STATE OF THE INDUSTRY

2017 | FSC/UBS ASSET MANAGEMENT

FSC FINANCIAL SERVICES COUNCIL

UBS

CONTENTS

FOREWORD

Financial Services Council

Welcome to the 2017 FSC/ UBS Asset Management State of the Industry Report, the third iteration of the annual comprehensive summary of the financial services industry in Australia.

The report outlines the big picture view of the entire industry as it currently stands, covering key areas, including the sector's crucial role in the overall economy, as well as snapshots of the life insurance, superannuation, financial advice, funds management and trustee services businesses. Its layout is intended to provide industry professionals with a must-have, quick reference guide to all the headline numbers.

The standout fact in this year's report, as in previous years, is that financial services, alongside mining, is truly one of the centrepieces of the Australian 2015-16 economy. In fact in the 2015-16 financial year, the sector cemented its place as the biggest contributor of any other industry, accounting for $145.8 billion of our $1.7 trillion economy.

Financial services is also one of the nation's largest employers, providing jobs for 416,500 people – 50 per cent of whom are women.

Recognising that trade in financial services is still small – just 3.6 per cent of Australia's $2.8 trillion funds management industry is sourced from other countries – this year we've also included in the publication a special report examining the massive opportunity Australia has to grow financial services as an export industry. There is pent up demand for our world-class expertise and products from institutions and consumers in Asia in particular and other trade partners further afield. The remaining regulatory and competitive barriers must be lifted if Australia is to fulfill its huge potential.

Financial services will continue to play a critical role in our future financial security and in the national economy. We are proud of our industry and will continue to advocate for policy outcomes which enable the sector to deliver innovative, flexible and consumer-focused products and services to enable all Australians to better manage, protect and grow their wealth in the years to come.

Sally Loane

Chief Executive Officer
Financial Services Council

FOREWORD

UBS Asset Management

The importance of Australia's financial services industry cannot be overstated. As Australia's largest industry, the financial services sector is a critical driver of GDP growth, a major employer and one of the core industries in Australia's economy. Australians rely on the financial services sector to grow their savings and fund their retirements.

Superannuation underpins Australia's financial services industry. As the fourth largest private pension system in the world and just 25 years old, our $2.1 trillion superannuation system is projected to double to $4 trillion in the next 10 years. Australia can be proud of our world class pension system, however there is still a critical need to reduce the dependence of Australian retirees on government welfare. As an industry, we have a responsibility to educate and enable Australians to make informed decisions in order to save for a secure and dignified retirement.

We are pleased to partner with the Financial Services Council for the third year to commission this comprehensive summary of the financial services industry and its central place in the Australian economy.

Bryce Doherty

Head of Australia and New Zealand
UBS Asset Management

A SNAPSHOT OF THE INDUSTRY

$2.8 TRILLION INDUSTRY

ECONOMIC CONTRIBUTION

Contributes $145.8 billion to Australian economy

416,500 Australians employed

SUPERANNUATION

$2.1 trillion

583,924 SMSFs

249 APRA regulated funds with more than 4 members

LIFE INSURANCE

28 LIFE companies

$15.5 billion in-force premium

$8.1 billion claims paid

INVESTMENT

$2.8 trillion Total Funds under management

3.6% of funds exported

FINANCIAL ADVICE

25,363 active financial advisers

2,764 Australian financial services licensees

TRUSTEES

1,500 Charitable Trusts

$4.37 billion Charitable Trust market capitalisation

EXCHANGE TRADED PRODUCTS

$24.6 billion total market capitalisation

150 number of ETPs

INTRODUCTION

As Australia's largest industry – larger than mining, manufacturing and construction – financial services has a critical role to play in our future employment and economic growth.

Over the 2015-16 financial year, the financial services sector directly contributed $145.8 billion of economic activity to our $1.7 trillion economy.

The sector rate of contribution to the economy grew by 4.3 per cent – over one and a half times faster than the rate of GDP.

Financial services is one of the largest employers in the country, employing 416,500 people - 50 per cent of whom are women.

The Australian financial services industry manages $2.8 trillion, the fourth largest pool of contestable funds in the world. The importance of financial services is not just a measure of its contribution to the economy but also for its role in delivering integration and efficiency to increase the wealth, protect the lives and provide a comfortable retirement for Australians.

This report focuses on the financial services industry covering:

- Financial services contribution to jobs, growth and exports
- The life insurance industry
- The superannuation industry
- The financial advice industry
- The investment management industry
- Exchange traded products
- Licensed trustee companies and public trustees
- Preparing for the export opportunities of the Asian regions funds passport

FINANCIAL SERVICES

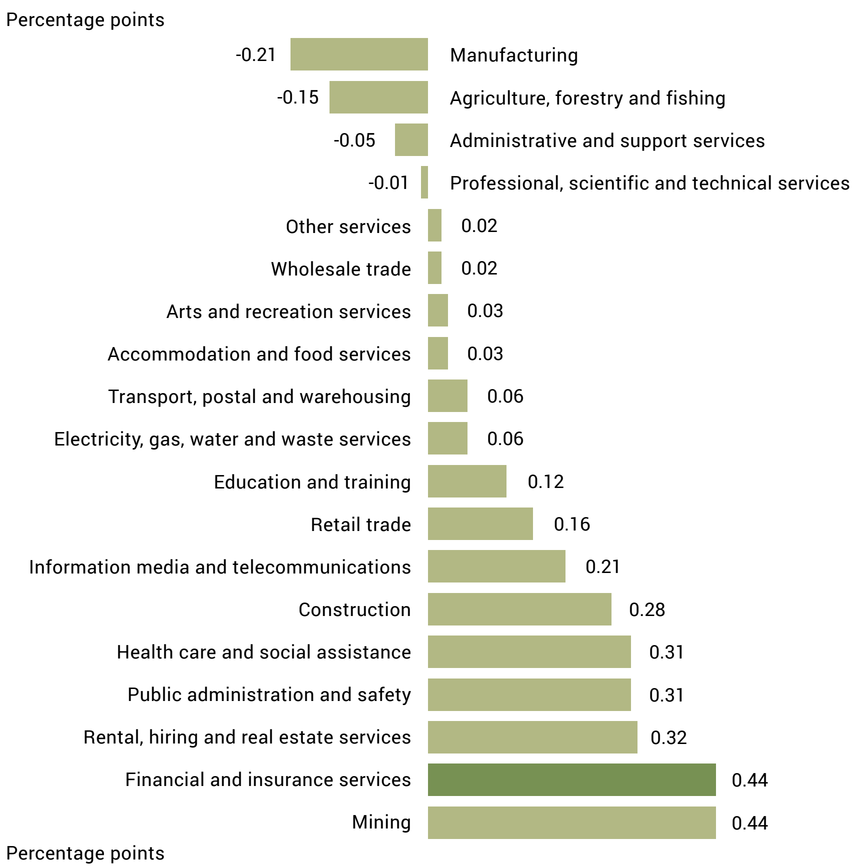
Contributing to growth, jobs and exports

Over the 2015-16 financial year, the financial services sector directly contributed $145.8 billion of economic activity to our $1.7 trillion economy. Financial services contributed approximately $6,000 for every man, women and child in Australia in the last financial year.

That equates to financial services growing by 4.3 per cent – over one and a half times faster than the rate of GDP.

Over the last year, financial services was the second most important driver of growth in economic activity after mining. While industries in Australia grew as a whole by 2.4 per cent, mining and financial services both contributed approximately 0.44 percentage points to this growth.

Figure 1: Contribution to growth in industry value added (percentage points)

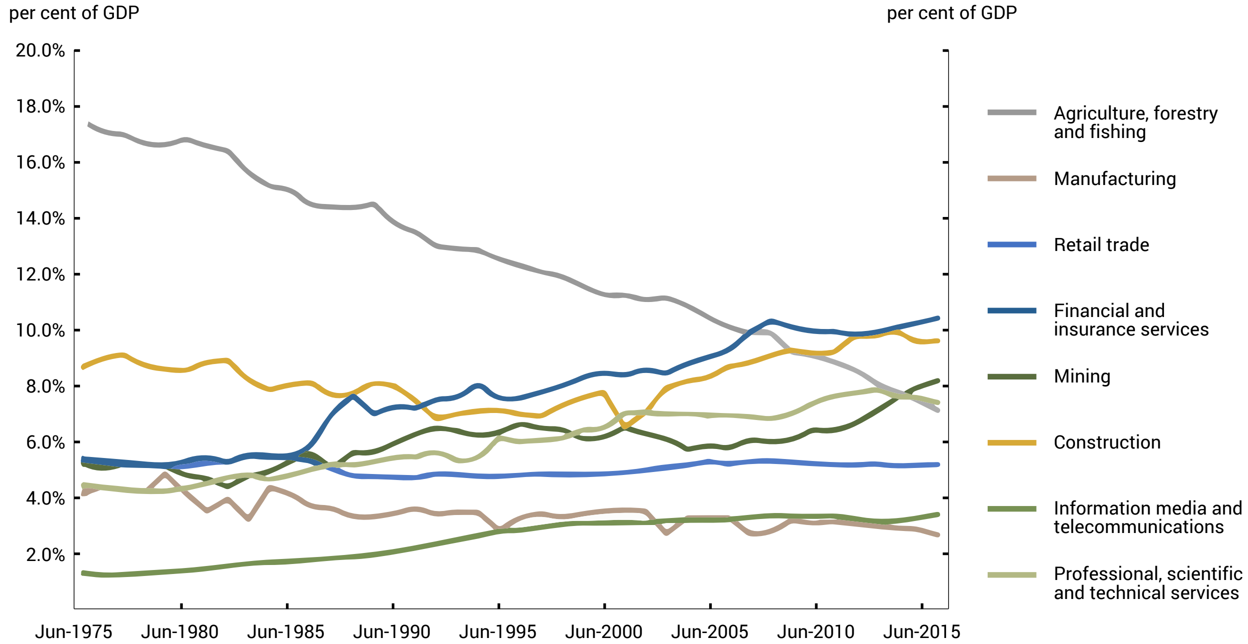


Source: ABS and FSC Estimates.

Financial services is by far the largest sector in the Australian economy, contributing 10.4 per cent of total industry Gross Value Added (GVA). Over the past 40 years this represents a doubling of the financial services share of the economy and its share of economic activity in the economy from 5.2 per cent in 1976.

It's closest rivals – construction and mining – make up just 9.6 per cent and 8.2 per cent to total industry GVA respectively.

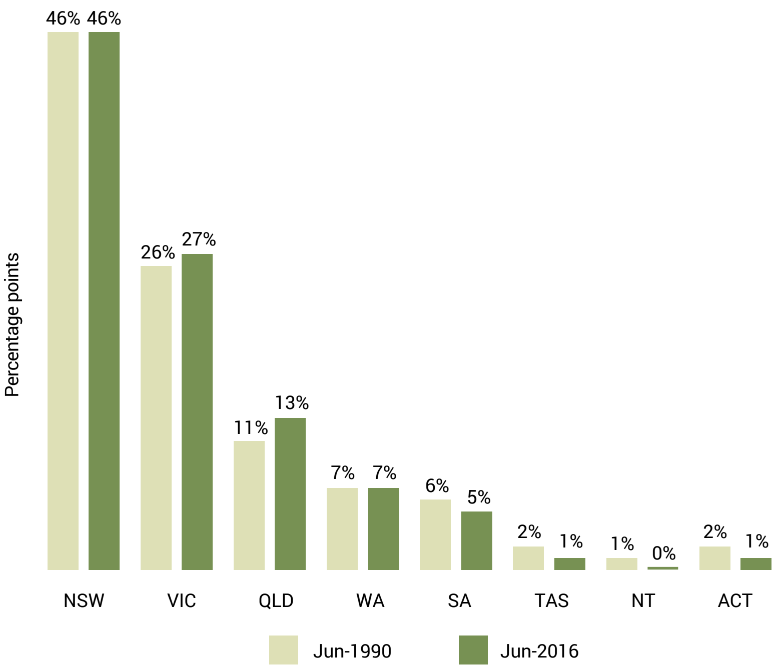
Figure 2: Industry share of gross value added 2015-16 (selected industries)



Source: ABS and FSC Estimates.

The break-up of financial services activity around the country has remained relatively stable, with NSW capturing the lion's share of economic activity from financial services with 46.1 per cent of total financial services gross value added in 2015-16, followed by Victoria at 27.0 per cent. Queensland has been able to increase its share of total financial services GVA since the 1990s at the expense of WA, SA, TAS, NT and ACT, while NSW and Victoria have modestly increased their shares.

