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# The Hedge Funds Industry in Australia

**DATA FILE SERIES | 2006–07**



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# The Hedge Funds Industry in Australia

## INTRODUCTION

Australia's A\$62.7 billion (US\$46.6bn<sup>1</sup>) hedge fund industry, underpinned by Australia's globally significant investment management industry, has grown rapidly in recent years to become the largest in Asia.

Hedge fund managers in Australia control more assets than Hong Kong and Singapore put together. Seventy one per cent of the country's hedge fund manager assets are invested in global and regional markets – demonstrating the international funds management expertise of the Australian hedge fund industry.

The success and growth of hedge funds in Australia have been aided by access to a highly skilled and experienced talent pool, drawn from the nation's sophisticated managed funds and investment banking community. Indicative of this capability and depth are Australia's stock market, the largest in Asia (ex-Japan<sup>2</sup>), its international debt securities market, the largest in Asia<sup>3</sup>, and Australia's foreign exchange market and OTC derivatives market, which are the fastest growing in the region<sup>4</sup>.

The hedge funds industry forms part of Australia's A\$1.03 trillion (US\$764bn)<sup>5</sup> managed funds industry that has developed in response to a growing mandatory pension fund scheme and a large pool of high-net-worth individuals and retail investors. Australia has been recognised as the best country in the world for funds management firms to do business<sup>6</sup> and Australia's contestable pension assets are set to become the largest in Asia by 2015<sup>7</sup>.

Australia's hedge funds industry has attracted, and is supported by, strong service providers. Their provision of risk assessment, unit pricing and operational procedures within the sound regulatory and governance framework that underpins Australia's financial services industry more generally, is an important aspect of the Australian hedge funds industry.

**'Australia remains the biggest of the Asia Pacific hedge fund centres.'**

*AsiaHedge Press Release, 19 July 2006*

**'Australia and Japan experienced the fastest rates of (hedge fund) asset growth in the region.'**

*HedgeFund Intelligence Press Release, 27 March 2006*

<sup>1</sup> All currency conversions use an exchange rate: A\$1 = US\$0.7433 as at 30 June 2006, sourced from Reserve Bank of Australia, unless otherwise stated.

<sup>2</sup> Standard & Poor's, *The World by Numbers: Global Stock Market Review*, June 2006.

<sup>3</sup> Bank for International Settlements (BIS), *International Financial Statistics*, June quarter 2005.

<sup>4</sup> BIS, *Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in 2004*.

<sup>5</sup> Australian Bureau of Statistics, *Managed Funds Australia*, June quarter 2006.

<sup>6</sup> Lodestar Favourability Indicators, *Cerulli Global Update Mid-Year, 2005*.

<sup>7</sup> Allianz Global Investors, *Asia-Pacific Pensions, Reform Trends and Growth Opportunities*, June 2005.

## SIZE OF THE AUSTRALIAN HEDGE FUNDS INDUSTRY

Hedge fund managers located in Australia directly control A\$41.1 billion (US\$30.5bn) in assets, more than Hong Kong and Singapore put together.

### TOTAL HEDGE FUND ASSETS MANAGED BY HEDGE FUND MANAGERS IN KEY ASIAN FINANCIAL CENTRES

|  | Assets Under Management US\$ billion |
|--|--------------------------------------|
| Australia  | 30.5                                 |
| Japan  | 22.3                                 |
| Hong Kong  | 19.6                                 |
| Singapore  | 6.0                                  |
| Other Asia or other centres investing in Asian markets | 2.0                                  |
| USA (investing in Asian markets)                       | 28.0                                 |
| UK (investing in Asian markets)                        | 19.6                                 |
| <b>TOTAL</b>   | <b>128.0</b>                         |

Source: AsiaHedge, July 2006. Data covers hedge funds only.

When Australia's fund of hedge fund sector is included, the size of the Australia Hedge Fund industry increases to A\$62.7 billion (US\$46.6bn).

### TOTAL SIZE OF THE AUSTRALIAN HEDGE FUNDS INDUSTRY

|                       | Assets Under Management US\$ billion      |
|-----------------------|---|
| Hedge fund managers*  | US\$30.5bn (A\$41.1)                      |
| Fund of hedge funds** | US\$16.1bn (A\$21.6)                      |
| <b>TOTAL</b>          | <b>US\$46.6bn<sup>(1)</sup> (A\$62.7)</b> |

(1) Unadjusted for double counting. Anecdotal evidence suggests that adjustments for double counting will not materially reduce the total figure.

