

Autumn Issue

Welcome to the sixth issue of ALPHA INVESTOR, the Minter Ellison Rudd Watts newsletter with a focus on alternative investments and, in particular, the absolute return sector. Advising in this area, we draw on a multidisciplinary team across our Corporate, Banking and Tax groups and individuals with expertise in areas such as private equity, venture capital, hedge funds, structured products and other innovative forms of capital raising and investment.

In this issue

- International – Deutsche Bank 2006 Alternative Investment Survey
- NZ – NZARA increases membership, NZ Investment Forum
- NZ – Super Fund securities lending appointment
- NZ – NZVCA networking evening – 2 May 2007
- NZ – New Zealand Innovation Fund launch
- Australia – New ING 80% capital protected alternatives fund
- Asia – AsianInvestor: Asian Hedge Fund Vendors Guide 2007
- UK – AIMA welcomes FSA moves on retail hedge funds
- Keynote article (1) – Taxation of foreign portfolio share investments

- Keynote article (2) – AIMA's guide to sound practices for hedge fund valuation
- Profiles – John Elias and Nathan Cahill, Minter Ellison, Sydney
- How Minters can help you

News

International – Deutsche Bank 2006 Alternative Investment Survey

According to the 2006 Alternative Investment Survey released in January by the Hedge Fund Capital Group division of Deutsche Bank, the expectation is that hedge funds are set to have a good year. The annual survey is based on opinions sought from over 700 entities collectively responsible for investing \$US900 billion, or 64%, of the estimated \$US1.4 trillion in hedge funds. The survey predicts that this year an additional \$US110 billion will be invested in hedge funds. Despite being a reduction from the three previous years, this represents a growth rate of 8%. The median prediction for hedge fund returns across all strategies is 10%, which is lower than the past three years, but not insignificant.

The forecasted most profitable geographical investment regions are, in descending order, Asian emerging markets, Japan, Europe and the US. The survey notes that "Asia is the region of focus for 2007." China is not predicted as a highest-returning country for 2007, yet 35% of those surveyed wish to increase exposure to that market despite it being difficult to access.

The trend of private equity investment, which was so noticeable in 2006, is set to change. Thirty-nine percent of those surveyed disapproved of hedge funds utilising this other alternative investment category, 46% were neutral or undecided, and only 15% positive.

The highest return expectations based on hedge fund investment styles are, in descending order, for long/short equity, global macro, event-driven, and distressed debt. Convertible arbitrage is expected to return as a popular investment strategy.

The full survey is available on the Deutsche Bank website, www.db.com.

[Source: Deutsche Bank 2006 Alternative Investments Survey, January 2007; see also Michael Coote's summary in the NBR 19 January 2007]

NZ – NZARA increases membership, NZ Investment Forum

The New Zealand Absolute Return Association (NZARA) has welcomed a number of new individual and corporate members this year, including some of the new players in this investment space. NZARA members are also presenting in a block at the NZ Investment Forum in Auckland on 24 May 2007. Anyone interested in joining NZARA or finding out more can contact us (Jeremy Muir, DDI +64 9 353 9819 or jeremy.muir@minterellison.co.nz) and we'll put you touch.

To tell us what you think of this newsletter, or to have colleagues added or yourself deleted from the mailing list, contact moreinfo@minterellison.co.nz

Minter Ellison
Rudd Watts and
the NZVCA
(now the “New
Zealand Venture
Capital and
Private Equity
Association”) but
keeping the
catchier
moniker of
“NZVCA”) are
hosting a
networking
evening on 2
May 2007 with
guest speaker
Kim Ellis (ex MD
of Waste
Management
and the current
chair of
Hirequip).

NZ – Super Fund securities lending appointment

The New Zealand Superannuation Fund announced the appointment of eSecLending as its third-party provider to manage its securities lending programme. The Fund previously decided to implement a securities lending programme to capture additional revenue by lending securities to approved borrowers. eSecLending specialises in managing customised securities lending programmes via an auction model to achieve optimal returns for the Fund as well as minimising the risk.

