COUNTRY REPORT AUSTRALIA 2008

1. Economic and Financial Background

Table 1: Key Economic Indicators*	
Population (million)	21,181,000
GDP (AUD$ millions)	1,037,027 (2007- 08) 891,843 ($US)
GDP growth rate	2.7% (2007- 08)
Inflation rate (%)	4.5% (June 2008)
Unemployment rate (%)	4.3% (June 2008)
Stock market capitalisation	$1,291,366 (July 2008) 1,110,575 ($US)
Official Interest Rate	7.0%
Exchange rate of $AUD1 = $US0.86 current as at 3 September 2008	

2. Data on funds under management and portfolios

Table 2: Net assets of the Australian Industry (30 June 2007)

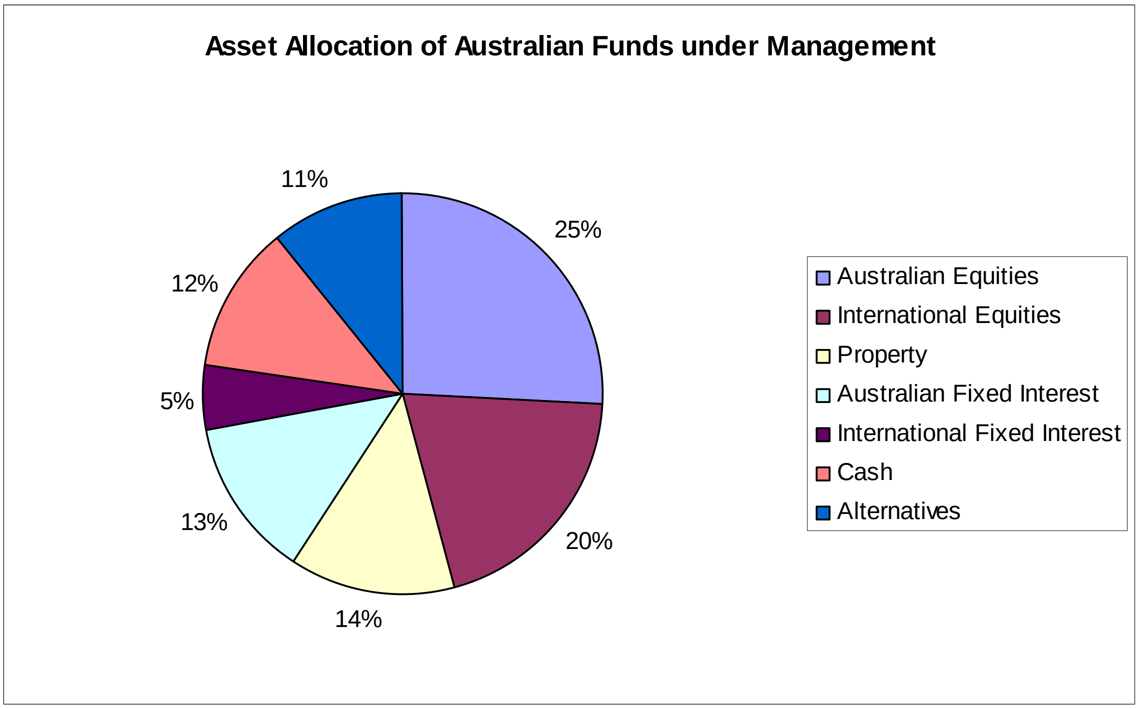
Year (as at June)	Total assets under management (US$ millions)	Total assets under management (AUD$ billion)
2001	328	646
2002	363	644
2003	434	643
2004	532	750
2005	697	915
2006	784	1,028
2007	1,099	1,335
2008	1,093	1,271

Table 3: Australian Industry Size – 30 June 2008	
Asset class	**$A millions**
Equity funds	**505,660**
Bond funds	**83,663**
Money market funds	**248,949**
Other	**432,617**
Total (excluding Fund of Funds)	**1,270,889**
Total in US$	**1,092,965 million**

3. Key trends in flows and assets under management

The Australian funds management sector has experienced high growth rates since its inception in 1993, underwritten by the 9% of salary compulsory employer contributions – 'the superannuation guarantee levy'.