Figure 3: Proportion of financial services Gross Value Added by State



Source: ABS and FSC Estimates.

Table 1: Importance of GVA to States and Territories

State	Financial Services GVA per cent of Total Industry GVA	Industry rank within own State
NSW	15.4%	1st
VIC	12.7%	1st
QLD	7.0%	5th
SA	8.4%	2nd
WA	4.4%	7th
TAS	6.6%	9th
NT	2.8%	11th
ACT	4.4%	6th

Source: ABS and FSC Estimates.

Employment

At November 2016, some 416,500 Australians were employed in financial and insurance services, this represents a decrease of close to 35,600 jobs over the previous year.

This reflects a natural tendency to cluster financial services in the largest population and employment centres, as well as historical anchors.

Looking at the breakdown of all financial services employment in November by mode, we note that:

- 341,200, or 81.9 per cent, worked full-time
- 208,500, or 50.0 per cent, were female

Figure 4: Financial services as a percentage of employment by State and Territory

Source: ABS and FSC Estimates.

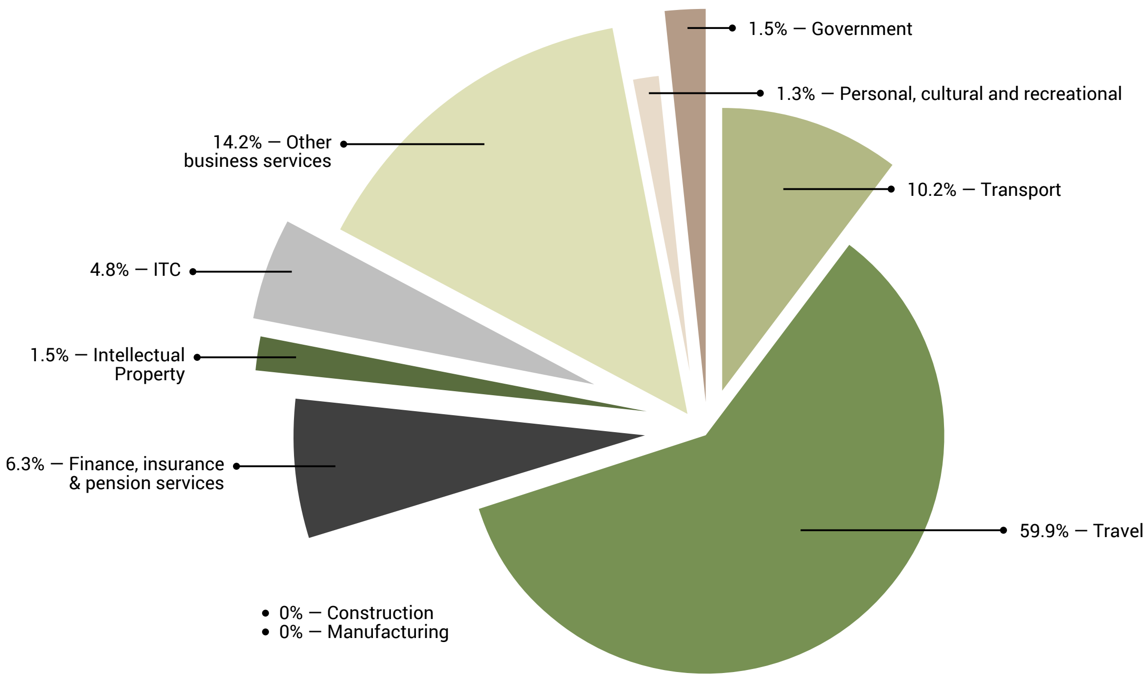
Exports

In the last 12 months since June 2016, Australia exported around $312 billion in goods and services, with around 78 per cent or $244 billion in goods exports and just 22 per cent or $70 billion services exports.

However, of our service exports, only 6.3 per cent or $4.3 billion of total exports was from service exports in financial, insurance and pension services.

Further, only $556 million, or just 0.8 per cent of all service exports were related to insurance and superannuation services, an industry in which Australia has an obvious comparative advantage and in which we have a booming domestic industry with deep skills and expertise.

Figure 5: Services exports by category



Source: ABS and FSC Estimates.

LIFE INSURANCE

Managing risk during the work years

KEY STATISTICS

NUMBER OF COMPANIES

28

CLAIMS PAID

$8.09 billion

PRODUCTS & SERVICES

- Disability insurance
- Total & permanent disability cover
- Income protection
- Trauma insurance

For Australian households, life insurance – along with staple products such as disability and income protection insurances – are products which provide family security.

In the event that a family income earner suffers illness, injury, death or disability, there is the surety that critical expenses, including mortgages, education and daily living expenses will be covered.

The Australian Prudential Regulatory Authority (APRA) currently lists 28 institutions offering life insurance within Australia.

The size of the total life insurance market in Australia as at June 2016 as measured by premiums in force was $15.52 billion, or $20.8 billion as measured by net assets for the sector.

Life insurance provides a significant benefit to the community, with life insurers paying over $8 billion in claims for the year ending 30 June 2016. A review into life insurance claims by ASIC in 2016 (Report 498) found that the majority of claims are paid in the first instance. In the five years between 2011 and 2016, 81 cents for every dollar received by group insurers was paid out in claims.

Social security and welfare continue to be the largest source of federal government spending, budgeted at $158.6 billion in 2016-17, which is more than double the cost of health expenditure and equating to 35 per cent of total expenditure.

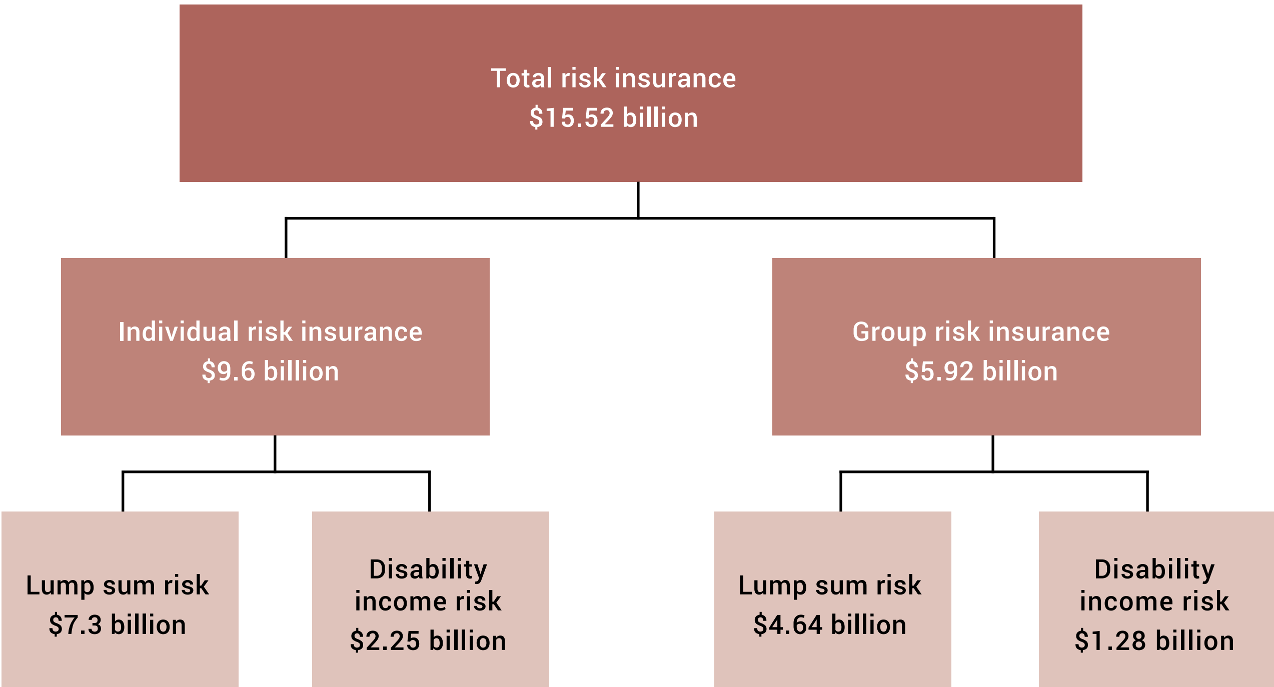
The transfer of financial risk associated with premature death and unexpected disability to the private insurance sector is therefore vital to reducing the burden on taxpayers of publicly funded social security. Group insurance reduces the annual cost to Government of social security by about $403 million.

Life insurance is distributed in three main ways:

- **Group** — as a group policy (e.g. purchased by the trustee of a superannuation fund, or an employer, with fund members/employees ultimately given the benefit of the cover under the policy);
- **Retail** — by financial advisers; and
- **Non-advised** — directly by insurers or their partners/affiliates.

In Australia today, around $9.6 billion or 62 per cent was from individual risk insurance business acquired directly or through an adviser, while $5.92 billion, or 38 per cent was from group risk insurance business usually acquired via superannuation channels.

Figure 6: Life insurance market in Australia



Source: ABS and FSC Estimates.

Consumers interact with these distribution channels very differently:

Group insurance traditionally provides default levels of insurance under automatic acceptance limits, either through a superannuation plan or employer sponsored arrangements. The trustee or employer selects the insurer and insurance levels provided under the scheme. Members of a group insurance scheme can usually also apply for additional cover with underwriting beyond the default cover that is generally provided without underwriting. Default cover without underwriting is generally subject to eligibility criteria.

Non-advised or direct insurance products are usually accessed through relatively simple application processes (i.e. telephone or online), often with less underwriting questions when compared to applications for retail advised life insurance. Where an intermediary is involved (i.e. in an outbound sales capacity) they are usually not authorised to provide personal advice but instead provide general advice about the product following a script where they identify product features, benefits and risks including exclusions. These intermediaries primarily act as a facilitator to the application process but are able to answer any questions about the terms and conditions of the product.

Retail advised insurance generally provides the most comprehensive insurance range of products and definitions with sophisticated product structures that can be adapted to a wide variety of personal and business insurance needs (including flexible combinations of cover inside and outside of the super environment). The levels of cover available in retail insurance is usually much higher than the other channels, with acceptance of risk by way of detailed underwriting. Advisers or brokers typically provide retail clients with personal advice in relation to life insurance.

The life insurance industry has also been proactively implementing self-regulatory reform. As part of the industry's response to the Trowbridge review, in 2015 the FSC proactively committed to developing a Life Insurance Code of Practice (Code). The recently released Code sets standards above existing law in many areas and is a reflection of the commitment of life insurers to strengthen industry standards for the benefit of all Australians. These important reforms seek to improve the life insurance industry for the benefit of consumers.

SUPERANNUATION

Post-retirement income

KEY STATISTICS

SUPERANNUATION POOL

$2.1 trillion

APRA REGULATED

$1.3 trillion

SMSF

$600 billion

OTHER (EXEMPT AND LIFE OFFICE)

$179 billion

APRA-regulated funds managed **62%** of Australia's superannuation assets

SMSFs represent **29.6%**

Superannuation underpins Australia's financial services industry. As the fourth largest private pension system in the world and just 25 years old, our $2.1 trillion superannuation system is projected to double to $4 trillion in the next 10 years and reach $9.5 trillion by 2035.[1]

Superannuation is vital in ensuring Australians save enough throughout their working lives to provide them with adequate incomes to meet their quality of life in retirement. This also ensures we can sustain public finances by reducing government outlays as our population ages. Currently, Australians contribute 9.5 per cent of their income as compulsory superannuation payments.

1 — Deloitte (2015)

How Superannuation arrangements work post the new changes

The superannuation system helps Australians to enhance their retirement incomes and can supplement or reduce reliance on the Age Pension. Since the advent of compulsory superannuation in 1992, employers have been required by law to make minimum payments to a complying superannuation fund to help employees save for retirement. This rate is currently 9.5 per cent and is scheduled to rise to 12 per cent between 1 July 2021 and 1 July 2025.

Australians are also able to make additional voluntary contributions to superannuation in order to boost their retirement savings. Superannuation benefits are generally preserved until the age of 55 years (increasing to 60 years).

