also surveyed the manner in which outsourced arrangements are monitored by those who retain responsibility for them. The results showed that everybody relies on SLA's, with a high proportion supplementing them with observance of KPI's and service meetings. The survey also indicated that there is a greater recognition that higher amounts of spend is required to manage outsourced relationships.

Figure 5.44: How much do you spend as a percentage of the total contract value managing the outsourced relationship?

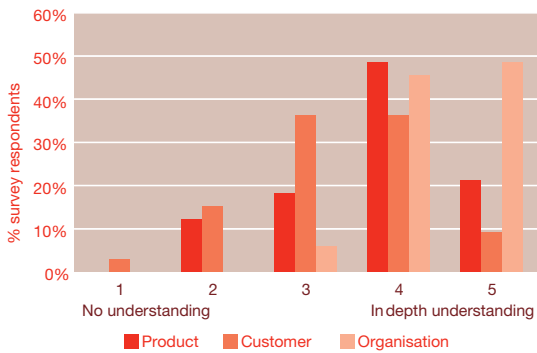


In prior years most respondents had reported that they considered a spend of between 2% and 5% as ideal, while this years survey indicates a spend between 5% and 10% is more appropriate. While there continues to be a gap between what is considered to be ideal and how much is actually being spent, it does appear that actual spend as a percentage of contract value has increased from the prior year.

Finance function and management information

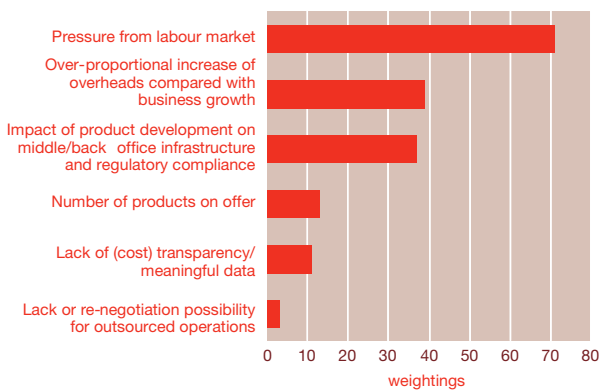
Our survey results continue to indicate that the level of understanding of organisational profitability is very high. The drive to better understand profitability of customers and products is improving. This is important; customer profitability is at the heart of segmentation strategy and understanding product profitability will be increasingly vital if product rationalisation legislative relief does eventuate.

Figure 5.45: How would you describe your current level of understanding of your costs and income by product, customer and from organisation perspective?



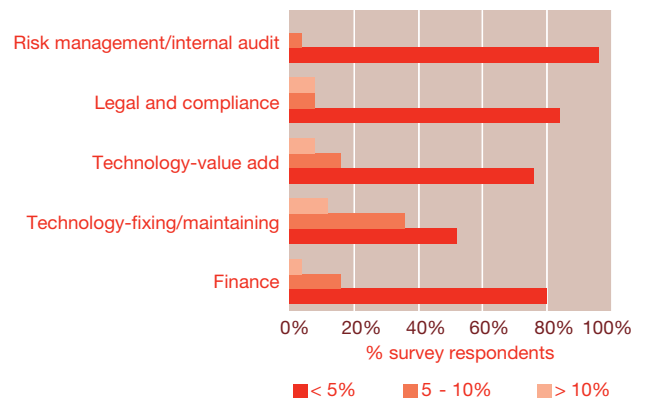
The war for talent is having a profound effect on organisations. While CEO's see it, rightly, as a major obstacle to manage to fulfil their growth objectives, CFO's on the other hand note the immediate pressure from the labour market as their top concern in controlling the cost base of an organisation.

Figure 5.46: Please indicate your organisations top 3 areas of concern in controlling you organisations' cost base



When asked to indicate their spend as a % of revenue across a number of areas, the spend on technology and in particular fixing and maintaining IT is the area with the highest cost impact.

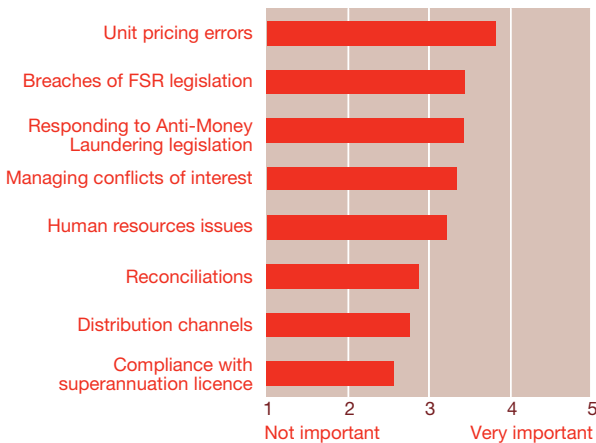
Figure 5.47: Total spend as a % of revenue for the following:



Governance, risk and compliance

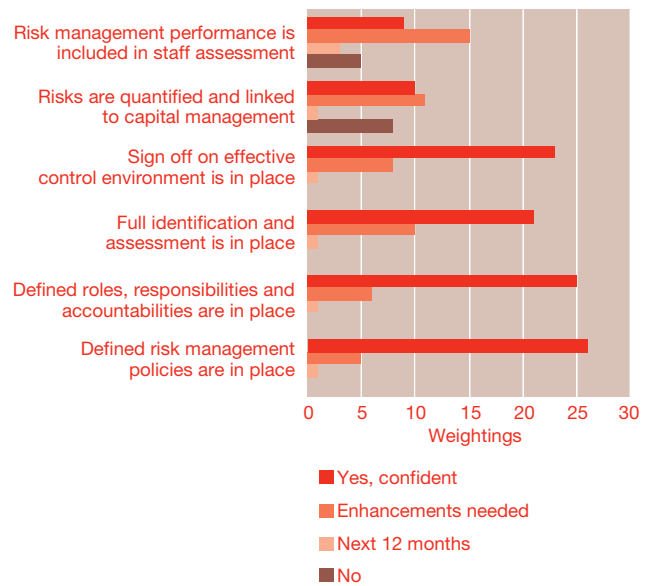
When asked to rate the biggest risk management issues facing their organisations, respondents rated unit pricing errors as the number one risk, with breaches of FSR legislation, responding to anti-money laundering legislation and managing conflicts of interest the next most significant. Unit pricing remains a challenge and important priority to manage – no doubt reflecting the open ended nature of potential breaches. For the industry, effectively managing unit prices is central to the ability to deliver equitable and fair outcomes to investors – and despite its overt simplicity, the hidden complexity has resulted in much guidance from the regulators and the industry. While the regulators indicated some leeway while organisations achieved compliance with the guidance, one would think the clock is well and truly ticking on that score. So too is the need for urgency in ensuring compliance with AML requirements. These requirements demand attention – particularly at the distribution end of the value chain.

Figure 5.48: What are the biggest risk management issues facing your organisation?



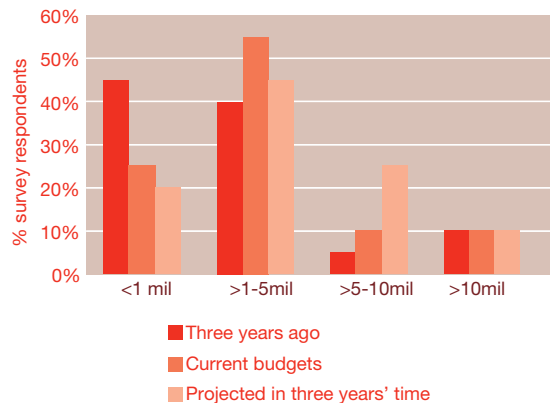
The industry has a good track record of managing risk – and are confident on many scores, albeit noting that times change, complexity is a given and continual improvements are needed. When rating their own risk management arrangements, the areas where most enhancement and improvement can be achieved is in quantifying risks and linking that quantification to capital and including risk management performance in staff assessments.

Figure 5.49: How would you rate your firm's current risk management arrangements in the following areas?



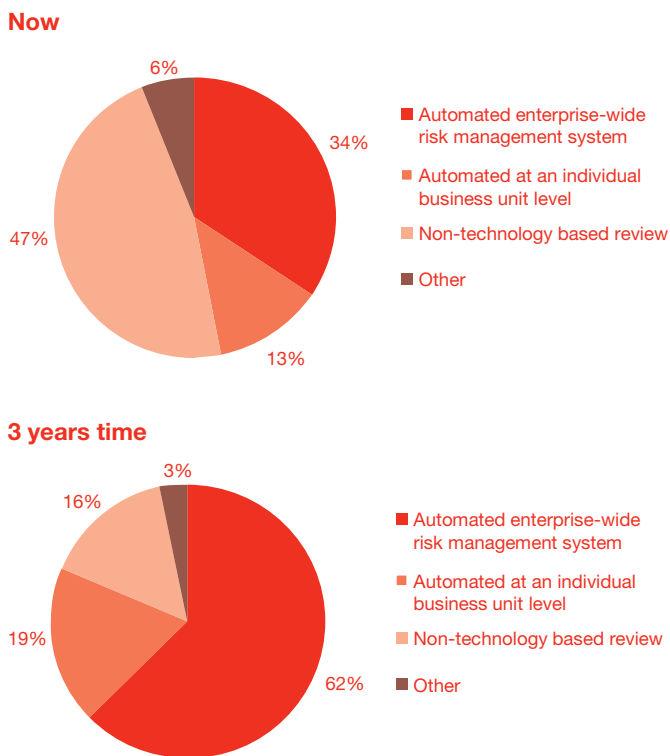
Spend on risk and compliance programs continues to increase with over 50% of respondents budgeting for a spend greater than \$1 million compared to 40% three years ago. The projected amount in three years time with 25% of respondents projected a spend greater than \$5 million. Clearly, there are some very significant commitments being made to managing risk and compliance.

