

2015 AUSTRALIAN INVESTMENT MANAGERS CROSS-BORDER FLOWS REPORT

Financial Services Council and Perpetual



INTRODUCTIONS FROM THE FINANCIAL SERVICES COUNCIL AND PERPETUAL



Sally
Loane,
CEO
Financial
Services
Council

Welcome to the 2015 Australian Investment Managers Cross-Border Flows Report.

The FSC is pleased to again partner with Perpetual to produce the fourth Cross-Border Flows publication.

The 2015 FSC-Perpetual Australian Investment Managers Cross-Border Flows Report shows investment by foreign fund managers into Australian Managed Investment Trusts (MITs) has doubled from \$20.3 billion to \$43.6 billion over the past five years. However, the proportion of financial exports has remained consistent at 3.6% over that period.

As Australia transitions into a services-based economy, the expertise of our world-class fund managers and cross-border trade of financial services will become imperative for our future economic growth.

Australia's \$2.6 trillion funds management industry is the fourth largest in the world. It could grow even more if we embrace the right policies to enable the export and trade of financial products and expertise – particularly with our closest region, Asia.

How well we establish the regulatory architecture for financial services now,

will determine our level of success as an exporter of financial services into the future. And the opportunities are significant.

Asia currently accounts for 65% of cross-border flows. As the world's most densely populated region and with the fastest growing middle-classes, more demand from Asia for financial products and services is imminent.

Trade agreements with Japan, Korea and China, the Asia Region Funds Passport (Passport) and the recently negotiated Trans-Pacific Partnership, will enable this growth. It is imperative that the government embeds the architecture behind these agreements as a matter of priority.

This report shows the positive impact of the Johnson reform recommendations on the flow of funds into Australia. It is now critical for these recommendations to be completed so Australia can effectively compete for market share with other jurisdictions.



Geoff Lloyd,
CEO and
Managing
Director
Perpetual
Limited

Perpetual is delighted to support the publication of the 2015 edition of the Australian Investment Managers Cross-Border Flows Report.

We are one of Australia's largest independent wealth managers and

recognise that the future growth of our domestic financial services industry is dependent on global investment.

Our geographical location means our neighbours in the Asia Pacific region are natural trading partners for us and it is not surprising to see it as the dominant region for total fund flows.

This year's report shows 56% of fund flows are being invested into overseas asset classes. This is testament to Australia's world-class investment management expertise being sought after globally.

We continue to make good progress on the Passport, with the recent signing of the Statement of Understanding by Australia, Korea, New Zealand, the Philippines, Thailand, and Japan. This will help to further stimulate fund flows across the region.

Free trade agreements (FTAs) with Japan and Korea are already having a positive impact on capital flows, and with the China FTA and Trans-Pacific Partnership underway, there is strong momentum to achieve further growth in the near future.

As a corporate trustee facilitating cross-border flows, and a fund manager which contributes to the report's findings and benefits from these flows, the data captured in this report provides valuable insights into future pathways for growth. We believe introducing additional types of collective investment vehicles will further increase capital flows in the years ahead.

EXECUTIVE SUMMARY

The Australian Investment Managers Cross-Border Flows Report was first commissioned in 2012 to determine the extent to which overseas sourced funds flowing into Australia had increased following tax policy changes introduced in 2010 as a response to the Johnson Report¹. The Report provides the only available insight into which regions, asset classes and investor types have experienced the greatest growth (or loss) inflows since these changes were implemented.

The Report provides a meaningful basis from which to analyse trends and better understand investment flows. It provides a unique insight into the nature of cross-border fund flows, with fund managers surveyed in the report collectively managing an estimated \$43.6 billion out of a possible total \$82.7 billion² of overseas sourced funds.

Over the five year period from 1 January 2010 to 31 December 2014, investment by foreign investors into Australia through MITs has more than doubled from \$20.3 billion to an estimated \$43.6 billion.

The results again show that Asia Pacific is the most common origin for funds

inflow with 65% sourced from the region. A feature of last year's study was to identify which countries these fund flows are sourced from and this analysis has been continued in the 2015 study. Japan accounted for 56% (\$11.9 billion) of the investment flows sampled.