Sources: \*AsiaHedge, \*\*LCA Group, as at 30 June 2006.

## GROWTH OF THE AUSTRALIAN HEDGE FUNDS INDUSTRY

The Australian industry is also growing at a rapid pace. Assets under management by hedge fund managers have almost tripled in the past two years.

### GROWTH IN ASSETS UNDER MANAGEMENT OF THE AUSTRALIAN HEDGE FUNDS INDUSTRY

| Year (as at 30 June) | Assets Under Management A\$ billion |
|----------------------|-------------------------------------|
| 2000                 | 2 <sup>(1)</sup>                    |
| 2001                 | 4 <sup>(1)</sup>                    |
| 2002                 | 10                                  |
| 2003                 | 18                                  |
| 2004                 | 26                                  |
| 2005                 | 45 <sup>(2)</sup>                   |
| 2006                 | 60.1 <sup>(3)</sup>                 |

(1) Estimates.

(2) Data for 2005 was revised upwards from A\$35bn to A\$45bn.

(3) Total figures for the industry differ slightly according to different data providers. Measures of the overall industry size range from A\$60.1bn to A\$62.7bn.

Source: LCA Group, as at 30 June 2006.

## GROWTH IN AUSTRALIAN-BASED PRODUCTS AND MANAGERS FOR HEDGE FUNDS AND FUND OF HEDGE FUNDS

| Year (as at 30 June) | Number of Single Strategy Hedge Fund Products | Number of Fund of Hedge Fund Products | Number of Managers – Hedge Funds | Number of Managers – Fund of Hedge Funds |
|----------------------|---|---------------------------------------|----------------------------------|--|
| 2002                 | 45  | 22                                    | 27                               | 13                                       |
| 2003                 | 65  | 28                                    | 42                               | 15                                       |
| 2004                 | 86  | 40                                    | 49                               | 15                                       |
| 2005                 | 115   | 46                                    | 59                               | 16                                       |
| 2006                 | 130   | 58                                    | 66                               | 17                                       |

Source: LCA Group.

## INVESTMENT STRATEGIES

The Australian hedge funds industry covers global, regional and domestic markets. Seventy one per cent of assets managed by Australian hedge fund managers are deployed using global or regional investment strategies, demonstrating the availability of sophisticated international investment skills within the country.

## INVESTMENT STRATEGIES OF AUSTRALIAN HEDGE FUND MANAGERS

| Strategies   | Assets Under Management<br>A\$ million | Number of Funds |
|--|--|-----------------|
| Global Fixed Income                                | 1,978                                  | 10              |
| Global Managed Futures                             | 179                                    | 10              |
| Global Macro                                       | 2,496                                  | 7               |
| Japan Long Short and Absolute                      | 3,697                                  | 8               |
| Global Long Short and Absolute                     | 17,548                                 | 21              |
| Asia Long Short and Absolute                       | 2,244                                  | 6               |
| Global Arbitrage; FX; and Multi-Strategy           | 912                                    | 9               |
| <b>Sub Total Global and Asian strategies (71%)</b> | <b>29,054 (US\$21.6bn)</b>             | <b>71</b>       |
| Australia Event Driven                             | 161                                    | 8               |
| Australia Long Short and Absolute                  | 11,011                                 | 41              |
| Australia Market Neutral                           | 834                                    | 8               |
| <b>TOTAL (100%)</b>                                | <b>41,060 (US\$30.5bn)</b>             | <b>128</b>      |

Source: AsiaHedge as at 30 June 2006.

There are 66 hedge fund managers in Australia offering a wide range of strategies including: long/short; relative-value; arbitrage; event-driven and macro strategies in global and regional equities; fixed income/credit; derivatives and futures. This is indicated by the top ten hedge fund managers listed below.