The Government has recently introduced a range of changes to superannuation arrangements:

- From 1 July 2017, Pre-tax contributions of up to $25,000 pa into superannuation funds are taxed at a flat rate of 15 per cent in the fund.
- From 1 July 2017, there will be a $1.6 million transfer balance cap on the total amount of accumulated superannuation an individual can transfer into the tax–free retirement phase. Subsequent earnings on balances in the retirement phase will not be capped or restricted. Savings beyond this can remain in an accumulation account (where earnings are taxed at 15 per cent) or outside the superannuation system.
- From 1 July 2017, the Government will lower the annual non–concessional contributions cap to $100,000 and will introduce a new constraint such that individuals with a balance of $1.6 million or more will no longer be eligible to make non–concessional contributions. As is currently the case, individuals under age 65 will be eligible to bring forward up to 3 years of non–concessional contributions.
- Currently superannuation fund earnings in the accumulation phase are generally taxed at 15 per cent, while superannuation fund assets that support a retirement income stream are tax exempt. However from 1 July 2017 the assets that support a retirement income stream before a consumer reaches preservation age will be taxed at 15 per cent.
- From 1 July 2017, the threshold at which high income earners pay additional contributions tax (Division 293) will be lowered from $300,000 to $250,000.

Superannuation will continue to be taxed concessionally than some other forms of saving, such as bank deposits, in recognition of the fact that superannuation saving cannot be accessed until retirement.

Source: Treasury Super Changes Fact Sheets

The Australian superannuation fund sector has a critical role in minimising reliance on social welfare, through tax-effective and mandatory savings over a lifetime of work.

Over the twelve months to September 2016, there was a 7.4 per cent increase in superannuation assets under management to $2.1 trillion.

Table 2 breaks down APRA regulated funds into the four major fund providers – Retail, Corporate, Public Sector and Industry, as well as SMSF and other. After SMSF funds, Retail funds are the largest superannuation provider with $558.6 billion of assets under management, and 139 different fund providers across 13.8 million accounts.

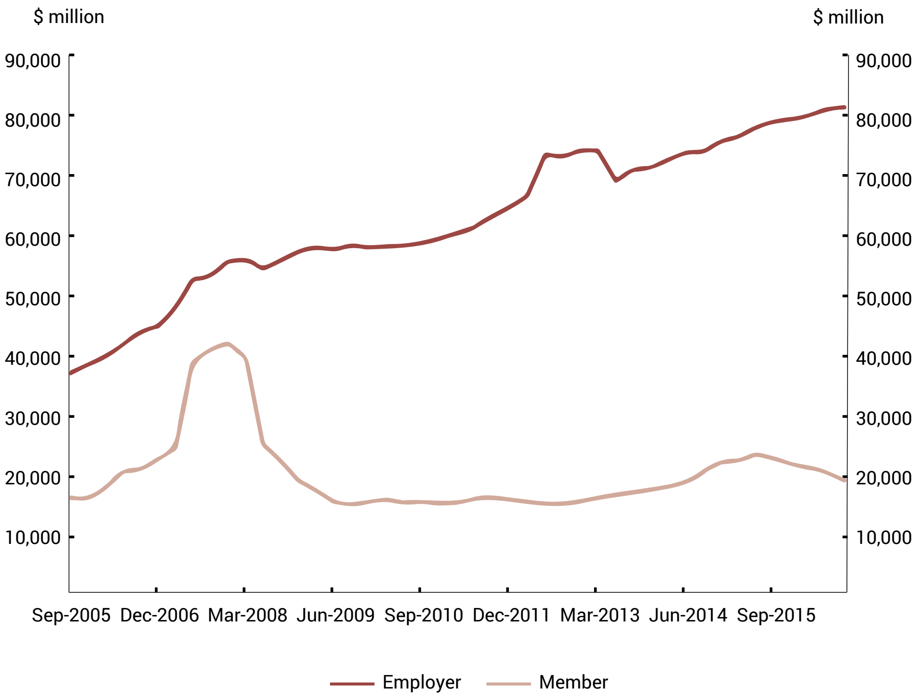
Table 2: Superannuation Industry Overview

Superannuation Industry Overview			
Type of Fund	**Total Assets $b**	**No. of funds**	**No. of accts ('000)**
Retail	558.6	139	13,751
Corporate	56.3	31	346
Public Sector	355.2	38	3,524
Industry	481.7	41	11,303
SMSF	637.9	583,924	1,054
Balance of statutory funds	56		
Total	**2,145.6**		

Source: APRA, ATO and FSC Estimates

The rate at which contributions to the superannuation system are made have been falling, with total contributions dropping 1.1 per cent from previous levels over the past 12 months. While employer contributions added a positive 0.3 percentage points to total contributions, member contributions subtracted 1.5 percentage points. This suggests that while slower wage growth may be a factor in lower contribution rates generally, recent uncertainty around superannuation system settings have resulted in a fall in member contributions driving total contributions lower as a whole.

Figure 7: Member and Employer Contributions ($million)

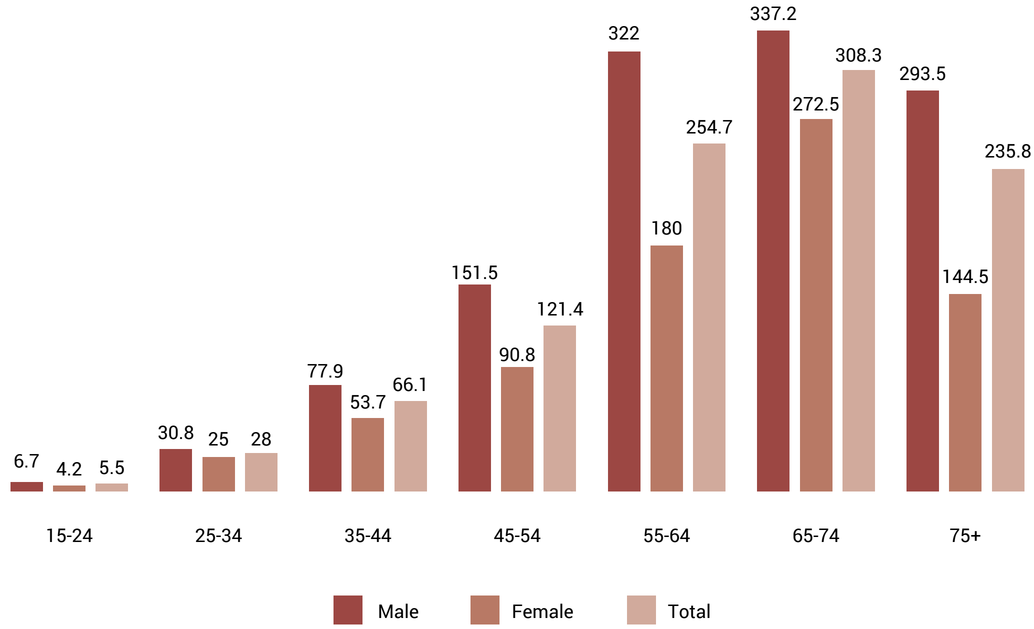


Source: APRA and FSC Estimates

How much money do you have?

As at 2013-14, the average superannuation account balance in Australia is approximately $110,000 – with the gender imbalance prevalent with males as a group having an average account balance of $135,000 compared to $83,000 for females. Figure 8 shows average account balances by age and gender.

Figure 8: Mean Superannuation Account Balance by Gender and Age $'000

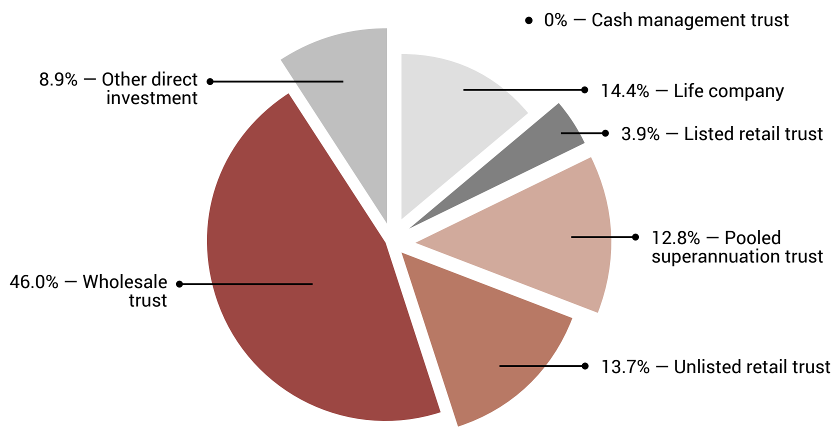


Source: APRA and FSC Estimates

Who actually invests your money?

APRA regulated superannuation funds, which hold $1,429 billion in assets may be invested in a variety of ways, including directly investing in assets, or indirectly – such as an investment with an investment manager. APRA regulated superannuation funds currently invest $517 billion directly, and $912 billion indirectly – of which $781 billion is placed with investment managers, and $131 billion is superannuation provided through a life insurance company. Wholesale trust mandates are the most common form of indirect investment making up 46.0 per cent of indirect investment (See figure 9).

Figure 9: Indirect investment allocation for superannuation funds, percentage



Source: APRA and FSC Estimates

MySuper funds are the default way your money will be invested and offer a single diversified investment option or a lifecycle investment option.

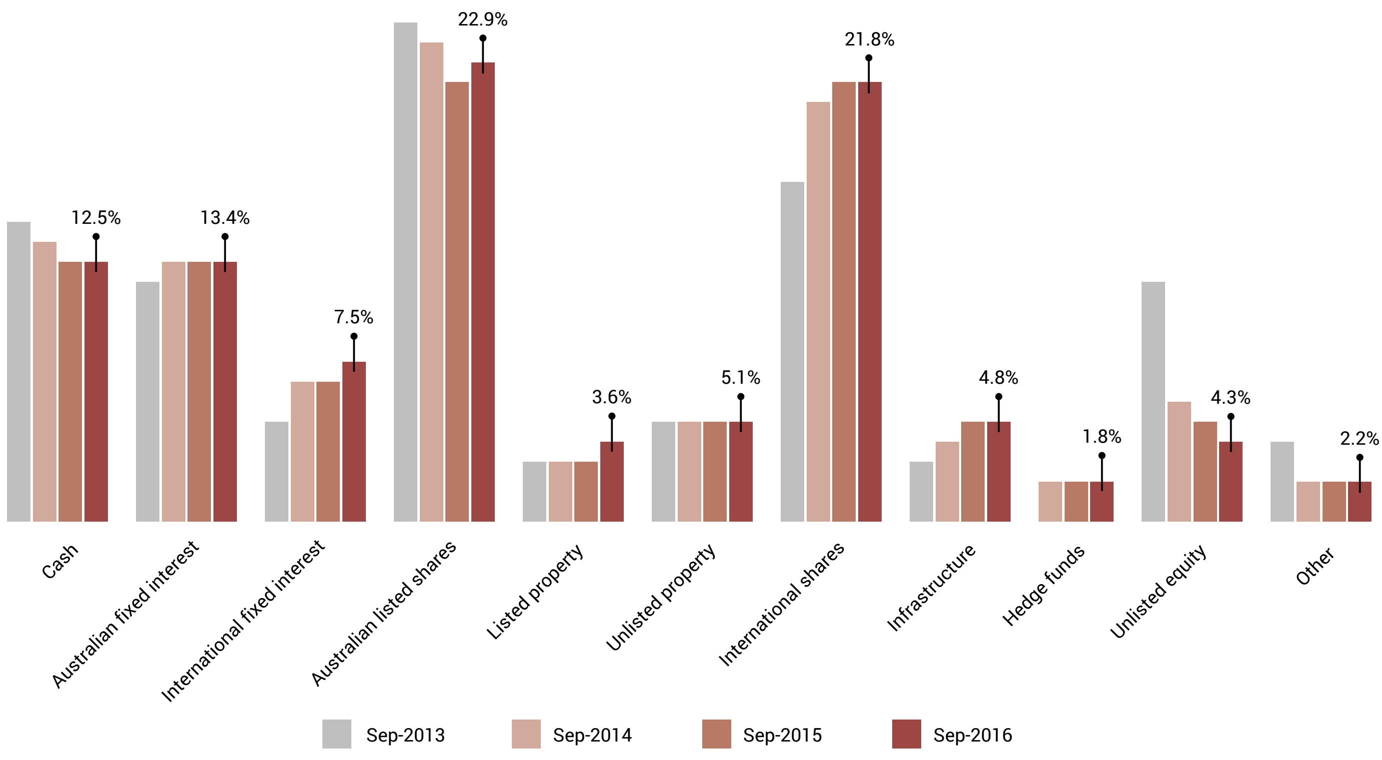
- **Balanced investment option** - your money will be put in a standard mix of investments and the risk-reward approach will stay the same for your whole life. It is common for these funds to have a balanced/growth approach to investing with 70 per cent of assets in growth (e.g. shares and property) and 30 per cent in defensive investments (e.g. cash and fixed interest).
- **Lifecycle investment strategy** - Super funds that offer a lifecycle option will move your money from growth investments when you're young to more conservative investments when you're older.