65% of funds are sourced from the Asia Pacific region

This finding shows the significance of Japan as an existing trading partner and highlights the potential for future opportunities under the Japan Australia Economic Partnership Agreement (JAEPA) and the Asia Region Funds Passport. The JAEPA was executed on 15 January 2015 and provides substantial opportunities for Australia and Japan to mutually benefit from increased trade in financial services. On 11 September 2015, Japan also signed a Statement of Understanding to join Australia, South Korea, New Zealand, the Philippines and Thailand in the Passport.

New Zealand and South Korea were also prominent investment sources in the Asia Pacific region contributing

23% (\$4.9 billion) and 9% (\$2.1 billion) to fund inflows sampled, respectively. This shows the importance of both the Passport and the Korea Australia Free Trade Agreement (KAFTA), with both new policy initiatives having the potential to considerably increase fund inflows from these economies.

The investors using Australian-based managers are predominantly Fund Managers (34%), Pension Funds (11%) and Private Investors (21%).

Interestingly, over half of these fund inflows are being invested offshore (56%) into overseas asset classes. This demonstrates that the expertise of Australian investment managers is being sought in managing global investment portfolios and supports conclusions drawn in the Johnson Report that Australian fund managers have world class capability.

Foreign fund flows contributed \$434 million in total value added to the Australian economy in 2012-13³. With the right policy settings in place, Australia can take advantage of the potential for domestic fund managers to form a significant and growing proportion of future export activity.

1 The Johnson Report was published in November 2009 by the Australian Financial Centre Taskforce, "Australia as a Financial Centre - Building on our Strengths" <http://cache.treasury.gov.au/treasury/afcf/content/final_report/downloads/AFCF_Building_on_Our_Strengths_Report.pdf>

2 Total of \$82.7 billion reported by the Australian Bureau of Statistics: Source - ABS: 5655.0 - Managed Funds Australia, January 2010 to December 2014 - Assets: Funds managed by Australian Investment Managers on behalf of overseas investors; Consolidated Assets Total Managed Funds Institutions - Overseas Assets

3 Deloitte Access Economics, "The economic impact of increasing Australian funds management exports", report prepared for the Financial Services Council, May 2014. <http://www.fsc.org.au/downloads/file/ResearchReportsFile/2014_0806_EconomicimpactofincreasingAustralianfundsmanagementexports_e64a.pdf>

KEY FINDINGS

DOMINANT REGION:
65% ASIA PACIFIC (\$21.3 BILLION)

LARGEST FROM ASIA PACIFIC:
56% JAPAN (\$11.9 BILLION)
23% NEW ZEALAND (\$4.9 BILLION)
10% SOUTH KOREA (\$2.1 BILLION)

LARGEST FROM OUTSIDE ASIA PACIFIC:
9% USA (\$2.8 BILLION)
7% EUROPE INC UK (\$2.3 BILLION)
6% MIDDLE EAST (\$2.1 BILLION)
13% REST OF THE WORLD (\$4.3 BILLION)

FOREIGN INFLOWS \$43.6 BILLION

Investment by foreign investors into Australia through Managed Investment Trusts has more than doubled over the past four years – from \$20.3 billion to \$43.6 billion

INVESTMENT SOURCES

34%
FUND MANAGERS

11%
PENSION FUNDS

21%
PRIVATE INVESTORS

15%
RELATED OVERSEAS GROUP

ASSET CLASSES

28%
SHARES AND AUSTRALIAN FIXED INTEREST/ CASH EQUAL

28%
OVERSEAS SHARES

16%
OVERSEAS FIXED INTEREST AND CASH

OVERSEAS ASSET CLASSES

56%
OF ALL FUND INFLOWS ARE INVESTED INTO OVERSEAS ASSET CLASSES

METHODOLOGY

The Report is undertaken annually to better understand the implications of policy changes flowing from the *Johnson Report* and other policy changes impacting on the export of managed funds products to offshore investors.

The 2015 Report builds on the data collected previously and also provides a historical view over a five year period from 1 January 2010 to 31 December 2014.