#### TOP 10 HEDGE FUND MANAGERS IN AUSTRALIA

|    | Fund Manager                        | Assets Under Management<br>A\$ million | Strategy                            |
|----|-------------------------------------|--|-------------------------------------|
| 1  | Platinum Asset Management           | 20,000                                 | Global and Asian long/short         |
| 2  | PM Capital                          | 4,133                                  | Global and Asian long/short         |
| 3  | Barclays Global (Australia)         | 3,721                                  | Equity long/short, macro            |
| 4  | Grinham Managed Funds               | 2,000                                  | Global macro/futures                |
| 5  | AMP Capital Investors               | 1,053                                  | Equity long/short                   |
| 6  | Optimal Fund Management             | 1,009                                  | Long/short                          |
| 7  | Basis Capital Funds Management      | 1,000                                  | Alternative fixed income and credit |
| 8  | WestLB Asset Management (Australia) | 898                                    | Long/short                          |
| 9  | Kaiser Trading                      | 777                                    | Macro/futures                       |
| 10 | Portfolio Partners                  | 719                                    | Long/short                          |
|    | <b>TOTAL</b>                        | <b>35,310</b>                          |                                     |

Source: LCA Group. As at 30 June 2006.

#### GROWTH ENVIRONMENT

There are currently 129 hedge fund products in Australia<sup>8</sup>, well ahead of the 92 in Singapore and 61 in Japan and just behind the 139 in Hong Kong.

#### NUMBER OF HEDGE FUND PRODUCTS BY ASIAN LOCATION

| Location     | 31 Dec<br>2001 | 31 Dec<br>2002 | 31 Dec<br>2003 | 31 Dec<br>2004 | 31 Dec<br>2005 | 30 June<br>2006 |
|--------------|----------------|----------------|----------------|----------------|----------------|-----------------|
| Australia    | 33             | 46             | 73             | 98             | 121            | 129             |
| Hong Kong    | 41             | 58             | 73             | 98             | 128            | 139             |
| Japan        | 17             | 25             | 36             | 46             | 61             | 61              |
| Singapore    | 19             | 26             | 44             | 65             | 86             | 92              |
| <b>TOTAL</b> | <b>110</b>     | <b>155</b>     | <b>226</b>     | <b>307</b>     | <b>396</b>     | <b>421</b>      |

Source: EurekaHedge, 30 June 2006.

<sup>8</sup> EurekaHedge cites 129 hedge fund products, AsiaHedge cites 128 and LCA Group cites 130.

This rapid growth has spurred the development of Australian hedge fund and boutique fund incubators that offer seed capital in addition to start-up management and administrative services. There are 12 such incubators in Australia.

## AUSTRALIAN HEDGE FUND AND BOUTIQUE FUND INCUBATORS

|                                  |                         |                     |                              |
|----------------------------------|-------------------------|---------------------|------------------------------|
| ■ Ascalon Capital Managers*      | ■ Macquarie Bank        | ■ Saltbush Capital  | ■ Treasury Group*            |
| ■ Challenger Financial Services* | ■ Pengana Capital       | ■ Tricom            | ■ Magellan Financial Group** |
| ■ Equity Trustees                | ■ MFS Alternative Asset | ■ Dawnay Day Walden | ■ Loftus Capital Partners*** |

\*Focusing on 'boutique funds' that are typically absolute return long-only funds.

\*\*Formerly Pengana Managers. \*\*\*Takes equity stakes in boutiques and hedge fund managers.

Source: Basis Point Consulting.

Hedge fund launches in Australia have been aided by the low start-up and annual running costs. Australia has the lowest annual recurring costs within the key centres in Asia.

## START-UP AND RUNNING COSTS

|           | Start-up Costs US\$ Low-to-High Range | Annual Recurring Costs US\$ Low-to-High Range |
|-----------|---------------------------------------|---|
| Australia | 81,000 to 195,000                     | 162,000 to 340,000                            |
| Singapore | 54,000 to 117,000                     | 211,900 to 318,900                            |
| Hong Kong | 60,000 to 305,000                     | 195,000 to 612,000                            |
| Japan     | 190,000 to 530,000                    | 357,000 to 880,000                            |

Source: Ernst & Young. Reproduced with the permission of AsiaHedge, published by HedgeFund Intelligence.

## FUND OF HEDGE FUNDS

A key component of the hedge funds industry is the Australian fund of hedge fund and structured hedge fund product sector that accounts for A\$21,620 million (US\$16,070m) in assets and is regarded anecdotally as Asia's largest.