Around 37 per cent of total APRA regulated super fund assets or $492.2 billion are in a MySuper product, with $161.6 billion in a lifecycle product. There are 111 MySuper products, of which 30 are a lifecycle investment option. The remaining $937 billion of APRA regulated superannuation assets are in choice products.

How is your money invested?

Total superannuation assets for APRA regulated funds had 23 per cent in Australian listed shares, 22 per cent in international shares, 13 per cent cash, 13 per cent Australian fixed interest, 8 per cent international fixed interest, 5 per cent in unlisted property, 5 per cent in infrastructure, 4 per cent in listed property, 4 per cent in unlisted equity, 2 per cent in hedge funds, and 2 per cent in other investments. Over the last 3 years since September 2013, one of the major shifts in asset allocations have been from Australian shares into international shares.

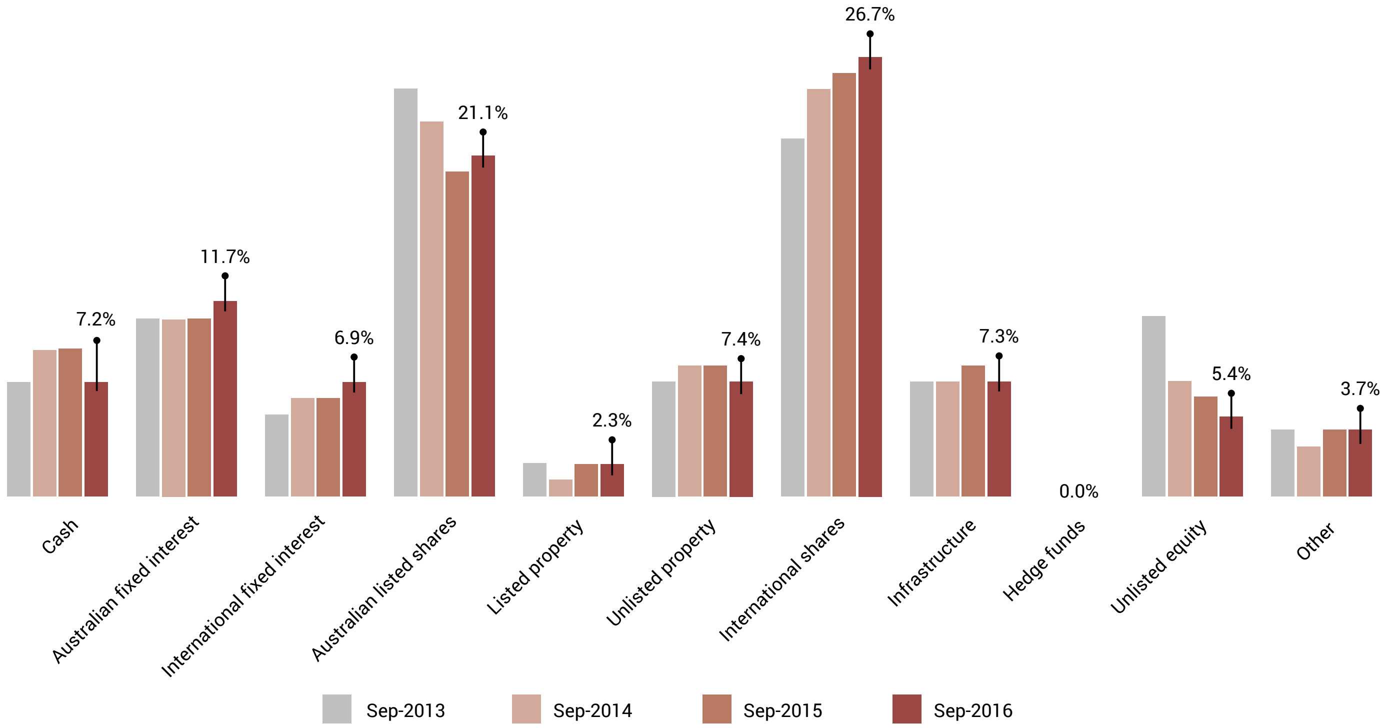
Figure 10: Asset allocation – all APRA regulated superannuation funds



Source: APRA and FSC Estimates

MySuper Fund Asset allocations have been broadly similar to total asset allocations for APRA regulated superannuation funds.

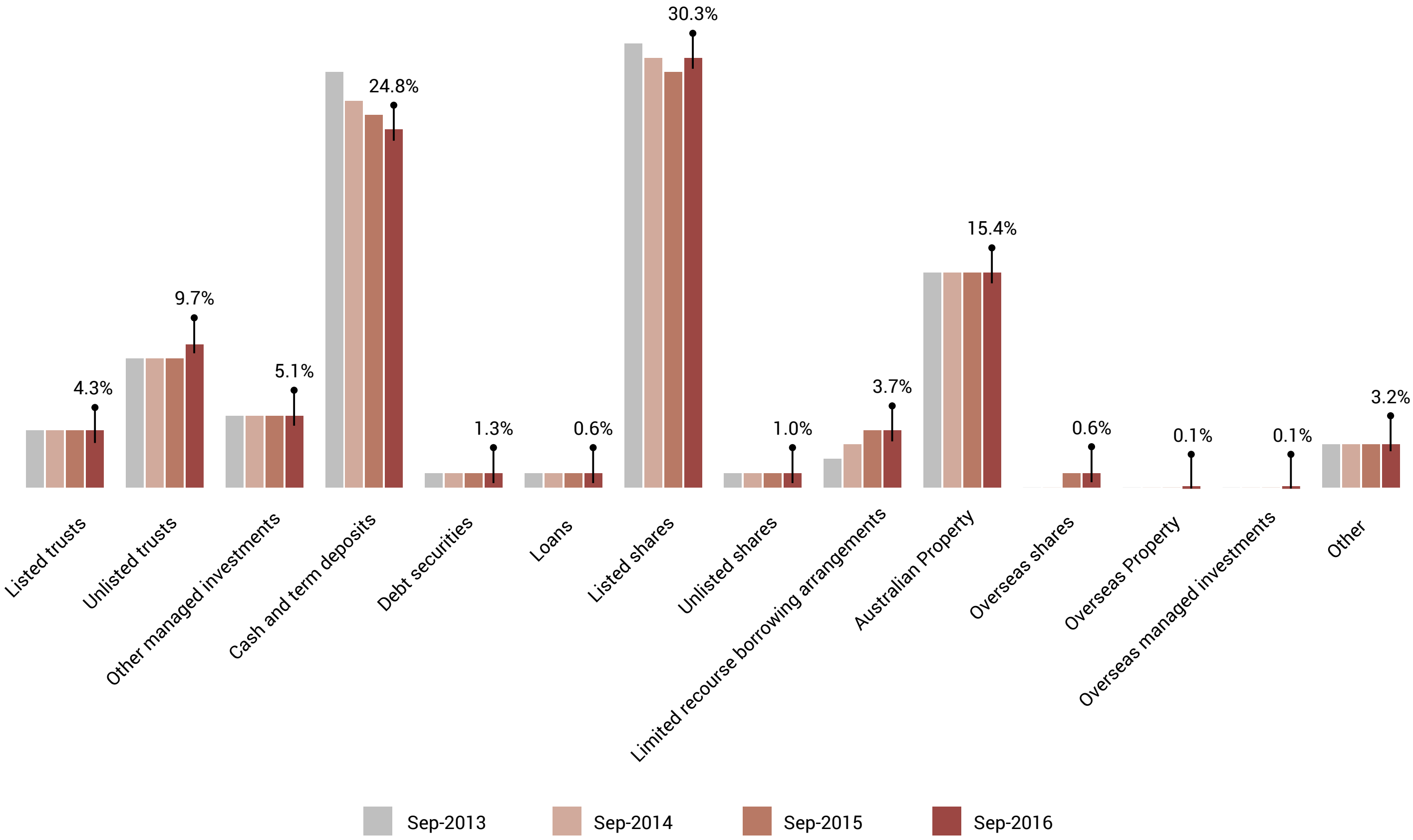
Figure 11: Asset allocation – MySuper Products



Source: APRA and FSC Estimates

SMSF funds have a significantly lower investment allocation to overseas shares, at 0.1 per cent and a larger allocation to property, with Australian property at 15.4 per cent.

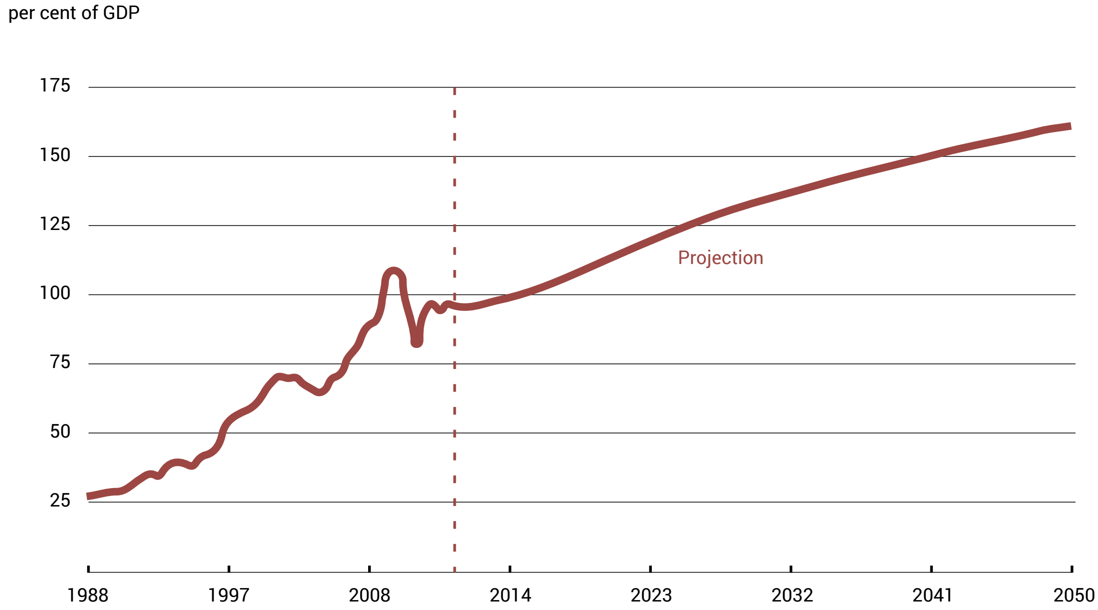
Figure 12: Asset allocation SMSFs



Source: ATO and FSC Estimates

A longer-term projection of superannuation assets as a fraction of GDP is as follows:

Figure 13: Superannuation assets to 2050

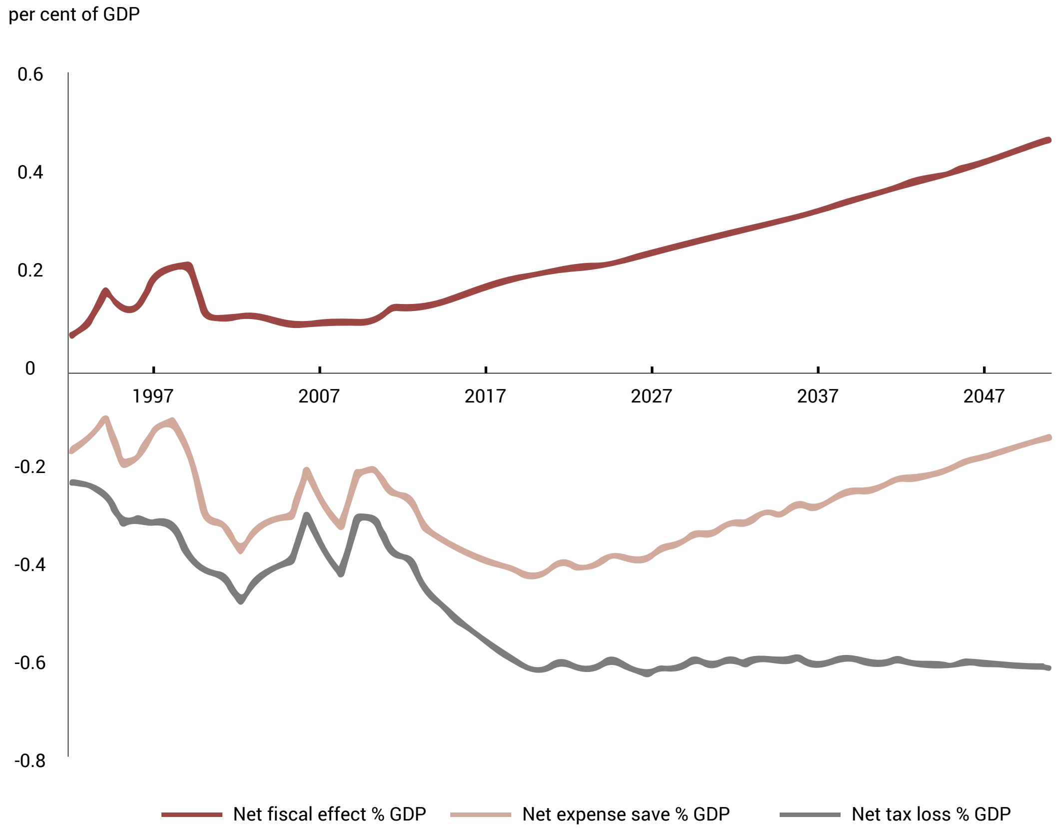


Source: Treasury

It is worth noting, however, that in terms of retirement income adequacy, the 12 per cent contribution rate is the fulcrum point at which retirement savings start closing the gap to income requirement. The delay in phase-in is estimated to deliver a $136 billion shortfall in retirement savings over the same period.