The chart below shows the asset allocation of Australian funds under management. Of particular interest is the high allocation to growth assets (75%), and the significant amount invested overseas (approximately 35% including overseas property and alternative investments).



IFSA expects the trend towards overseas investment to increase and over time the allocation to growth assets to diminish as more Australians near retirement.

Additionally, following the recent volatility of listed property assets, there is expected to be, at least in the short-term, a shift away from listed property towards unlisted property – especially in superannuation and at a wholesale/institutional level.

4. Regulatory developments

Financial Services Working Group

The recently elected Federal Government has established a combined Government and industry Financial Services Working Group with the primary focus of “Improving Product Disclosure” and finding a way to shorten Product Disclosure Statements to improve consumer understanding and decision making.

The working group is also developing proposals that are designed to make more affordable financial advice available to members of superannuation funds.

Superannuation forecasts

IFSA is in the process of responding to an ASIC consultation paper seeking comments on the use of end benefit estimates in member statements as a means of engaging members with their superannuation.

Product rationalisation

Government has established a Product Rationalisation Advisory Panel to consider making laws that will enable the termination of old financial products that are often uneconomic, or are supported on redundant technology platforms. The law should enable investors in those old products to be transferred without penalty (e.g. taxation) to a more modern financial product that offers similar benefits.

It is expected that to the Government will formulate a detailed legislative mechanism to give effect to product rationalisation.

Reduction of Withholding Tax for Managed Funds

The Government has replaced the previous 30 per cent non final withholding tax applying to distributions of Australian source net income (other than dividends, interest and royalties) of Australian managed investment trusts to foreign residents with a final withholding tax regime.

Residents of jurisdictions with which Australia has effective exchange of information arrangements will be subject to a non-final withholding tax at the rate of 22.5 per cent for distributions from managed funds in relation to 2008-09; a final withholding tax of 15 per cent for distributions from managed funds made in relation to 2009-10; and a final withholding tax of 7.5 per cent for distributions from managed funds made in relation to 2010-11 and later financial years.

An initial list of 37 countries have qualified for the reduced withholding tax rates, including Canada, China, France, Germany, India, Italy, Japan, Netherlands, United Kingdom and the United States of America. Residents of other jurisdictions are subject to a 30 per cent final withholding tax.

Board of Tax Review of the Tax Arrangements Applying to Managed Funds

The Australian Government has asked the Board of Taxation to undertake a review of the tax arrangements applying to Australia managed funds. The Board of Taxation is an advisory body charged with contributing a business and broader community perspective to improving the design of taxation laws and their operation.

The objective of the review is to provide advice on options for introducing a specific tax regime for managed investment trusts which would reduce complexity, increase certainty and minimise compliance costs.

The Board has been asked to provide a final report to the Government around the middle of 2009.

First Home Saver Accounts

A new tax-preferred investment vehicle has been introduced for first home buyers in Australia. First Home Saver Accounts can be offered in a range of forms, including as bank accounts or managed funds, and are designed to assist people to save for a deposit for a first home. Contributions up to a set level attract matching contributions from Government at a rate of 17 per cent of the amount contributed. The accounts are subject to regulatory requirements which restrict eligibility to open accounts, the level of contributions and the withdrawal of funds.

International Regulatory Developments

<u>Qualified Domestic Institutional Investor (QDII) recognition from China</u>

Recognition of Australia and Australian funds under the Chinese QDII scheme was obtained in June 2008.

The recognition flows from Memorandums which the Australian Securities and Investment Commission has in place with both the China Securities and Regulatory Commission (CSRC) as well as with the China Banking and Regulatory Commission (CBRC).

