

# IFSA

Investment & Financial Services Association Ltd  
ACN 080 744 163

Thursday, 28 November 2002

Mr Jerry Antioch  
Board of Taxation Secretariat  
C/o Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Jerry

Further to IFSA's appearance before your Board on 18 November 2002 please find attached some additional material on the matter of community and economic benefits consequent to the reform of section 98/3 and 98/4 of the ITAA.

Yours sincerely



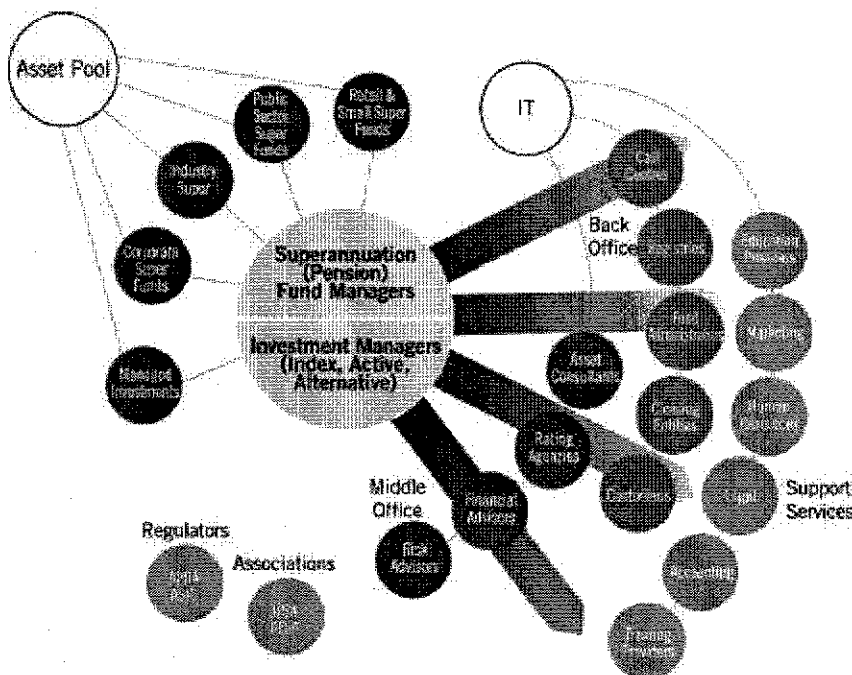
Richard Gilbert  
Chief Executive Officer

## Chapter 4 Proposals – Additional Comments

During the Board's meeting with IFSA on 18 November 2002 it was requested that additional information be provided on the tangible employment benefits to the Australian economy if the suggested measures were adopted.

Our starting point is to emphasise that the Managed Funds industry is the hub which financially sustains a myriad of support services.

### Australia's Managed Funds Industry



This diagram illustrates the cluster of financial services activity centred around Australia's growing funds management industry. Research from Axiss Australia indicates that should the current unfavourable tax treatment on foreign funds be removed, there is considerable scope for participants in Australia to offer their skills and expertise on a regional and perhaps even global, basis.

Source: Axiss Australia

The measures proposed will at first instance only give rise to an increase in funds under management ("FUM"). An increase in FUM has a direct beneficial effect on management fee revenue as such revenue is a percentage of FUM. However, as FUM increases management costs also rise. Whilst the relationship is not as direct broadly speaking an increase in FUM gives rise to an increase in costs. This relationship is a "stepped" one in that for the individual managers relatively small increases in FUM give rise to no or very little increase in cost. However, there reaches a point of which additional costs cannot be avoided. In particular staff costs rise with FUM.

The following table shows the relationship between FUM and staff numbers for one Australian fund manager. (This particular manager has been chosen because FUM has not decreased over the period and thus the relationship is clear).

<b>As at</b>	<b>FUM \$ billion</b>	<b>Staff Numbers</b>
31.12.1995	2	92
31.12.1996	4	150
31.12.1997	7	226
31.12.1998	25	265
31.12.1999	31	526
31.12.2000	38	635
31.12.2001	46	737
30.06.2002	81	1000

Generally it can be said that across the entire funds management industry there will be a cost to revenue ratio that as an aggregate figure does not vary enormously from year to year. For example in the Australian context the figures for the last two years were:

1999/2000 year	86%
2000/2001 year	84%

Similarly in the United Kingdom the comparable figures were:

1998	66%
1999	61%
2000	67%
2001	77%

*Source: Investment Management Survey 2002 PWC Consulting*

It is important to realise that these figures are for the entire industry and that the various participant companies will each have quite different cost to revenue ratios. The key conclusion to take from these figures is the percentages are remarkably consistent. Hence if these measures are implemented it would be expected that in the medium term at least 80% of the additional management fee revenue would be spent on additional costs.

It is very difficult to obtain a category breakdown of expenses across the industry but anecdotally about 50% of costs seem to be employee related.

On this basis a rough estimate of the tangible employment benefits from these measures is as follows:

Additional FUM for the industry as a whole (conservatively)	\$10 billion
Consequent fee revenue @ 1%	\$100 million
Additional costs @ 80%	\$80 million
Additional employee related costs @ 50%	\$40 million

[It is not possible to break this figure into actual job numbers]

This cost percentage relates to direct employees of fund managers. Other significant costs such as IT, advertising and professional services will also have a labour component. Thus there should be further indirect employment benefits. We can offer no reliable estimates on the size of such benefits.

It should be noted that whilst we have attempted to provide a tangible employment benefits figure, as requested, it does conflict with one of the assumptions of the Econtech modelling previously provided. That assumption was that "national employment is fixed". Hence any benefit was in the form of substitution from low wage to higher wage jobs. For the purposes of probity we have expressly noted this conflict and stress that the above analysis has only been provided because of a request by the Board for some estimate of tangible employment benefits.

It should also be noted that any such benefit is not static but is on a continuing basis. Additional FUM in future years would provide further increases in the medium to long term.

Lastly, we draw attention to the lower cost to revenue data for the UK, a country which has similar market and regulatory conditions. The lower cost ratios for that jurisdiction are the result of just one factor, scale. IFSA suggests that these reforms will lead to improved scale and thus lower cost structures. Hence reforms such as the abolition of section 98(3) and (4), whilst targeted at non-residents, will indirectly benefit resident investors too.