## TOP 10 OF 17 FUND OF HEDGE FUND ENTITIES IN AUSTRALIA

| Entity                                 | Assets Under Management A\$ million |
|--|-------------------------------------|
| 1 Man Investments Australia*           | 5,510                               |
| 2 HFA Asset Management                 | 2,500                               |
| 3 Everest Babcock & Brown              | 2,100                               |
| 4 GMO Australia                        | 1,904                               |
| 5 Warakirri                            | 1,600                               |
| 6 BT Financial Group*                  | 1,500                               |
| 7 Harris Associates                    | 1,000                               |
| 8 UBS GAM                              | 960                                 |
| 9 FRM                                  | 800                                 |
| 10 MQ Specialist Investment Management | 610                                 |
| Other fund of hedge funds              | 1,646                               |
| Other structured hedge fund notes**    | 1,490                               |
| <b>TOTAL</b>                           | <b>21,620</b>                       |

Sources: LCA Group; \*Basis Point Consulting as at 30 June 2006; \*\*LCA estimates.

# Australian Investors

Australian pension funds, high-net-worth individuals and retail investors represent some of the largest investment pools in Asia. According to the Investment Company Institute, Australia's investment fund assets are the fourth largest in the world<sup>9</sup>. Funds under management in Australia reached A\$1.03 trillion (US\$764bn) in the June quarter of 2006<sup>10</sup>.

## AUSTRALIAN PENSION FUND INVESTORS

Australia's contestable pension fund market is projected to reach US\$1.9 trillion by 2015, making it the largest in Asia. This is shown in the table below. In Australia, there is no real distinction between 'public' and 'private' pension funds, as all pension funds are contestable. The table below may not include (public) government monies elsewhere in Asia that may be outsourced to private pension schemes.

### PENSION ASSETS UNDER MANAGEMENT IN ASIA – US\$ BILLION

| Country          | 2004         | 2015           |
|------------------|--------------|----------------|
| <b>Australia</b> | <b>527.5</b> | <b>1,908.7</b> |
| Japan            | 761.1        | 896.6          |
| Singapore        | 68.8         | 123.9          |
| Hong Kong        | 39.6         | 112.0          |
| South Korea      | 31.4         | 275.0          |
| Taiwan           | 2.7          | 98.5           |

Source: Allianz Global Investors, *Asia-Pacific Pensions, Reform Trends and Growth Opportunities June 2005*.

## HIGH-NET-WORTH INDIVIDUALS

Australia has 317,241 'self-managed' pension funds, worth a combined A\$208.4 billion (US\$154.9bn)<sup>11</sup>. They are typically established by high-net-worth and 'mass affluent' individuals as their private pension fund, and they take responsibility for asset allocation decisions. Among the four financial centres in Asia, Australia has the highest number of high-net-worth individuals, ex-Japan.

### HIGH-NET-WORTH INDIVIDUALS IN ASIA

| Country            | Number of High-Net-Worth Individuals <sup>(1)</sup> |
|--------------------|---|
| Japan              | 1,406,000   |
| <b>Australia</b>   | <b>146,000</b>                                      |
| Hong Kong          | 77,000  |
| Singapore          | 55,000  |
| <b>Comparisons</b> |   |
| US                 | 2,669,000   |
| UK                 | 448,000   |

(1) High-net-worth individuals are defined as having at least US\$1 million in financial assets.

Sources: *World Wealth Report 2006* and *Asia-Pacific Wealth Report 2006*, both produced by Merrill Lynch and CapGemini.

<sup>9</sup> Investment Company Institute, *Worldwide Mutual Assets and Flows*, March quarter 2006. 'Investment Fund' refers to publicly offered, open-end fund investing in transferable securities and money market funds.

<sup>10</sup> Australian Bureau of Statistics, *Managed Funds Australia*, June quarter 2006.

<sup>11</sup> Australian Prudential Regulation Authority, *Quarterly Superannuation Performance*, March 2006.



## RETAIL INVESTORS

Australian total household wealth (combining retail and high-net-worth individuals) is more than four-times that of Singapore and more than double that of Hong Kong. In addition, wealth in Australia grew roughly six-times faster than both Hong Kong and Singapore from 2000 to 2005.

### TOTAL WEALTH OF HOUSEHOLDS AND PER CENT GROWTH

| Country   | Financial Assets<br>US\$ trillion | Per Cent Growth<br>2000–05 |
|-----------|-----------------------------------|----------------------------|
| Australia | 1.3                               | 14.5                       |
| Hong Kong | 0.5                               | 2.1                        |
| Singapore | 0.3                               | 2.8                        |

Source: The Boston Consulting Group, *Wealth Market Sizing Database 2006*.

Australia has one of the world's highest percentages of individuals with direct and indirect (via managed funds) investments in the stock market<sup>12</sup>. Australia also has an active retail market in futures, margin FX, contracts for differences, warrants and exchange traded options.