The subject of this report is limited to funds managed through structures meeting the tax law definition of a Managed Investment Trust (MIT), which was legislated on 24 June 2010. A MIT is a managed investment scheme that is listed, widely held or held by certain collective investment entities.

The report provides a unique insight into the fund flows into Australian MITs. The information revealed by this report is not part of the standard data series collected by the Australian Bureau of Statistics (ABS) or research houses. While the ABS data series does report funds sourced overseas by Australian investment managers (\$82.69 billion at 31 December 2014) the data is not broken down any further.

Notably, the ABS data coverage is wider than the subject of this study (Australian MITs) as it includes both wholesale and retail registered MITs but also individual portfolios, such as mandates for institutional investors and separately managed accounts for individuals.

Participants

We thank the following 12 leading fund managers for their time and efforts in responding with data for the 2015 Report. These managers include:

- Aberdeen
- AMP Capital
- Colonial First State
- Franklin Templeton
- Henderson
- Invesco
- Macquarie
- Nikko AM
- Perpetual
- Russell
- Schroder Investment Management
- UBS

We would also like to thank independent actuarial and research firm, Plan for Life, which prepared the 2015 Report for us.

The report provides a unique insight into the fund flows into Australian MITs.

RESULTS

MONIES FLOWING INTO AUSTRALIAN MITs

Money flowing into Australian MITs from overseas sources has increased over the five year study period.

This year's study saw a smaller number of managers contribute data with a total sample of \$32.80 billion collected. The data set has been built over four consecutive years and allows for a reasonable estimate to be calculated for those managers who did not provide data to this year's study.

In Table 1, the total funds inflow more than doubled over the study period from \$20.3 billion at 1 January 2010 to an estimated \$43.6 billion at 31 December 2014.



TABLE 1 - MONIES FLOWING INTO AUSTRALIAN MANAGERS' FUNDS FROM OVERSEAS

	STUDY: OVERSEAS- SOURCED FUNDS \$BILLION	STUDY: INCREASE IN EACH 6 MONTH PERIOD \$BILLION	ABS: OVERSEAS- SOURCED FUNDS \$BILLION	% THAT STUDY REPRESENTS OF ABS FUND	BALANCE OF OVERSEAS- SOURCED FUNDS \$BILLION
1 January 2010	20.30		48.92	41.5%	28.62
30 June 2010	23.47	3.17	51.15	45.9%	27.68
31 December 2010	26.86	3.39	60.18	44.6%	33.32
30 June 2011	30.76	3.90	65.76	46.8%	35.00
31 December 2011	30.86	0.10	65.03	47.5%	34.17
30 June 2012	34.39	3.53	68.29	50.4%	33.90
31 December 2012	36.19	3.80	77.34	46.8%	41.15
30 June 2013	36.40	0.21	72.89	49.9%	36.49
31 December 2013	40.40	4.00	76.71	50.0%	36.31
30 June 2014 *	40.50	0.10	76.82	52.7%	36.32
31 December 2014*	43.60	2.90	82.69	52.7%	39.09
Annual Compound Rate of Increase 1/1/10 -31/12/14	16.5%		11.1%		6.4%

* indicates some estimates for 30 June and 31 December 2014.

CHART 1 - GROWTH IN STUDY FUND SIZE AND GROWTH IN TOTAL OVERSEAS-SOURCED FUNDS (\$ BILLION)