The first is that in terms of direct costs (indirect tax subsidy v. savings), there is a 30-year process over which Australian superannuation moves into fiscally-positive territory.

Figure 14: Reduction in taxes and aged pension outlays from the superannuation guarantee[2]



Source: Treasury

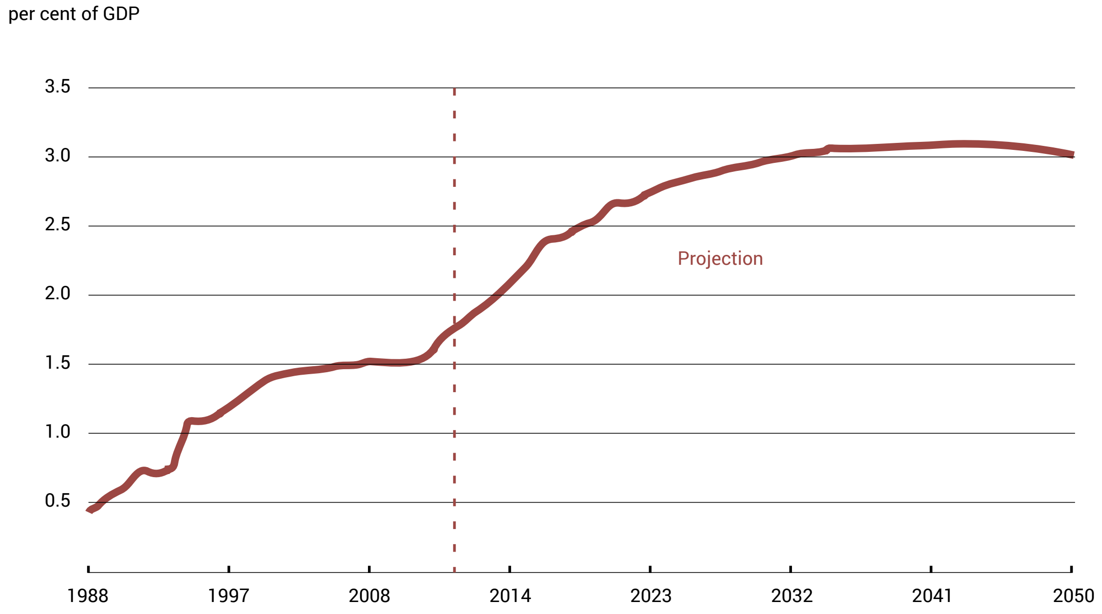
2 — Australian Government Treasury, "Report on the Super Charter and Super Council", 5 July 2013

Figure 14 shows the net tax foregone from indirect Government support for superannuation, compared to the net savings from replacement of public pensions with private retirement incomes. The taxation cost becomes flat when the Superannuation Guarantee rises to 12 per cent of incomes, so the net fiscal effect is positive from then on.

In the meantime, concessional tax rates for superannuation are justified primarily by the principle of considering retirement income across an entire lifetime (both working and non-working) rather than just during labour-market participation.

The tax foregone does not tell the whole story. Alongside the fiscal benefits, the increase in capital stock from mandatory and tax-effective superannuation has important implications:

Figure 15: Estimated contribution of compulsory super to private saving



Source: Treasury

This doubling of savings as a percentage of GDP over a 15-year period has significant implications for domestic capital availability and pricing, and consequently for foreign debt.

FINANCIAL ADVISERS

Guiding household savings

KEY STATISTICS

NUMBER OF ACTIVE FINANCIAL ADVISERS

25,363

NUMBER OF AUSTRALIAN FINANCIAL SERVICES LICENSEES

2,764

Financial advisers help households achieve their financial goals and grow their wealth for a comfortable lifestyle. Our industry currently has 23,363 financial advisers who provide advice through 2,764 Australian financial services licensees. Financial advice is an industry that is increasing adviser standards and is transforming into a profession.

- ASIC launched its register of financial advisers on 31 March 2015, providing consumers with both a guide to financial advice, as well as search access to the register of financial advisers, via its Moneysmart website.
- A snapshot of the ASIC register at 1 January 2017 shows 47,481 unique entries, of whom 25,363 are registered as current, with the remainder ceased.
- The ASIC adviser register will provide a clear snapshot of advisers who give personal advice to retail clients. It will provide a single port of call for consumers to access information on what each adviser can advise on, who they are licensed by, their qualifications, if they are a member of an association and if they have been disciplined. It will also enable the industry and other stakeholders to accurately track the number of advisers and any changes in numbers from 31 of March 2015. Previous reported figures were estimates that ranged from self-reported figures reported by the largest licensees and did not capture the whole market.

Figure 16: New advice framework

NEW STANDARDS BOARD		
	NEW ADVISERS	**EXISTING ADVISERS**
REQUIREMENTS	Complete a bachelor degree or equivalent qualification which meets the Standards Board requirements	Complete degree equivalent or transition pathway recognised by Standards Board
	Exam	Exam
	Professional Year required	NA
	Continuing Professional Development	Continuing Professional Development
	Code of Ethics	Code of Ethics

Source: Proposed framework set out in exposure draft legislation, Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015

On 23 November 2016, the Government introduced legislation into parliament to raise the education, training and ethical standards of financial advisers who provide personal advice on relevant financial products.

The legislation proposes to establish a new independent standards body which will set education standards for financial advisers. The new body will be established as a Commonwealth company. The body will have responsibility for developing the exam, the code of ethics and setting appropriate education requirements.

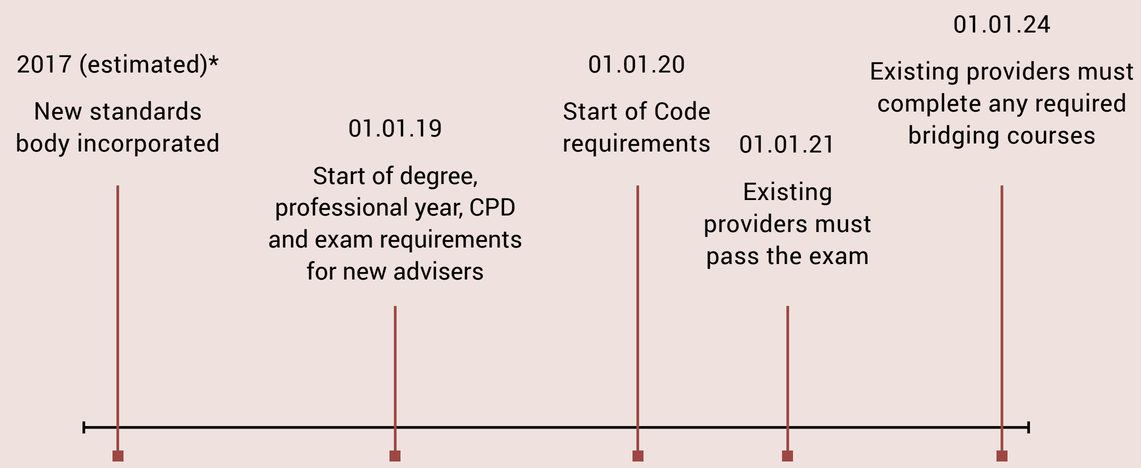
The increased education and ethical standards requirements include:

- compulsory education requirements for new and existing advisers;
- professional year requirements for new advisers;
- code of ethics;
- continuing professional development; and
- an exam.

The new framework commences 1 January 2019. All financial advisers who provide personal advice on relevant financial products commencing from this date will be required to hold a relevant degree, complete a professional year and exam, as well as undertaking ongoing professional development and will need to adhere to a code of ethics.

Transitional arrangements will require existing advisers to have completed the exam by 1 January 2021 and the degree or equivalent qualification by 1 January 2024.

Figure 17: Summary of transition arrangements for existing providers[3]



01.01.19 — 01.01.24: Transition period for existing providers

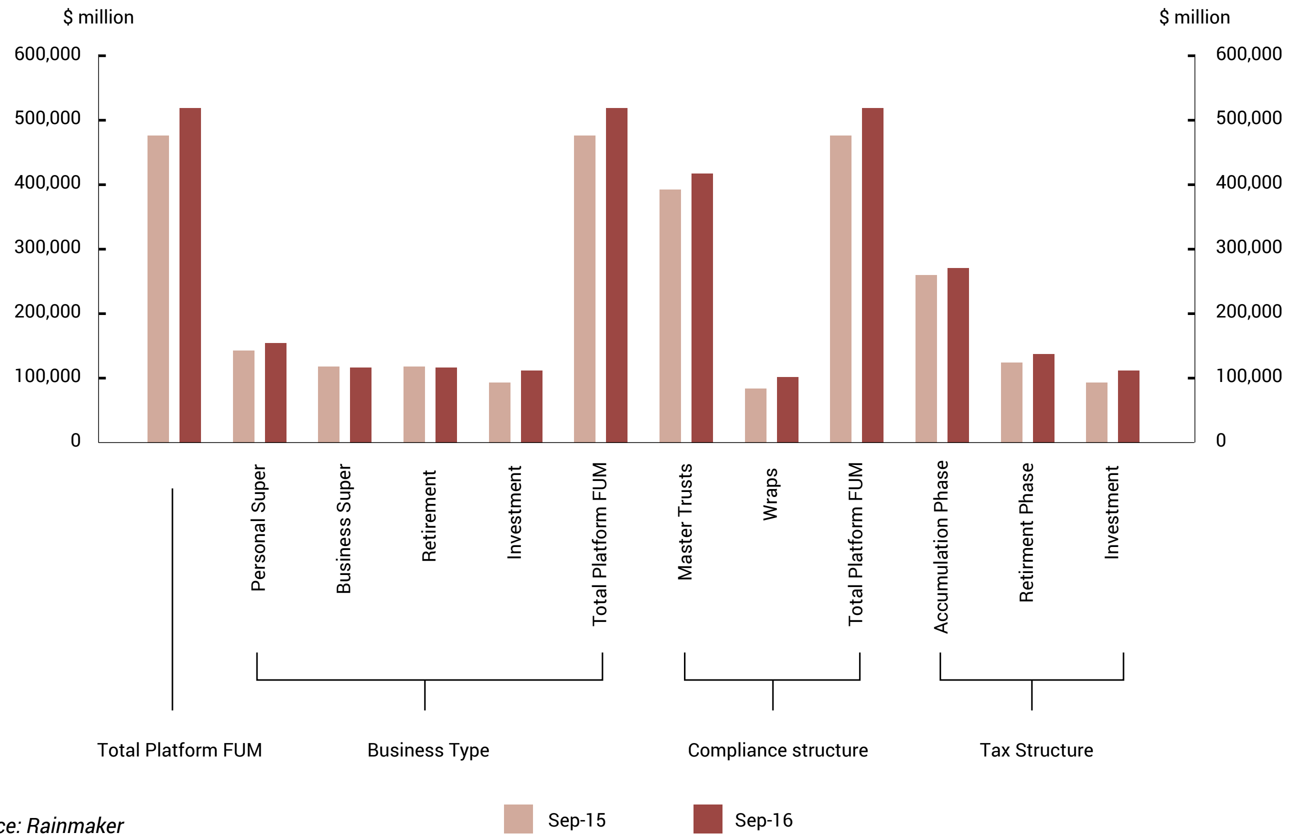
Source: Explanatory Memorandum Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016

The legislation also importantly restricts the terms 'financial adviser' and 'financial provider' to those who meet the requisite education and professional standards requirements. This will allow consumers to distinguish those who meet the new education standards.