## AUSTRALIAN INVESTORS IN HEDGE FUNDS

Investors allocating to Australian hedge funds and fund of hedge funds include Australian high-net-worth individuals, retail, and pension fund investors as well as offshore institutional investors.

### INVESTORS IN HEDGE FUNDS AND FUND OF HEDGE FUNDS

| Investor Type                        | Per Cent Allocation |
|--------------------------------------|---------------------|
| Australian high-net-worth and retail | 65                  |
| Australian pension funds             | 20                  |
| Offshore institutional investors     | 15                  |
| <b>TOTAL</b>                         | <b>100</b>          |

Source: LCA Group. Estimates as at 30 June 2006.

## HIGH-NET-WORTH INDIVIDUALS AND RETAIL INVESTORS IN HEDGE FUNDS

Australian high-net-worth individuals and retail investors have made significant allocations to hedge funds, particularly to fund of hedge funds and structured hedge fund products.

For example, Australia's largest three fund of hedge funds, accounting for A\$10,110 million (US\$7,515m) in assets, each sources the majority of its monies from high-net-worth individuals and retail investors. In comparison, as at 31 March 2006, the total asset size of Hong Kong's retail hedge fund market was approximately US\$1,150 million<sup>13</sup>.

In addition, the Australian Stock Exchange offers a Listed Managed Investment (LMI) program that has garnered more than A\$970 million (US\$721m) from predominantly retail investors into ten listed hedge fund and absolute return funds<sup>14</sup>.

<sup>12</sup> Australian Stock Exchange, *2004 Australian Share Ownership Study*, 24 February 2005.

<sup>13</sup> Hong Kong Securities and Futures Commission [SFC], Press Release, 18 October 2006.

<sup>14</sup> Australian Stock Exchange, *Listed Managed Investment Monthly Update*, August 2006.

## PENSION FUND INVESTORS IN HEDGE FUNDS

Australian pension fund investors have also been increasing their allocation to hedge funds over the past four years, climbing from 3 per cent in 2001 to 32 per cent of institutions in 2005.

### PERCENTAGE OF INSTITUTIONAL\* INVESTORS [BY REGION] ALLOCATING TO HEDGE FUNDS

| Year | Australia | North America | Europe | Japan |
|------|-----------|---------------|--------|-------|
| 2001 | 3         | 17            | 15     | 30    |
| 2003 | 18        | 23            | 21     | 41    |
| 2005 | 32        | 27            | 35     | 59    |

\*Institutional investors surveyed described as large endowments, foundations and pension plans.

Source: 2005-2006 Russell Survey on Alternative Investing, Russell Investment Group. No survey data specifically on Asia was published.

At least A\$4,064 million (US\$3,021m) have been allocated by Australian superannuation funds to hedge funds and fund of hedge funds through the advice of asset consultants.

### ASSET CONSULTANTS ADVISING ON HEDGE FUND AND FUND OF HEDGE FUND ALLOCATION

| Asset Consultant                  | Total Allocated A\$ million |
|-----------------------------------|-----------------------------|
| JANA Investment Advisers          | 2,168.7                     |
| Watson Wyatt                      | 588.5                       |
| Mercer IC                         | 467.3                       |
| Frontier Investment Consulting    | 372.0                       |
| Towers Perrin                     | 153.0                       |
| Russell Investment Group          | 99.2                        |
| Strategic Capital Management      | 78.0                        |
| ipac Portfolio Management Limited | 57.0                        |
| Counterpoint Consulting           | 51.0                        |
| Other                             | 29.5                        |
| <b>TOTAL</b>                      | <b>4,064.2</b>              |

Source: InvestorSupermarket; InvestorInfo Ltd. Cumulative allocations 30 June 2003 to 30 June 2006. Information is sourced from super fund annual reports from June 2005 and December 2005 as well as additional mandate announcements to the market.

Note: Towers Perrin is shown separate to Russell Investment Group. Russell Investment Group announced in August 2004 that it had acquired Towers Perrin (Australia).

Pension fund allocations have been made to a wide range of hedge funds and fund of hedge funds, both domestic and international. The ten largest allocations amounted to A\$6,919.3 million (US\$5,143m).