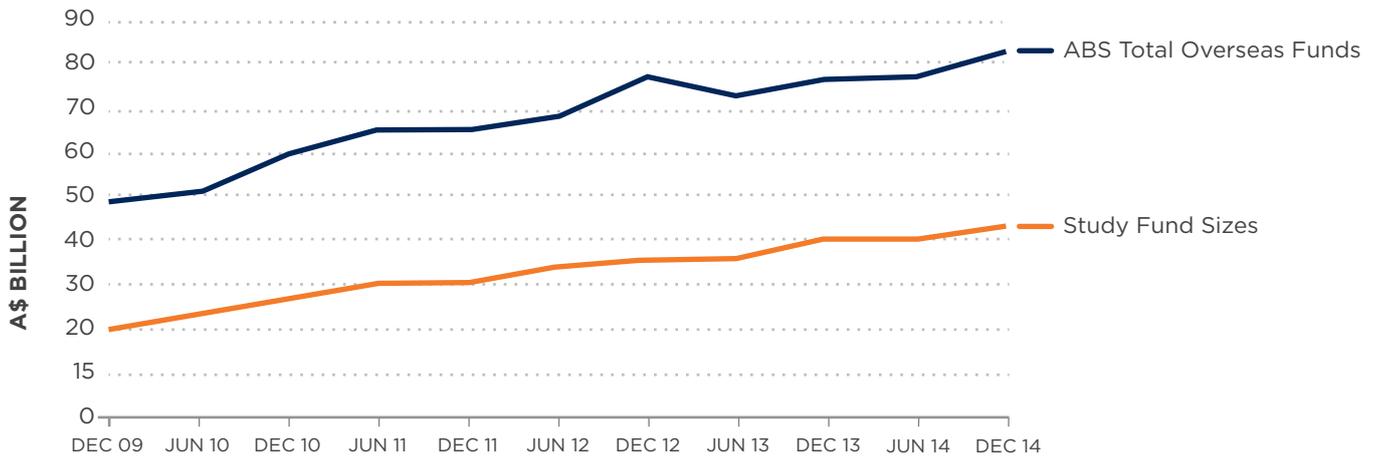
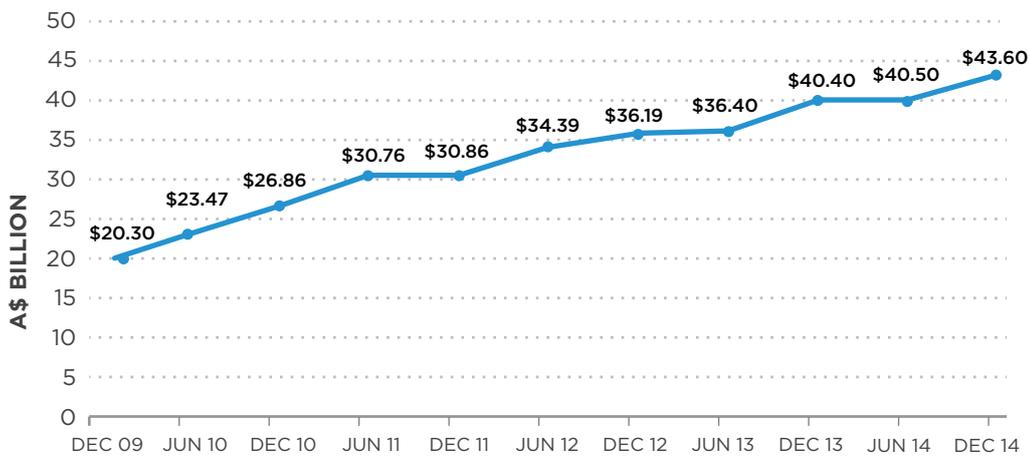


CHART 2 - GROWTH IN STUDY FUND SIZE - SIX MONTHLY INCREMENTS (\$ BILLION)



INVESTMENT ORIGIN

Table 2 below shows the Asia Pacific region made up 54.5% of the funds inflow at 31 December 2013 with \$17.46 billion, based on sample data of \$32.05 billion.