<u>Mutual Recognition of Cross-border Offering of Collective Investment Schemes between Australia and Hong Kong</u>

An agreement on mutual recognition of cross-border offerings of collective investment schemes between the Hong Kong Securities and Futures Commission and the Australian Securities and Investment Commission was announced in July 2008.

Following publication of the final legal instruments, Australian Managed Investment Schemes will be able to be offered to investors in Hong Kong subject to certain requirements as detailed in the mutual recognition agreement. These conditions are intended to place an Australian Scheme in a similar position to a locally incorporated Scheme in Hong Kong. Hong Kong funds will also be permitted to be offered to Australian investors without requiring a license from ASIC.

<u>Mutual Recognition of Securities markets between Australia and the United States of America</u>

The mutual recognition agreement provides a framework for the SEC, the Australian government and ASIC to consider regulatory exemptions that would permit U.S. and eligible Australian stock exchanges and broker-dealers to operate in both jurisdictions, without the need for these entities (in certain aspects) to be separately regulated in both countries.

IFSA expects that the agreement will reduce compliance costs for investors and further encourage cross border financial services.

<u>Mutual Recognition of Cross-border Offerings of Collective Investment Schemes between Australia and New Zealand</u>

The mutual recognition scheme allows an issuer to offer securities or interests in collective or managed investment schemes in both countries using one disclosure document prepared under regulation in its home country.

Issuers who wish to operate under the scheme will be able to comply with minimal entry and ongoing requirements agreed to between the two countries and prescribed in each country's law.

ASIC, New Zealand Companies Office (NZCO) and the NZSC have established processes for cooperation between the authorities in administering the mutual recognition scheme.

5. IFSA self regulatory Industry Standards and Guidence Notes

IFSA continues to build on its Industry Standards and Guidance Notes. These are designed to assist members achieve industry best practice, and to enhance consumer confidence. By adhering to the Standards, IFSA's full member companies have undertaken to develop processes and products that provide investors with a quality assurance that goes beyond the base-line legislative and regulatory framework. In recognition of this, IFSA is committed to the promotion of the Standards as a demonstration of integrity.

Over the last year the following work has been undertaken in relation to IFSA's Industry Standards and Guidance Notes:

- Standard 7 (References to the IFSA logo), Standard 8 (Scheme Pricing) and Standard 9 (Valuation of Scheme Assets & Liabilities) were all updated;
- Two new Standards were launched: Standard 17 on Incorrect Pricing of Scheme Units – Correction and Compensation and Standard 18 on Best Practice Guidance for Disclosure in the mortgage trust sector.
- New Guidance Notes were launched as follows:
  - Guidance Note 21: Calculators – Best Practice Guidelines
  - Guidance Note 22: IT Fraud and Security Guidelines
  - Guidance Note 23: IFSA Major Disaster Plan
  - Guidance Note 24: IFSA/FPA Guidance on managing mutual obligations under Chapter 7 of the Anti-Money Laundering/Counter Terrorism Financing Rules
  - Guidance Note 25: Product Performance: Calculations of After-Tax Returns.

All of IFSA's Standards and Guidance Notes can be found on the IFSA website at:

http://www.ifsa.com.au/public/content/ViewCategory.aspx?id=617

The compliance process for IFSA Standards continues to be rigorous and robust and a report will be submitted to the IFSA Board on the current 2008 compliance process in October this year with a summary likely to be published in early November.

In December 2007 IFSA published the results of its 2007 Compliance Managers' Survey which found that IFSA members continue to demonstrate a high level of commitment to IFSA's Industry Standards and Guidance Notes. The 2007 Survey indicated a high degree of integrity in the compliance process with IFSA member companies signing off on compliance at Board level.

The Compliance Managers' Survey exercise has again been undertaken for 2008 with a number of responses received thus far. We envisage publishing the results of the compliance process in December 2008.