## TEN LARGEST SUPERANNUATION FUND ALLOCATION TO HEDGE FUND/FUND OF HEDGE FUNDS

| Super Fund                        | Total Allocated (A\$m) | Managers  |
|-----------------------------------|------------------------|---|
| ARIA*†                            | 2,803.6                | Perpetual Investments, Suncorp Investment Funds, Harris Alternatives LLC, Mesirow Financial Holdings Inc, Barclays Global Investors, Platinum Asset Management, Bridgewater Associates, GMO Australia Ltd, Orbis Investment Management Ltd, Holowesko Global Fund |
| REST                              | 772.5                  | GMO Australia Limited, Harris Alternatives L.L.C., Holowesko Global Fund, Warakirri Asset Management  |
| UniSuper†                         | 713.2                  | GMO Australia Limited, State Street Global Advisors   |
| AustralianSuper**                 | 564.1                  | Barclays Global Investors, Bridgewater Associates, WestLB, FRM Investment Management Limited, Harris Alternatives L.L.C   |
| Health Super                      | 452.3                  | Barclays Global Investors, FRM Investment Management Limited, UBS Global Asset Management   |
| Telstra Super Scheme, Telstra SS† | 605.0                  | Aetos Capital LLC, BT Financial Group Pty Ltd, Colonial First State Investments Ltd, FRN Investment Management Ltd, The Blackstone Group, UBS Global Asset Management (Australia) Ltd   |
| QLGSS                             | 271.9                  | AMP Capital Investors, BT Financial Group, UBS Global Asset Management  |
| Qantas SP                         | 253.4                  | BT Financial Group, UBS Global Asset Management   |
| HESTA                             | 243.4                  | FRM Investment Management Limited, Quellos Group  |
| HOSTPLUS                          | 239.9                  | Acadian Asset Management (Australia) Ltd, GMO Australia Limited, Harris Alternatives L.L.C., Perpetual Investments  |
| <b>TOTAL</b>                      | <b>6,919.3</b>         |   |

\*Formerly PSS/CSS.

\*\*AustralianSuper was recently formed from the merger of ARF and STA.

Sources: †Advised by fund as at 30 June 2006. All other data from InvestorSupermarket; InvestorInfo Ltd. Information is sourced from super fund annual reports from June 2005 and December 2005 as well as additional mandate announcements to the market.

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# Service Providers to the Hedge Funds Industry

A number of service providers have established operations in Australia, or are marketing into Australia, to capitalise on the rapid industry growth. The presence of these services in turn contributes to Australia's hedge fund industry operating within an environment with a sharp focus on risk assessment and management.

## HEDGE FUND ADMINISTRATORS

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Citco Fund Services runs its Asia Pacific headquarters from Sydney while Kingsway Taitz Fund Administration has also been established. A number of major administrators market to Australia's hedge funds community from offshore.

## PRIME BROKERS

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Prime brokers with Australian-based teams include Citigroup Global Markets, Deutsche Bank, Merrill Lynch, Fortis Clearing and UBS. Morgan Stanley has announced it is establishing an Australian-based team in the third quarter of 2006. Other firms providing brokerage services from Australian-based teams include ABN AMRO, ANZ Investment Bank, BBY, Calyon Financial Group, Daiwa Securities SMBC, Fimat, Goldman Sachs JBWere, Grange Securities, Instinet Pacific, Macquarie Bank\*, Man Financial Australia, National Australia Bank, Société Générale Corporate & Investment Banking and Tricom\*<sup>15</sup>.

## OTHER PROVIDERS

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Structured credit providers have sought out Australian hedge fund business. Providers with operations in Australia include Barclays Capital, BNP Paribas, Credit Suisse, Goldman Sachs JB Were, JP Morgan, Morgan Stanley, Nomura Australia, Royal Bank of Scotland, and Westpac Institutional Bank<sup>16</sup>.

Legal providers with Australian-based teams include Henry Davis York, Phillips Fox, Blake Dawson Waldron, Mallesons Stephen Jaques, and Pillsbury Winthrop Shaw Pittman. Accounting and business services providers include Ernst & Young and KPMG<sup>17</sup>.

Global hedge fund research and advisory firms with major Australian fund of hedge fund clients include Federal Street Advisors, Gottex Fund Management, Grosvenor Capital Management, Harcourt Investment Consulting and Lighthouse Partners<sup>18</sup>. Others include Mesirow Financial, and Greenwich–Van<sup>19</sup>.