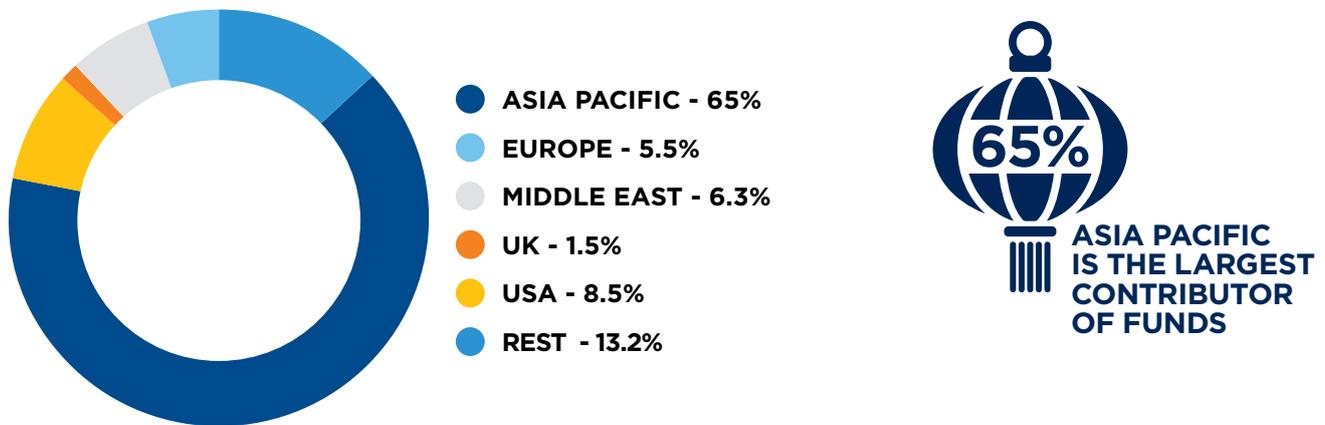
It is suspected that the decrease in contribution to funds inflow from the Asia Pacific in 2013 may be the result of some money being attributed to “Rest of the World”, which accounted for 11.4% of inflows.

Europe was the second biggest regional contributor at 11.0% (\$3.50 billion), whilst the USA contributed 9.8% (\$3.14 billion) and the UK 7.2% (\$2.30 billion).

TABLE 2 - ORIGIN OF FUNDS AT 1 JANUARY 2010 AND 31 DECEMBER 2014

REGION	FUNDS AT 1 JANUARY 2010 \$ BILLION	1 JAN 2010 %	FUNDS AT 31 DEC 2014 \$ BILLION	31 DEC 2014 %	INCREASE OVER PERIOD \$ BILLION	INCREASE P.A. OVER PERIOD
Asia Pacific	14.75	67.6%	21.33	65.0%	6.59	7.7%
Europe	2.79	12.8%	1.80	5.5%	-0.97	<0%
Other Regions	0.07	0.3%	4.32	13.2%	4.25	>100%
USA	0.67	3.0%	2.78	8.5%	2.12	>100%
United Kingdom	2.32	10.6%	0.48	1.5%	-1.84	<0%
Middle East	1.21	5.6%	2.06	6.3%	0.85	11.2%
Total	21.81	100%	32.77	100%	11.00	

CHART 3 - SOURCES OF FUND INVESTMENT IN AUSTRALIA FROM OVERSEAS - DECEMBER 2014



FURTHER COUNTRY BREAKDOWN

An additional breakdown of regional sources by country has again been undertaken this year.

Over half of inflows 55.5% (\$11.85 billion) were sourced from Japan. New Zealand was the next largest contributor at 23.2% (\$4.95 billion) and South Korea was third with 9.7% (\$2.06 billion).

ASIA PACIFIC	31 DEC 2013 \$ BILLION	31 DEC 2014 \$ BILLION
Japan	9,866	11,845
New Zealand	4,283	4,948
South Korea	1,032	2,064
Singapore	274	243
China	210	1,163
Malaysia	126	15
Hong Kong	22	183
Other	1,645	873
Total	17,458	21,334

Notable country contributions from outside the Asia Pacific region included the United States at 8.5% (\$2.78 billion) of total funds surveyed, Luxembourg at 2.7% (\$0.88 billion) and Canada at 5.1% (\$1,658 billion).

ASSET CLASSES

In Table 3 the two most popular asset class were Overseas Shares with 28.4% (\$9.31 billion) and Australian Fixed Interest and Cash with 28.0% (\$9.18 billion) of funds invested, out of the \$32.80 billion sample. Overseas Fixed Interest & Cash was the next most popular at 15.5% (\$5.09 billion). Both Overseas Property and Australian Shares each accounted for 11.6% (\$3.81 billion) and Australian Property accounted for 4.9% (\$1.61 billion). Notably the top four asset classes account for almost 80% of all investments sampled (79.6%).

Over half of incoming fund flows are being invested into investments located outside Australia. The asset classes of Overseas Shares, Overseas Property, and Overseas Fixed Interest and Cash comprise a total 55.5% (\$18.20 billion) of the funds inflow.