Funds under advice in platforms increased by 9 per cent over the last 12 months to September 2016 to reach around $623.7 billion of funds under advice in Australia.

Platforms have around $273 billion in the accumulation phase, $183.2 billion in the retirement phase, and $112.4 billion outside of the superannuation system as investment business.

Figure 18: Platform assets by business type, compliance structure and tax structure



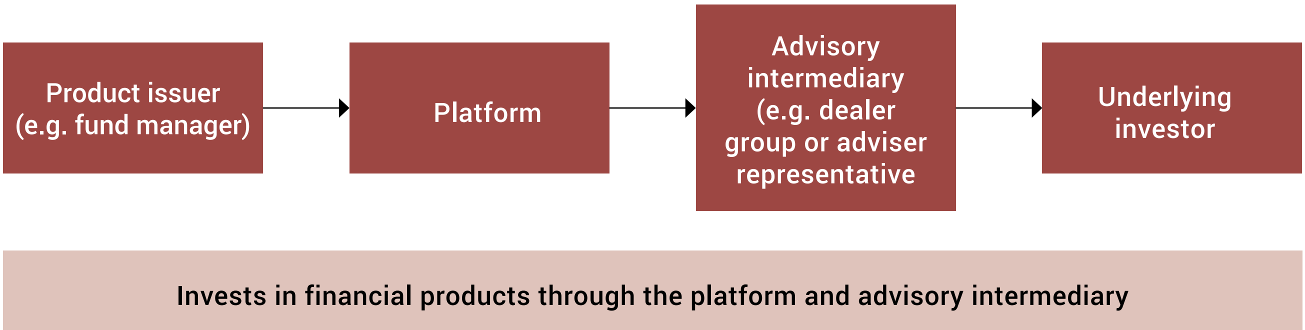
Source: Rainmaker

2 — Explanatory Memorandum Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016

What is a platform?

A platform is an online service that allows financial advisers to manage their clients' investment portfolios. Some platforms can be used by customers directly. In its most basic form, a platform aggregates data from several sources to provide a consolidated view of the client's total investments. Many platforms, however, also provide facilities for investments to be selected, bought and sold. In addition, platforms can offer a range of investment profiling and planning tools, including tools for analysing clients' attitude to risk and for allocating assets between different asset classes.

Figure 19: How platforms operate



Source: ASIC

The majority of platform business is invested via a master trust structure, with some $421.7 billion invested via a master trust and $102.0 billion invested via a wrap structure.

What is a master trust and what is a wrap?

A master trust is a product assembled under a trust deed. All super has to be packaged this way but investment platforms don't have to be. The terms "wrap" and "platform" used to be more or less interchangeable, but as the market has developed, a wrap is usually understood to refer to a type of platform offering access to a wide range of investments.

Clients investing in a platform either via a master trust or a wrap have the expectation of cost savings (e.g. through the netting of transactions or the pooling of funds to acquire investments) or access to investments that would not otherwise be available to them.

INVESTMENTS

Managing savings for growth

KEY STATISTICS

TOTAL FUNDS UNDER MANAGEMENT

$2.774 trillion

FUNDS WITH RESIDENT INVESTMENT MANAGERS

$1.931 billion

FUNDS WITH NON-RESIDENT INVESTMENT MANAGERS

$854.3 billion

PERCENTAGE OF FUNDS EXPORTED

3.6%

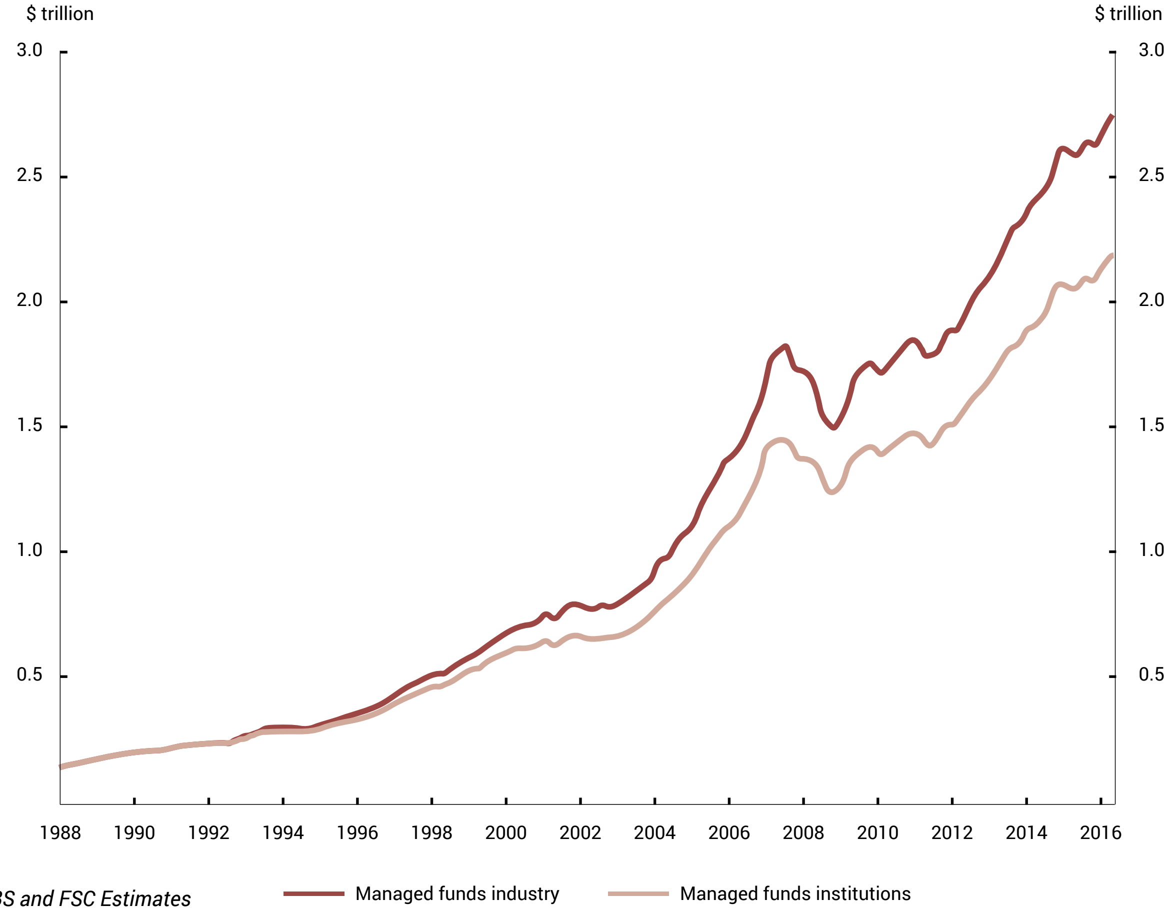
At September 2016, the ABS reports over $2.774 trillion as the size of the total managed funds industry, up from $2.715 trillion in the previous June quarter.

Within the data supporting Figure 21, we again see the dominance of superannuation funds at:

- 78 per cent of managed assets;
- with retail trusts at 12 per cent;
- and life insurance corporations at 8 per cent.

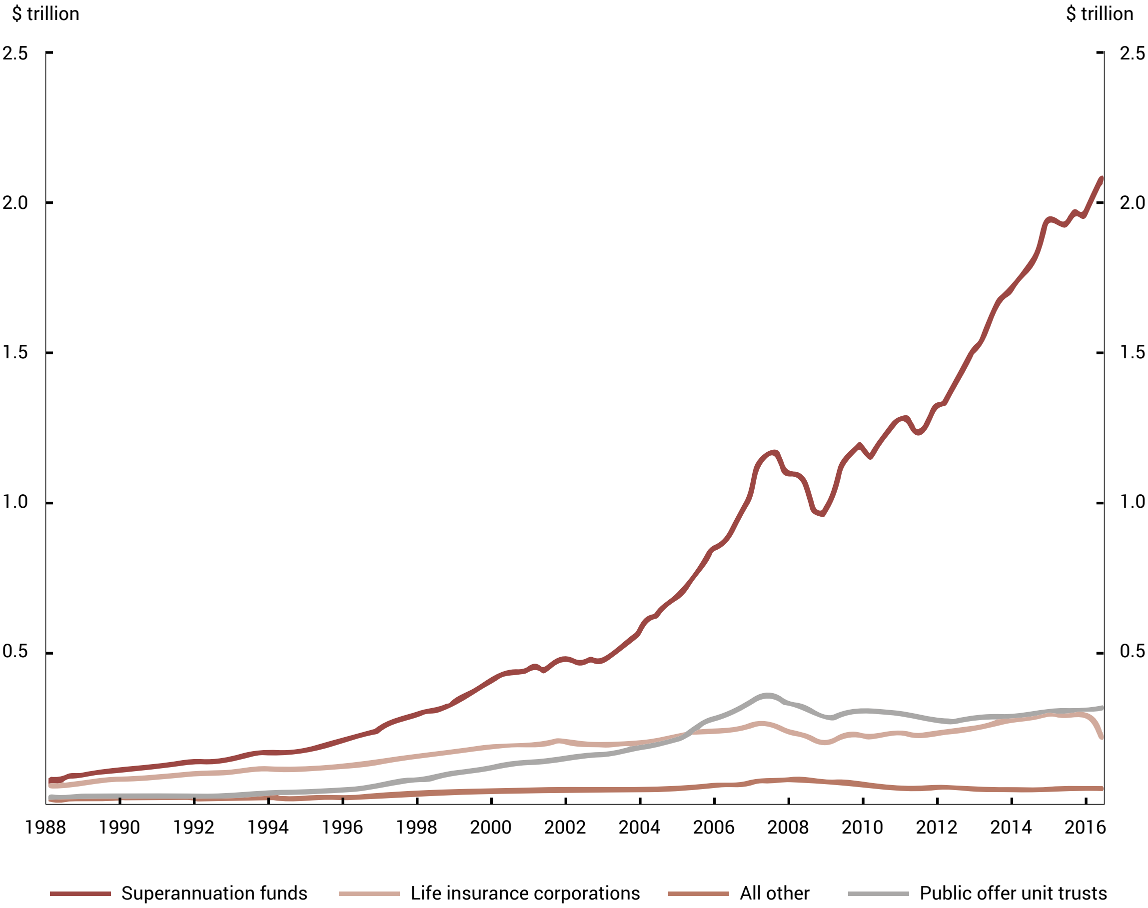
The growth of this market has been dramatic over the past decade.

Figure 20: Size of funds under management[4]



Source: ABS and FSC Estimates

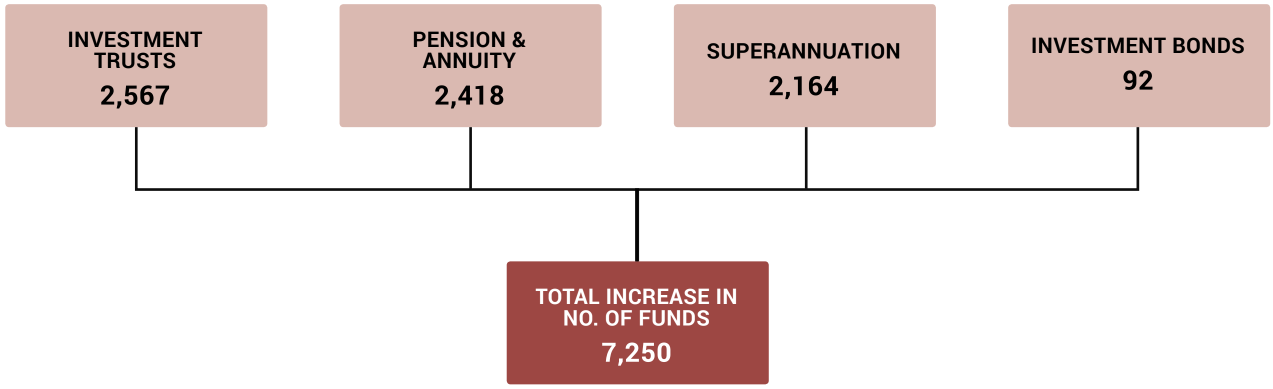
Figure 21: Unconsolidated assets by type of institution[5]



Source: ABS and FSC Estimates

4 — ABS, 5655.0, Managed Funds - Australia, September 2016. 5 — Ibid.