Macquarie University, in conjunction with fund of hedge fund manager, Colonial First State, offers a specialist postgraduate course on hedge funds as part of the university's Master of Applied Finance course. It is one of the few specialist hedge fund programmes offered by a university anywhere in the world.

Research firms providing hedge fund product research to financial planners and investors include AEGIS, Assirt, InvestorWeb, LCA Group, Lonsec, van Eyk Research and Zenith Investment Partners<sup>20</sup>.

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<sup>15</sup> List compiled from the *Cure Our Kids Asia-Pacific Hedge Fund and Alternatives Directory 2005 and 2006*, produced with the support of the Alternative Investment Management Association Australian Chapter. \*Not in directory.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid. Also includes 2004 directory.

<sup>18</sup> Van Eyk, *Hedge Fund of Funds Sector Overview*, November 2005.

<sup>19</sup> Via an Australian joint venture Van MacDonald.

<sup>20</sup> Basis Point Consulting research.

## Regulation of the Hedge Funds Industry

'There are no specific regulations covering hedge funds in Australia. Like other types of managed funds, hedge funds fall under the scope of the Corporations Act 2001; the provisions that apply depend on whether they are structured as trusts or companies.

In the case of a trust, if a hedge fund is marketed to retail investors, then it must be registered with the Australian Securities and Investments Commission (ASIC), and is subject to certain operational and disclosure requirements designed to protect investors' interests.

These requirements include the appointment of a responsible entity charged with certain fiduciary duties, the provision of adequate product disclosure statements and annual or semi-annual reporting of financial statements.

Hedge funds that do not accept funds from retail investors are subject to fewer requirements, as their investors are considered to be better placed to monitor and manage their investments without government regulation.

Hedge funds structured as companies must comply with provisions covering capital raisings, corporate governance and disclosure requirements<sup>21</sup>.

Most significantly, apart from registration of the retail funds themselves, all hedge fund managers (whether their funds are retail or wholesale) must hold an Australian Financial Services Licence issued by ASIC under Chapter 7 of the Corporations Act 2001. All licensees have ongoing compliance requirements.

In general, Australia's financial regulatory environment is highly regarded by many other jurisdictions around the world. Its political and legal institutions are recognised globally for their transparency, impartiality and robustness, and the quality of corporate governance in Australia is ranked among the best in the world<sup>22</sup>.

### RECENT TAXATION CHANGES

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The tax treatment of hedge funds is covered by the Foreign Investment Fund (FIF) regime contained in Part XI of the Australian Income Tax Assessment Act, 1936.

Recent changes to FIF legislation have:

- exempted qualifying superannuation (pension) entities and fixed trusts from the FIF rules where all of the beneficiaries are complying superannuation entities;
- increased the FIF balanced portfolio exemption threshold from 5 per cent to 10 per cent; and
- removed 'management of funds' from the FIF 'black list' of non-eligible business activities for the purposes of claiming a FIF exemption.

These and other changes to the tax legislation are seen by many as encouraging the growth of the Australian hedge fund industry.

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<sup>21</sup> Reserve Bank of Australia, *Financial Stability Review*, September 2004.

<sup>22</sup> GovernanceMetrics International, *Global Governance Rankings (23 countries)*, February 2005.



## The Australian Environment

The strength and resilience of the Australian economy have underpinned fifteen years of uninterrupted economic expansion at a rate well above the global average. Being one of the largest financial markets in the region, Australia offers a highly competitive location with an open, transparent, world-best practice regulatory environment, a highly skilled and multilingual workforce, and an advanced business infrastructure.

**ROBUST DOMESTIC ECONOMY:** Australia's average annual GDP growth rate from 1998 to 2007 was 3.5 per cent, well above the rate of world growth and ahead of other developed economies including the USA, Japan, Germany and the UK<sup>23</sup>. Australia has also been ranked the most resilient economy in the world for the fifth successive year<sup>24</sup>.

**STRONG PRODUCTIVITY GROWTH:** Benchmarked against other OECD nations, Australia's productivity has shown strong and consistent growth. Over a nine-year period to 2004, Australia's annual average growth of 2.3 per cent, (measured by GDP per hour worked) was greater than that of major developed nations including the G7 countries (2.1) and the OECD countries (1.6)<sup>25</sup>.