CHART 4 - CROSS-BORDER INVESTMENT IN AUSTRALIA - BY ASSET CLASS AT 31 DECEMBER 2014

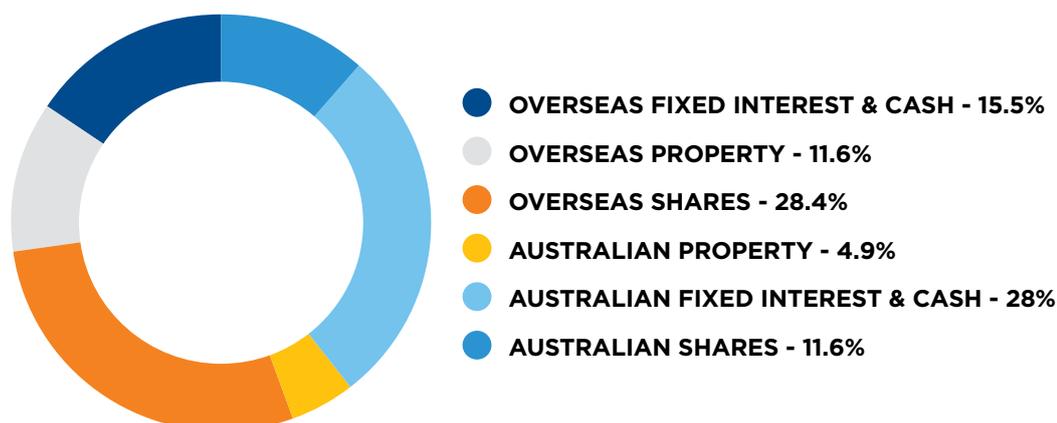


TABLE 3 - CHANGE IN ASSET CLASS BETWEEN 1 JANUARY 2010 AND 31 DECEMBER 2014

INVESTMENT TYPE	FUNDS AT 1 JAN 2010 \$ BILLION	1 JAN 2010 %	FUNDS AT 31 DEC 2014 \$ BILLION	31 DEC 2014 %
Australian Shares	2.11	19.5%	3.81	11.6%
Australian Fixed Interest & Cash	1.46	13.5%	9.18	28.0%
Australian Property	1.87	17.2%	1.61	4.9%
Overseas Shares	2.87	26.5%	9.31	28.4%
Overseas Property	2.53	23.4%	3.81	11.6%
Overseas Fixed Interest & Cash	-	-	5.09	15.5%
Total Funds in Sample	10.84	100%	32.80	100.0%

TYPES OF INVESTORS

In Table 4 below Fund Managers are the largest source of inflows at 34.3% (\$11.17 billion) of the \$32.59 billion sample. Fund Managers are defined as managers other than those of the particular entity offering the funds.

Private Investors placed \$6.86 billion or 21.1% of the funds and Pension Funds accounted for \$3.57 billion or 11%.

Fund Managers, Pension Funds and Sovereign Funds together account for just over half of funds sampled at 50.97% (\$16.62 billion).