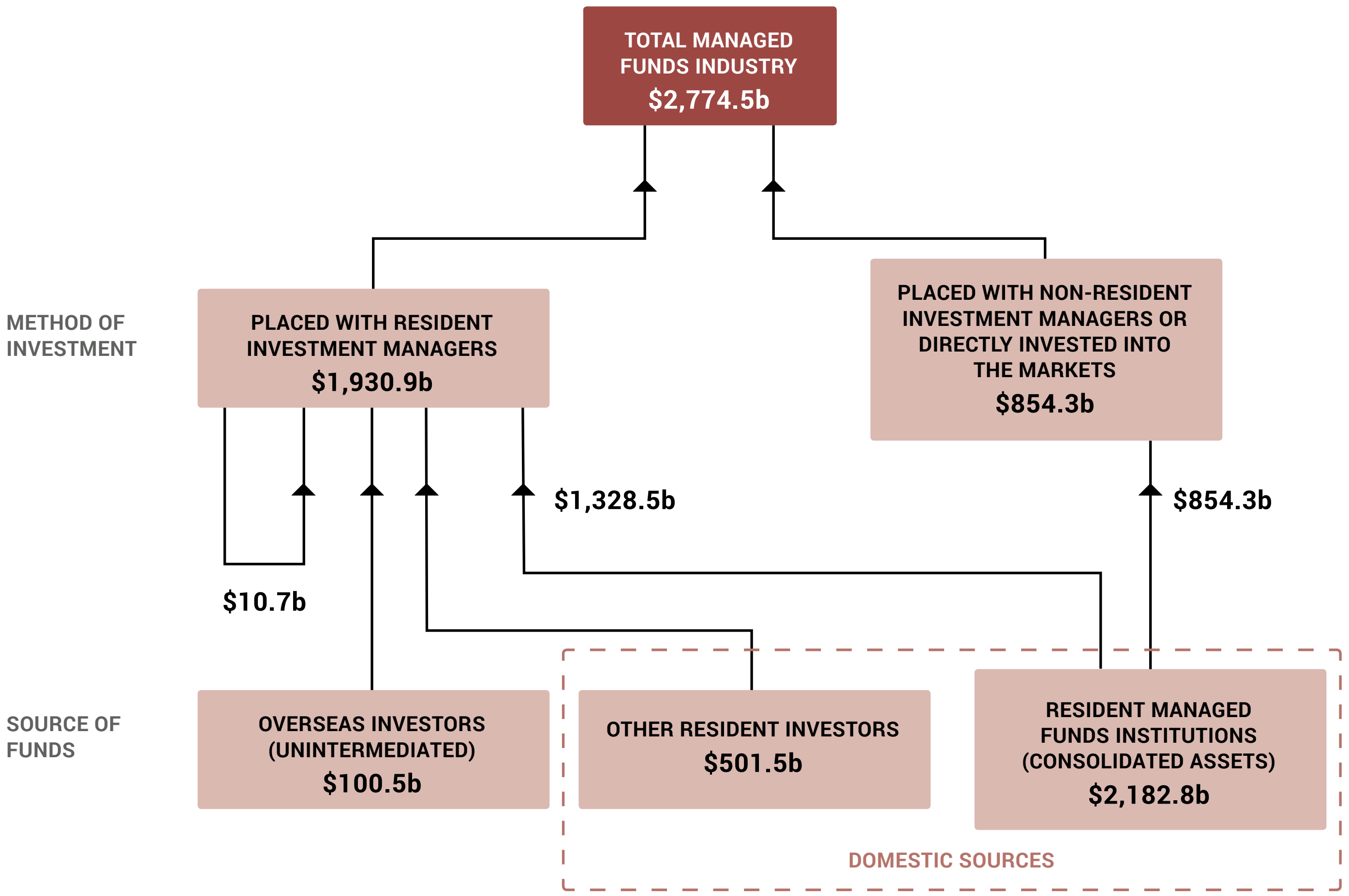
Figure 22: Increase in number of funds, 2005-2014



Source: Morningstar.

This is an inherently complex market investing in a range of securities and property both domestically and onshore. The structure of investment flows is described as follows:

Figure 23: Managed funds pathways



Source: ABS and FSC Estimates.

This is complemented by the export of Australia's funds management capabilities.

Figure 24: Funds under management on behalf of overseas investors as a proportion of total funds under management in Australia.

Source: ABS and FSC Estimates.

The chart above shows the percentage of funds under management in Australia on behalf of foreign investors.

Given the reliance of our economy on foreign capital, ensuring funds management increases its slice of revenues from inbound flows is an important goal.

Deloitte Access Economics has estimated that the export of funds management services contributes:

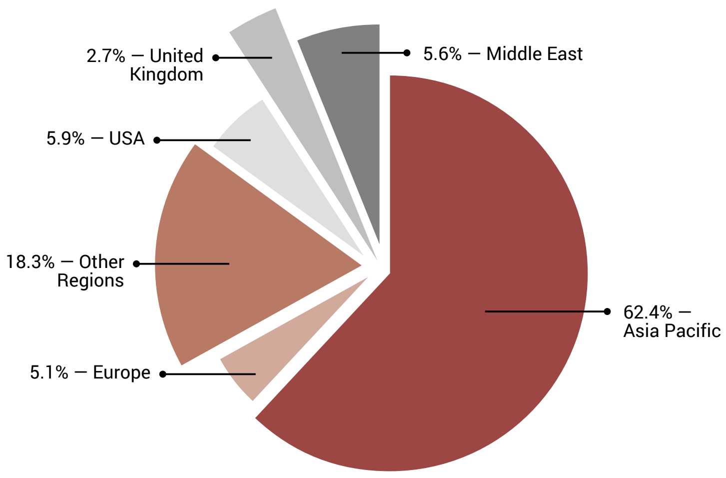
- $336 million directly to our economy; and
- is responsible for 1,426 full time equivalent jobs;

According to the FSC/ Perpetual Cross-Border Flows Report, investment through managed investment trusts has more than doubled in the past six years from $20.3 billion to $46.0 billion.

Sources are predominantly from Asia.

Greater innovation and the opening up of service export opportunities through bilateral and multilateral trade liberalisation agreements will hopefully see this growth continue.

Figure 25: Sources of fund investment in Australia at December 2015



Source: FSC/ Perpetual Cross-Border Flows Report.

EXCHANGE TRADED PRODUCTS (ETPs)

KEY STATISTICS

NUMBER OF ETPs

150

TOTAL MARKET CAPITALISATIONS OF ETPs

$24.57 billion

As of November 2016, there were 150 exchange traded products (ETPs) listed on the Australian Securities Exchange, up from 129 the previous year. The market has a capitalisation of $24.57 billion, up 17.2 per cent from November 2015.

Exchange traded products (ETPs) in this report include several products:

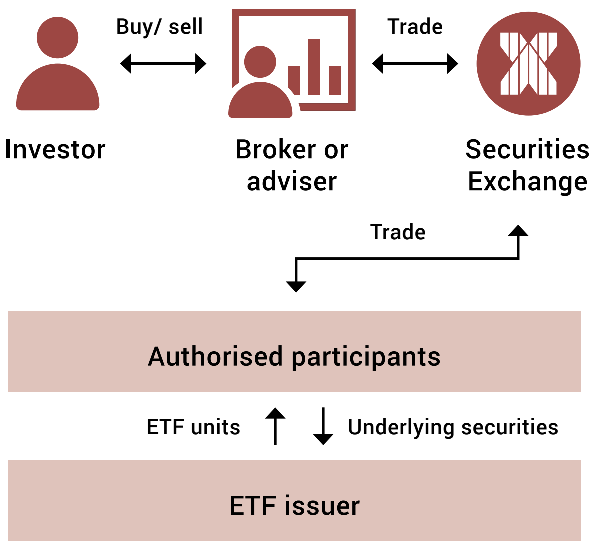
- Exchange traded fund (ETF)
- Exchange traded managed fund (MF)
- Exchange traded structured products (SP)

Broadly they are all described as exchange traded funds (ETFs), however the ASX has more specific naming conventions to capture the differences between exchange traded products.

Exchange-traded products are financial products traded on an exchange that invests in or gives exposure to securities (shares) or other assets such as commodities. Most ETPs generally seek to track the performance of a specified index or benchmark (such as the S&P/ASX 200 index) or a currency such as the USD or a commodity such as gold.

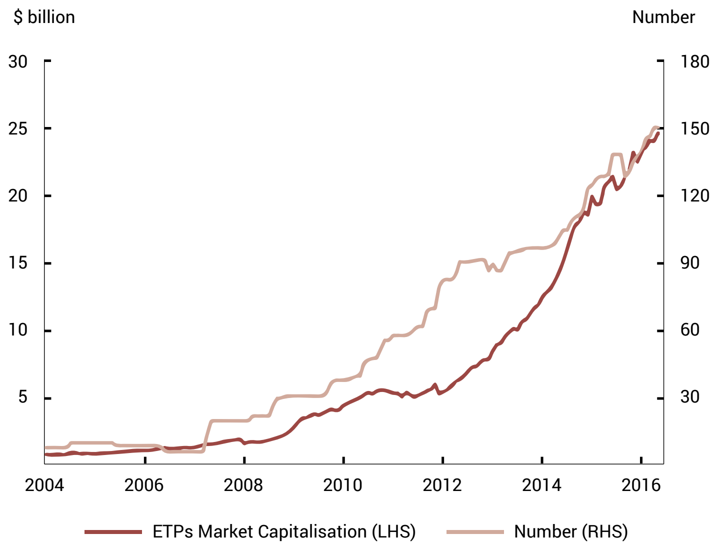
ETPs are open-ended, which means that the number of units on issue is not fixed but can increase or decrease in response to demand and supply from investors. This assists in ensuring that the ETPs trade at or near their net asset value (NAV). ETPs trade, clear and settle in the same way as shares on the ASX.

Figure 26: How an ETF Works



Source: FSC

Figure 27: ETPs Market Capitalisation and Product Numbers[6]

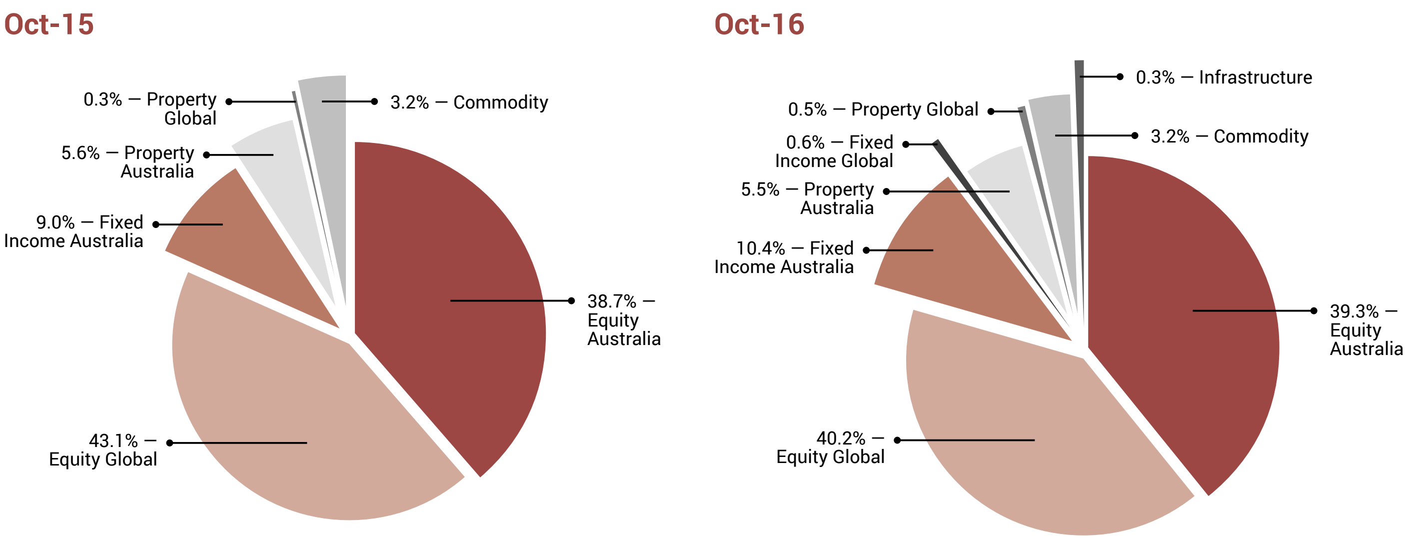


Source: ASX, Morningstar and FSC Estimates.