6. Corporate governance developments

Australia is well regarded in the region for the strength of its regulatory regime and market integrity. Sound corporate governance practices increase investor confidence in the integrity and efficiency of the Australian capital market, and in turn enhance the competitiveness of Australia as a leading financial centre and support the Australian economy more generally.

Recent market developments have included:

Short selling and securities lending

The Government is currently reviewing the disclosure practices and compliance with short selling related rules and regulations. IFSA has welcomed the review and advocated that short selling is a long established investment activity, an integral part of global capital markets, contributes to market liquidity and assists to ensure market price efficiency.

Specifically, IFSA has indicated it is supportive of enhancing the disclosure of short selling and securities lending practices directly to the market supervisor on a disaggregated and timely basis in order to promote market integrity and assist surveillance of the market.

Director and Executive trading, including margin lending

In June 2008, the ASX (Australian Securities Exchange) referred a number of possible breaches relating to insider trading, continuous disclosure rules and market manipulation to ASIC (Australian Securities and Investments Commission) for investigation. Consequently, ASIC is currently examining these possible breaches and also released a Regulatory Guide on how directors of listed companies should comply with disclosure obligations and when ASIC may take enforcement proceedings.

Where directors trade in a company's securities, the market expects that they will disclose such activity as currently required under the *Corporations Act 2001*, both upon their initial appointment and on an ongoing basis.

IFSA also supports companies having defined policies for directors and senior executives relating to trading and exposures in that company's securities. The company policy should set out the rules applying to directors or senior executives entering into margin loans and the disclosure of such loans to the market where the holdings and/or exposures are material.

Competition for market services

Government is currently considering advice from industry and ASIC in respect of Australian market licenses to operate competing venues for trading in ASX-listed securities. Given that multiple market providers will impose additional supervisory obligations on the ASX, IFSA continues to work with Government on examining the existing regulatory structure as it applies to new markets and the supervisory role of the ASX in the context of multiple markets.

IFSA has previously supported greater competition for execution and reporting services.

Australian review of credit rating agencies and research houses

In May 2008, the Minister for Superannuation and Corporate Law announced a review of the regulation of credit rating agencies and research houses in Australia. IFSA has been working closely with Government as part of the Minister's review and is interested in ensuring that any new regulation is consistent with international developments and does not inhibit innovation and competition in the market.

Improving Australia's proxy voting system

In June 2008, the Parliamentary Joint Committee on Corporations and Financial Services released its final report '*Better shareholders – Better company*', after an inquiry into shareholder engagement and participation in Australia.

IFSA has supported the Committee's report, particularly the recommendations on improving Australia's proxy voting system and maintaining confidence in the mechanisms that allow shareholders to exercise their voting rights.

Both IFSA and industry continue to work with Government on its proposal to implement an electronic proxy voting system.

Climate Change and the establishment of a Carbon Pollution Reduction Scheme

The Minister for Climate Change and Water committed to implementing a Carbon Pollution Reduction Scheme (Australian emissions trading scheme) in 2010. The Government has indicated that the framework will be a ‘cap and trade’ scheme and will have maximal coverage of greenhouse gases and sectors.

The impact of climate change will affect the value of investments managed by IFSA’s members and will therefore represent additional governance and investment risk that will need to be managed. Consequently, IFSA has supported the Government’s introduction of a national scheme.

7. Other major issues and developments

New Federal Government

Following 11 years in Office, the Liberal/National Coalition Government was not re-elected in November 2007. The new Labor Government, lead by Prime Minister Kevin Rudd, has taken a considerable interest in financial services, the services economy, climate change and education reforms.

International credit crisis ramifications

Instability in international markets caused by the global “credit crisis” has also affected the Australian Securities Exchange. The leading index for the Exchange has recorded an 18.4% drop over the last 12 months.

Despite the fall in listed equity values, Australia’s financial system has proved resilient to the credit crisis. This is largely due to Australia’s financial institutions having had almost no material direct exposures to US sub-prime assets as well the strength of Australia’s prudential regulation of banks and other financial institutions.