CHART 5 - CROSS-BORDER INVESTMENT IN AUSTRALIA BY TYPE OF INVESTOR AT 31 DECEMBER 2014

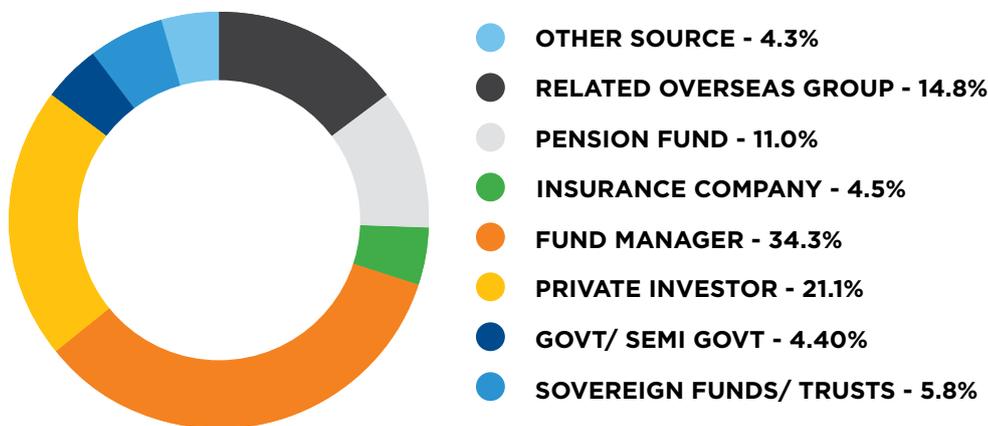


TABLE 4 - INVESTOR TYPES AT 31 DECEMBER 2014

	FUNDS AT 31 DEC 2014 \$ BILLION	31 DEC 2014 %
Related Overseas Group	4,810	14.8%
Pension Fund	3,568	11.0%
Insurance Company	1,453	4.5%
Fund Manager	11,165	34.3%
Private Investor	6,861	21.1%
Govt/ Semi Govt	1,435	4.4%
Sovereign Fund/Trusts	1,879	5.8%
Other Source	1,415	4.3%
Total	32,586	100.0%

CONCLUSIONS

Over the five years that the study has been conducted there has been a significant increase in the amount of funds estimated to be sourced offshore. Investment into Australian-based MITs has more than doubled from \$20.3 billion at 1 January 2010 to an estimated \$43.6 billion at 31 December 2014.

The inflows into Australian funds vindicates the policy value of the MIT regime but further changes are necessary if the true potential of Australia's funds management industry is to be unlocked. It is now a full six years since Mark Johnson released the *Johnson Report*⁴ 'Australia as a Financial Centre' and some of these important recommendations still remain outstanding.

One major success has been implementation of the Investment Manager Regime (IMR), which became law on 25 June 2015. The IMR removes uncertainties in the application of Australia's tax laws as they apply to widely-held foreign funds and foreign investors. In particular, the IMR clarifies the income tax treatment of

gains made by these foreign funds and made by foreign investors investing through Australian fund managers. The timing of the IMR's implementation means its impact will not flow through to study results until the 2016 and 2017 studies are undertaken.

The potential for financial services exports to positively impact Australia's economy is high and holds untapped potential.

The government must now urgently action the outstanding policy initiative to broaden the range of collective investment vehicles available in the Australian market.

The government's commitment to complete the Passport is encouraging and the announcement by Japan that it will join onto the Passport has sent

a ripple of excitement through the market. However the architecture established through the Passport is at risk of failing to produce any real benefits if associated Australian domestic reforms, such as allowing a broader range of collective investment vehicles, are not expedited.

Signing of the China-Australia Free Trade Agreement (ChAFTA) is particularly promising but the agreement must now be ratified as a matter of priority. More importantly, implementation of the financial services provisions through mutual recognition of both the ChAFTA and free trade agreements with both Japan and Korea must quickly follow so that the benefits to industry participants are clear and exports can begin to flow.

The potential for financial services exports to positively impact Australia's economy is high and holds untapped potential. The implication of successful capitalisation of these opportunities should not be overlooked, especially as the mining boom wanes.

As a proportion of the total \$2.6 trillion assets managed in Australia, overseas



sourced funds still only represents 3.6%⁵. The pool of foreign fund flows is increasing but growth is not outstripping the growth of domestic assets under management in Australia.

In 2012-13 foreign fund flows contributed \$434 million in total value added to the Australian economy⁶. Simply doubling funds management export revenue from the existing low base could lead to an increase in GDP of approximately \$330 million per annum by 2029/30⁷. It is large increases in the growth of funds management exports that are required and the following initiatives must be completed so that these benefits can begin to be realised.

ASIA REGION FUNDS PASSPORT

The Passport was a key recommendation of the Johnson Report for funds management and we commend the significant progress which has been made to date. The Passport will create much needed regulatory architecture to allow the interoperability of managed funds across participating jurisdictions when it becomes effective in 2016.

On 11 September 2015, Japan, Korea, New Zealand, the Philippines, Thailand and Australia signed a Statement of Understanding on the Passport. A Statement of Cooperation is expected to be signed by the respective Regulators prior to the end of 2015.