ETFs have become increasingly popular in Australia due to their low-cost, transparency and diversification benefits. In the past five years from November 2011, ETPs listed in ASX has grown from only 58 products to 150 products, with total market capitalisation from $5.1 billion to $24.57 billion.

As at October 2016, international equities is the largest asset category, which constitutes 40.2 per cent of total ETP funds. That lowers from 43.1 per cent in October 2015. Domestic equities is the second largest investments of ETPs, which accounts for 39.3 per cent. It is then followed by Australian fixed income securities (10.4 per cent) and Australian property investment (5.5 per cent).

Figure 28: Asset Allocation October 2015 v October 2016



Source: ASX, Morningstar and FSC Estimates.

In October 2015, 43.1 per cent of ETP assets were invested in international shares. That is followed by Australian domestic equity instruments (38.7 per cent). Australian fixed income securities and Australian property investment account for 9.0 per cent and 5.6 per cent respectively. In addition, 3.2 per cent of total ETP assets are commodities investment.

6 – Data extracted from ASX Funds Monthly Update

TRUSTEE SERVICES

KEY STATISTICS

NUMBER OF CHARITABLE TRUSTS

1,500

TOTAL MARKET CAPITALISATION OF CHARITABLE TRUSTS

$4.37 billion

NUMBER OF REGISTRABLE SUPERANNUATION ENTITIES

149

Trustees play a unique role in the financial services sector, spanning a diverse range of specialist services to individuals, not-for profits and the corporate sector. These services include complex estate planning, philanthropic advice, acting as trustee for corporate transactions, and helping Indigenous communities to maximise the opportunities offered by native title. Trustees also have an important role in protecting vulnerable members of the community by acting as trustee or financial manager for those who lack capacity to manage their own affairs (e.g. minors or the severely disabled).

For more than 100 years, trustees have been providing Australian philanthropists with specialist advice on how to best structure their support of the charitable sector, whether while living or in their will. Within the trustee sector of their businesses, trustees serviced by the FSC act a as trustee or co-trustee for over 1500 charitable trusts or foundations with assets of around $4.37bn. During 2013/14 alone, trustees distributed over $190 million to charities via donations and as project grants from those trusts and foundations.

More broadly, trustees play an important role in helping Australians to plan for the future, including writing wills, acting as executor and establishing and administering personal trusts. Trustees are chosen for their expertise in carefully managing complex family arrangements and providing independent, trusted advice.

Table 1: Managing risk in trustee selection

	INDIVIDUAL TRUSTEES	CORPORATE TRUSTEE
Separation of assets	There is a risk that fund assets may be intermingled with personal assets.	Having a separate corporate trustee reduces the risk of personal assets becoming intermingled with fund assets. Also, as companies have limited liability, a corporate trustee offers greater protection if the trustee is sued for damages.
Succession	A fund with individual trustees is not likely to continue to operate as usual when changes in trustees occur, unless an appropriate succession plan has been prepared.	A company continues in the event of a member's death. With a corporate trustee, control of an SMSF and its assets is more certain in the event of the death or incapacity of a member.

Trustees are particularly important for Australia's 1,051,097 self-managed super funds. As the ATO notes in its guide to selecting trustees, there are good reasons for corporate trusteeship (Table 1).

These are significant risk questions, which are commonly underestimated. The integration of Registrable Superannuation Entities (RSEs) with superannuation services, managed funds, financial advice and life insurance, with the addition of estate planning, provides continuity and market completion for Australia's financial services sector.

Beyond retirement services, Trustees play a range of roles, including custody and estate planning. Licensed trustees are also critical to the administration of charitable trusts.

Most recently available data compiled by the Australian Government states that:

- Licensed charitable trusts (LCTs) are the sole or co-trustee of 1,500 charitable trusts;
- 95 per cent of new trusts are sole trustee arrangements;
- These have a combined capitalisation of $4.37 billion;
- The entire charitable trust sector is estimated at around $7 billion;
- Annual distribution is around 4-6 per cent of total capital value.

This service provides a significant enhancement of fiduciary oversight for the Australian charitable sector.

PREPARING FOR THE EXPORT OPPORTUNITIES

of the Asian regions funds passport

The Asia Region Funds Passport (ARFP) is a mechanism to facilitate cross border distribution of managed fund products across the Asia region. Currently, funds are manufactured, distributed and administered within each jurisdiction, with little transferability across borders. Once operational, the ARFP will permit Australian domiciled investment funds to be sold directly to retail investors in participating jurisdictions and vice versa.

Australia's $2.8 trillion investment management industry stands to strongly benefit from the Asia Region Funds Passport (ARFP) initiative. Although this market represents the fourth largest investment management sector globally, Australia has been unable to export its expertise in this vital sector of the services economy with only 3.6 per cent of our funds under management sourced from offshore. The ARFP will also allow Australian investors a wider variety of managed fund products to choose from.

Benefits for consumers

There are many benefits for consumers in being able to access investment products developed outside their own jurisdiction.

Over the short term, consumers are anticipated to benefit from:

- Enhanced competition between product providers, which lead to competitive pressures on cost will reduce the cost of offering products across multiple;
- Improved access to a broader range of managed funds;
- Improved management of financial risk; and
- Improved capacity to save for retirement.

In the longer term, consumers will benefit from:

- A wider and inclusive network of Passport economies; and
- Targeted regulatory capacity building.

Why now?

The timing of this initiative's completion is fortuitous. The Asia region is expected to be a significant driver for growth of the global funds management industry in the future. This is due to economic and demographic changes that are occurring in the region. In particular Asia's middle class is growing quickly, which will drive demand for funds management as investors look for opportunities to invest and grow wealth, the region's population is also ageing quickly, which will drive the need for pension and retirement savings products, and many countries in the region do not yet have compulsory superannuation contribution systems for workers, which will further drive the need for individual savings plans.

There is considerable potential for Asia to increase its share of global funds under management. In addition to the drivers just outlined, the Asian region is currently punching below its weight in terms of share of global funds management activity, as shown in Figure 29 – Population and Funds Under Management – Asia, Europe and the Americas.

Figure 29: Population and Funds Under Management – Asia, Europe and the Americas[7]

Source: United Nations, Investment Company Institute and FSC Estimates.

Funds under management (FUM) in the region is currently only 13 per cent of worldwide FUM, despite Asia's population sitting at 60 per cent of the world's population. By comparison, the US manages 51 per cent of worldwide FUM but only accounts for 14 per cent of the world's population. Europe manages 36 per cent of the world's FUM yet accounts for only 10 per cent of world population.

7 — Chart created by FSC, population source United Nations, FUM source Investment Company Institute.

Current status of the Asian Region Funds Passport

On 20 September 2013, five countries signed a Statement of Intent to work together in developing the ARFP. Significant work was then undertaken to formulate a set of rules to guide the regime's operation. On 28 April 2016 Australia, Japan, Korea and New Zealand signed a Memorandum of Cooperation (MoC) agreeing to implement the ARFP rules by 31 December 2017.[8]

Initial members of the working group were allowed to join as foundation members until the MoC came into effect on 30 June 2016 and Thailand took this option bringing the participating jurisdictions to a total of five. Despite being an initial signatory to the Statement of Intent in 2013, Singapore has not yet signed the MoC.

All signatories ARFP MoC, including Australia, have until 31 December 2017 to pass legislation to implement the ARFP rules.

What Australian fund managers need to ensure success in the Asian Region Fund Passport

Although the ARFP will go some way towards removing regulatory barriers to the cross border export of Australian fund management services, there are still a range of important domestic tax and regulatory reforms necessary to give Australian fund managers the best opportunity to gain market share:

A broader range of collective investment vehicles

A corporate Collective Investment Vehicle (CIV) is critical to Australia's success in the Asia Region Funds Passport and must be introduced prior to 31 December 2017 if Australian investment managers are to compete on a level playing field with other passport jurisdictions.

The Johnson Report identified the need for a broader range of collective investment vehicles with tax flow-through treatment to be introduced into the Australian taxation landscape. Johnson identified a lack of understanding of Australia's investment vehicle structures, due in part to our common law based legal system and the use of trusts as an investment vehicle.[9]

Whilst other jurisdictions utilise investment structures labelled as 'trusts' their operation and taxation treatment are often codified rather than steeped in common law precedent, or practice. This fundamental difference was seen as contributing to foreign investors' reluctance to utlise Australian managers, in addition to the taxation uncertainty resulting from no investment manager exemption being in place in the Australian context, and the complexity associated with determining whether trusts are eligible for the benefits of double taxation treaties.

The Coalition government announced in the 2016 Budget that CIVs would be progressed and committed to introduce a corporate CIV in the financial year commencing 1 July 2017 and a limited partnership CIV in the income year commencing 1 July 2018.[10]

The industry is currently awaiting further detail from Treasury regarding the design of the corporate CIV.

8 — APEC Asia Region Funds Passport website. 9 — Johnson Report, page 62. 10 — 2016/17 Budget, Budget Paper 2 – Budget Measures, page 39

Competitive withholding tax arrangements

The complexity of the Australian system will put Australian managers at a competitive disadvantage in the ARFP, where other economies offer lower rates and simpler regimes for investors in their collective investment vehicles. Singapore for example, does not charge withholding tax on foreign investors investing into Singapore based funds.

Australia's withholding tax regime is extremely complicated and has particularly high headline rates. Withholding applies to foreign investors and is levied on different income characters including interest, dividends, royalties and managed investment trust fund payments. The rates applying to different types of income are based on a combination of international tax treaty rules, domestic taxation rules, and the character (or type) of income being generated.

The ARFP regime is specifically designed for retail investors so the ability to simply explain tax consequences will be a key advantage. Moreover, some income types receive exemptions under the current law, adding to the complexity and making it more difficult for investors to understand how their incomes will be taxed.

Having to identify potential high headline rates and then explain how different types of income are classified will be a disadvantage for Australian fund managers. In the 2008/09 Federal Budget the Labor government committed to reducing the withholding tax rates for fund payments from managed investment trusts (MIT WHT). The staggered decrease was implemented from 1 July 2008, however they then reversed this policy and doubled the MIT WHT rate to 15 per cent with effect from 1 July 2012 onward.

The ramifications in the market of this change were significant. This uncertainty and the higher rate added to the reasons why foreign investors might choose fund products domiciled in other geographic locations.

Since then industry concerns regarding Australia's withholding tax regime and its impact on foreign investment have grown and pressure has been mounting for the government to make the system simpler and more competitive.

In response, the Coalition government committed to review the withholding tax arrangements applying to non-resident investors in collective investment vehicles on 4 May 2016.

The FSC recommends that a simple, flat rate of withholding tax be available for Australian funds entering the ARFP regime.

Changes to withholding tax are an example of a policy initiative which has a low cost but the potential for significant gains in increased economic activity.

ABOUT FSC & UBS ASSET MANAGEMENT

FSC FINANCIAL SERVICES COUNCIL

Financial Services Council

The Financial Services Council (FSC) has over 115 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees.
The industry is responsible for investing more than $2.6 trillion on behalf of 11.5 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Financial Services Council

Lvl 24, 44 Market Street
Sydney NSW 2000

T +61 2 9299 3022
E info@fsc.org.au
W fsc.org.au
@FinServCouncil

UBS

UBS Asset Management (Australia) Limited

UBS Asset Management Australia offers a range of investment styles and strategies, including a range of equities, fixed income and multi-asset capabilities to institutional investors, intermediaries and retail investors.

Drawing on its 30-year heritage, UBS Asset Management strives to deliver outcome-oriented investment solutions for our clients, underpinned by a team-based approach and disciplined risk management.

With $30 billion of invested assets in Australia (at 31 December 2016) and approximately 65 employees located locally, UBS is one of the largest global asset management businesses in the Australian market. Globally, with approximately $894 billion of invested assets under management (at 31 December 2016) and approximately 3,500 employees located in 22 countries, UBS Asset Management is a truly global asset manager.

UBS Asset Management (Australia) Limited

Level 16, 2 Chifley Square
Sydney NSW 2000

T +61 2 9324 2000
E ClientServices-UBSAM@ubs.com
W www.ubs.com/am-australia

Disclaimer

This document provides information only and is based on the views of surveyed respondents. You should seek independent, professional advice before making any decision based on this information. Information in this report is believed to be accurate, however, subject to any contrary provision in any applicable law, neither UBS Asset Management (Australia) Limited, the Financial Services Council, nor any related parties, their employees or directors, provide any warranty of accuracy or reliability in relation to such information or accept any liability to any person who relies on it.