Figure 5.50: Please estimate the total spend in \$AUD millions on your risk and compliance program



But the industry is determined to not stand still. Automated enterprise-wide risk management systems are expected to increase, from 34% to 62% of respondents in three years time.

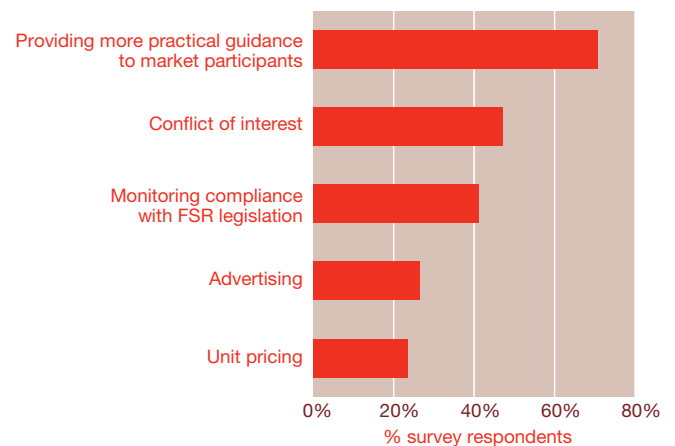
Figure 5.51: What does/will your firm use to monitor risk (a) now and (b) in 3 years time?



Asked on their views of the current regulatory environment, respondents agree strongly that the industry is comprehensively regulated. However, consistent with being critical in their own self-examinations, equally, the regulators were not spared. Respondents felt that there was inconsistent application of regulation within the industry and that regulators could improve their connection with the current business environment and demands.

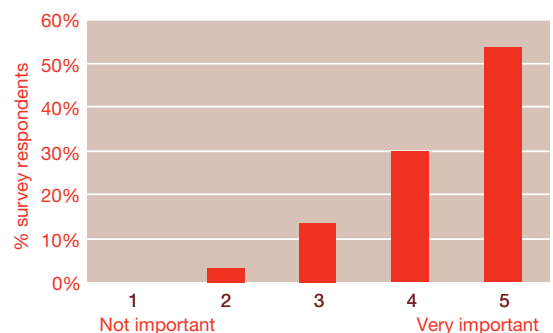
Respondents to the survey would like to see more practical guidance provided by the regulators and confirmed the regulatory position that conflicts of interest be an area of focus.

Figure 5.52: What areas do you believe should be the focus of regulators activity?



When asked the significance placed on internal controls reporting (eg SAS 70, AGS 1026 reporting), over 50% of respondents rated internal controls reporting as very important. While the current framework for internal controls reporting in Australia (AGS 1026 and AGS 1042) still has relevance, it has not kept pace with developments in other jurisdictions (particularly the UK and US). This, coupled with an increasing regulatory focus on internal controls reporting, and a growing increase in the number of internal controls reports issued, renders the current Australian framework ready for change.

Figure 5.53: Where you receive internal controls reports from providers of outsourced activities, how much significance do you attach to them?



The Australian Accounting Standards Board is revisiting the audit guidance in this area. Changes to the internal control framework for service organisations in the investment management space are anticipated to be issued in September 2007. Amongst other matters, the revised guidance aims to provide greater transparency of the tests performed by the reporting accountants and the results of that work (areas indicated as important in our survey responses). The new guidance also aims to encourage issuers of these reports to report on consistent control objectives.

PricewaterhouseCoopers

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

- Global Investment Management Perspectives
- Global Investment Management Survey 2006
- Global Private Equity Report
- ASIA IMRE News
- 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
- Private banking and Wealth Management Survey 2007
- The regulation, taxation and distribution of hedge funds around the globe June 2007
- M&A Asia

If you would like to receive any of these publications, please contact Sarah Lane, Marketing Coordinator, Australian Financial Services, on (02) 8266 0684 or sarah.lane@au.pwc.com.au.

Who to contact

PricewaterhouseCoopers (www.pwc.com) the world's largest professional services organisation, helps its clients build value, manage risk and improve their performance.

As a leading provider of professional services to investment managers, PricewaterhouseCoopers has a multi-disciplinary team of professionals comprised of business advisers dedicated to the industry.

Our specialist Investment Management and Real Estate Group includes over 40 partners, supported by a global network of professionals, whose specialist knowledge and experience enable us to provide our clients with insights into marketplace developments and global opportunities. PricewaterhouseCoopers offer industry-focused solutions and strong implementation capability, providing a globally coordinated approach to the investment management industry's business needs.

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 Sarah Lane, Marketing Coordinator, Australian Financial Services, on (02) 8266 0684 or sarah.lane@au.pwc.com.au.

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