**SOPHISTICATED FINANCIAL MARKETS AND LARGE MUTUAL FUNDS POOL:** Australia is one of the key centres for capital markets activity in the Asia Pacific with liquid markets in equities, debt, foreign exchange and derivatives. Total investment funds in Australia have more than quadrupled since 1991 with an annual compound growth rate of 11 per cent. After topping A\$1 trillion in the March quarter 2006, total consolidated assets under management rose a strong A\$16 billion to A\$1.03 trillion (about US\$765 billion) in the June quarter 2006<sup>26</sup>. The Australian custody industry has shown strong growth since its inception in the mid 1980s. Funds under custody and administration now total over A\$1,000 billion and the industry employs more than 2,500 people in Australia<sup>27</sup>.

**FOREIGN EXCHANGE MARKET:** Australia's foreign exchange (FX) market activity has expanded significantly over the past decade, and the Australian dollar is now the sixth-most actively traded currency in the world. In May 2006, the daily average value of FX turnover against all currencies was about A\$210 billion. Turnover in non-AUD transactions rose to about A\$120 billion a day, bolstered by an increasing number of firms locating their Asian time zone FX business in Australia<sup>28</sup>.

**HIGHLY SKILLED AND EXPERIENCED TALENT POOL:** Australia's primary advantage as a regional centre is the availability of a sizeable pool of skilled personnel. A further advantage is that over 850,000 Australians are fluent in one of the major Asian languages. International studies confirm the high skill level, productivity and professionalism of Australia's workforce, particularly for financial services. In many critical categories, such as economic literacy and education in finance, Australia's workforce rates among the best in the world<sup>29</sup>.

**DEMOCRATIC AND POLITICALLY STABLE:** Australia is one of the oldest and most stable democracies in the world. It was ranked the most politically stable in the world in 2006 and over the last five years, it is the only country consistently ranked in the top three<sup>30</sup>. In addition, a survey conducted in 2005 by independent ratings agency, GovernanceMetrics International (GMI), ranked Australia fourth in the world for its corporate governance standards. This survey covered 3,220 global companies from 23 countries.

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<sup>23</sup> International Monetary Fund, *World Economic Outlook Database*, September 2006.

<sup>24</sup> *World Competitiveness Yearbook (WCY) 2006*.

<sup>25</sup> OECD Productivity Database 2005.

<sup>26</sup> Australian Bureau of Statistics, Category 5655.0, *Managed Funds*, Australia June quarter 2006.

<sup>27</sup> Australian Custodial Services Association.

<sup>28</sup> Reserve Bank of Australia Bulletin Statistical Tables F9 and F10, data updated to 12 July 2006.

<sup>29</sup> Institute for Management Development, Switzerland, *World Competitiveness Yearbook 2006*.

<sup>30</sup> Institute for Management (IMD), *World Competitiveness Yearbook 2006*.

## Axiss Australia

Axiss is the financial services division of Invest Australia. The Australian Government established Axiss to position Australia as a global financial services centre in the Asian time zone. Axiss assists financial services institutions to establish and expand their activities in Australia.

Axiss also acts as a reference point for information on Australia's financial services sector, undertaking research and publishing benchmark studies on key business location determinants, such as industry structure and service capacity, workforce capability and regulatory and taxation matters.

Axiss produces newsletters, fact sheets, international data comparisons and reports on the Australian financial markets and business environment.

Axiss Australia's annual Benchmark Report provides key data and regional and global comparisons showing Australia's strengths as a global financial services centre.

Other information provided by Axiss includes Executive Briefings and Data Files on specific sectors within the financial services industry and its workforce and education in Australia.

All publications, research and charts can be accessed on [www.axiss.gov.au](http://www.axiss.gov.au) and the website contains general information about the regulatory and business environment for financial services in Australia.

## Useful Links

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| AusIndustry  | <a href="http://www.ausindustry.gov.au">www.ausindustry.gov.au</a>         |
| Australian Tax Office (ATO)                          | <a href="http://www.ato.gov.au">www.ato.gov.au</a>                         |
| Alternative Investment Management Association (AIMA) | <a href="http://www.aima.org">www.aima.org</a>                             |
| Australian Securities Lending Association (ASLA)     | <a href="http://www.asla.com.au">www.asla.com.au</a>                       |
| Axiss Australia                                      | <a href="http://www.axiss.gov.au">www.axiss.gov.au</a>                     |
| Invest Australia                                     | <a href="http://www.investaustralia.gov.au">www.investaustralia.gov.au</a> |

## Acknowledgements

Axiss Australia wishes to acknowledge the data and research provided by Basis Point Consulting and their contribution to the preparation of this report.

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