The Passport will offer the ability for Australian investment managers to sell products to retail customers located in these jurisdictions and vice-versa. However, it is essential that the remaining domestic changes are put in place so that Australian fund managers can benefit from the Passport.

BROADENING THE RANGE OF COLLECTIVE INVESTMENT VEHICLES

Australian fund managers are currently limited to one type of collective investment vehicle structure; a unit trust. This compares with successful global funds management centres such as Luxembourg, Ireland and the UK for many years have a range of collective investment vehicles with tax flow through treatment.

THE PROPORTION OF OVERSEAS SOURCED FUNDS STILL ONLY REPRESENTS 3.6%.

⁴ The Johnson Report was published in November 2009 by the Australian Financial Centre Taskforce, "Australia as a Financial Centre - Building on our Strengths".

⁵ ABS 5655.0 Managed Funds Australia Jun 2015, TABLE 1. SUMMARY MANAGED FUNDS INDUSTRY <http://www.abs.gov.au/ausstats/abs@nsl/mf/5655.0>

⁶ Deloitte Access Economics, "The economic impact of increasing Australian funds management exports", report prepared for the Financial Services Council, May 2014. http://www.fsc.org.au/downloads/file/ResearchReportsFile/2014_0806_EconomicimpactofincreasingAustralianfundsmanagementexports_e64a.pdf

⁷ Ibid.

Although Australia's unit trust structure is accepted by the Australian market, it is not well understood overseas. The *Johnson Report* found that "many potential non-resident investors in Australian funds, particularly in the Asia-Pacific region, do not come from common law jurisdictions. Neither they nor their investment advisors in the region are typically familiar or comfortable with trust structures"⁸.

This year's study showed a significant increase in investment sourced from Japan, South Korea and China.

By allowing additional types of collective investment vehicles, such as corporate or partnership structures, the potential to further increase fund inflows will be realised. In particular, a corporate structure which operates in a comparable manner to the UK's open ended investment company, or a Luxembourg Société d'Investissement à Capital Variable (SICAV), would place Australia on a level footing with these jurisdictions.

The current consideration of an expanded collective investment regime in the government's tax white paper process will result in lengthy delays to the regime's implementation. We urge the government to progress a corporate

collective investment vehicle as a matter of urgency, so that a framework can be developed and tested with industry prior to commencement of the Passport in 2016.

INCREASING FINANCIAL SERVICE EXPORTS THROUGH FREE TRADE AGREEMENTS

This year's study showed a significant increase in investments sourced from Japan (\$9.87 billion growing to \$11.85 billion), South Korea (\$1.03 billion up to \$2.06 billion) and China (\$0.24 billion to \$1.16 billion).

These increases bode well for the recent free trade agreements that Australia has entered into with Korea, Japan and China:

- The KAFTA came into effect on 12 December 2014. Korea is Australia's fourth largest trading partner and the KAFTA will facilitate greater mutual cooperation between Australia and Korea to increase financial services trade and capital flows between the countries.
- The JAEPA came into effect on 15 January 2015 and the Australian financial services industry will benefit from the commitments made by Japan to guarantee cross-border access for the provision of investment advice, portfolio management services and trade in wholesale securities transactions.

- The ChAFTA was signed on 17 June 2015 and provides unprecedented access for Australian fund managers into the Chinese market. The agreement must now be ratified.

Further, the announcement on 6 October 2015 that negotiations on the Trans-Pacific Partnership have been concluded has been welcomed by industry and details of the market access which will flow from this agreement are eagerly awaited.

It is critical that each of these agreements is now implemented quickly and effectively so that existing financial relationships can be strengthened and new opportunities explored.

ABOUT THE FSC

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees.

The Council has over 115 members who are responsible for investing more than \$2.6 trillion on behalf of 11 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.

ABOUT PERPETUAL

Perpetual is an independent financial services group operating in funds management, financial advisory and trustee services.

Our origin as a trustee company, coupled with our strong track record of investment performance, has created our reputation as one of the strongest brands in financial services in Australia. For further information, go to www.perpetual.com.au

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This study was conducted by Plan For Life (Asset International Australia Pty Ltd, a Strategic Insight company, ACN 147 440 140, ABN 42 147 440 140).

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