[Source: *New Zealand Superannuation Fund – News Release – 2 March 2007*]

NZ – NZVCA networking evening – 2 May 2007

Minter Ellison Rudd Watts and the NZVCA (now the “New Zealand Venture Capital and Private Equity Association” but keeping the catchier moniker of “NZVCA”) are hosting a networking evening on 2 May 2007 with guest speaker Kim Ellis (ex MD of Waste Management and the current chair of Hirequip). The event starts at 5.30pm and Kim will speak at around 6.00pm. This will be followed by drinks and nibbles through to around 7.30pm. Contact us or register online at www.nzvca.co.nz.

NZ – New Zealand Innovation Fund launch

Pioneer Capital, advised by Minter Ellison Rudd Watts, has completed the first closing of the New Zealand Innovation Fund, New Zealand’s first limited partnership-style investment fund concentrating on expansion stories primarily in the high-tech and specialised manufacturing industries. The Fund will co-invest with the New Zealand Venture Investment Fund (NZVIF).

Australia: New ING 80% capital protected alternatives fund

ING in Australia has added a new fund to its OneAnswer investment platform. Société Générale Asset Management devised the ING SGAM Protected Alternatives Fund for ING. According to ING’s website, the Fund “will give OneAnswer clients exclusive access to a globally diversified range of investments including long-only US equities, long/short European equities and a multi-strategies hedge fund - all with the comfort of rising capital protection”. The Fund provides 80% protection of the investments, rising in line with the underlying assets. So if it reaches a new high watermark, the underlying assets are protected at 80% of that higher level.

[Sources: *Money Management - 5 April 2007*, www.ing.com.au]

Asia – AsianInvestor: Asian Hedge Fund Vendors Guide 2007

Packaged together with its April 2007 edition, AsianInvestor magazine has produced a “Vendors Guide” with information on setting up a hedge fund in the Asian region and a directory of service providers. Concentration is obviously on Hong Kong and Singapore as domiciles for the investment management function, with a recognition of the dominance of Cayman for fund vehicles (either alone or in master-feeder structures). There are also useful examinations of the Fund of Hedge Funds (FoHF) market – noting that there are over 2,100 FoHF worldwide, of which 134 have over US\$1 billion in assets. Out of those 134, only two are headquartered in Asia. So, frequent flyer points will mount up for those chasing capital from this part of the world.

[Source: *AsianInvestor: Asian Hedge Fund Vendors Guide 2007*, with *AsianInvestor - April 2007*]

UK – AIMA welcomes FSA moves on retail hedge funds

On 27 March 2007, the Alternative Investment Management Association (AIMA) issued a press release welcoming details of the FSA's proposals to allow UK retail investors wider access to alternative investments. Funds of hedge funds are already marketed to retail investors in other European countries including France, Germany, Ireland and Spain. A copy of the FSA's proposal (Funds of Alternative Investment Funds – FAIFs) can be found at http://www.fsa.gov.uk/pubs/cp/cp07_06.pdf.

[Source: www.aima.org]

Keynote article (1) – Taxation of foreign portfolio share investments

Enactment of new Foreign Investment Fund (“FIF”) rules

The Taxation (Savings Investment and Miscellaneous Provisions) Act 2006 (Savings Investment Act), enacted on 18 December 2006, makes significant changes to the taxation of foreign portfolio share investments (i.e. investments of less than 10% in the shares of a non-resident company).

Our Tax team has produced a number of briefings and other documents summarising these changes that can be provided on request. This article is a short summary of part of that commentary only.

The first formulation of the rules, in a Bill introduced in Parliament on 17 May 2006, was the subject of significant public debate. Extensive submissions were received by the Finance and Expenditure Select Committee (FEC). In response to alternatives proposed by those submissions, the Minister of Finance and the Minister of Revenue announced on 15 September 2006 that they would be suggesting to the FEC an alternative method for calculating the tax liability on foreign portfolio shares to that contained in the Bill. On 6 December 2006 the FEC reported back to Parliament on the Bill and proposed the “fair dividend rate method” (FDRM) as the primary method for calculating FIF income using a 5% notional annual yield, which has now been enacted as part of the new rules for the taxation of foreign portfolio share investments (new FIF rules). This was rather hurriedly enacted in December 2006 with only limited submissions sought by the FEC on the new proposals.

Application dates

The new FIF rules apply from income years beginning on or after 1 April 2007. Entities that intend to elect into the new portfolio investment entity (PIE) regime (which is also contained in the Savings Investment Act) can elect to defer the application of the new FIF rules until the later of the first day of the first income year after 1 April 2007, or 1 October 2007.

Application of the new FIF rules

The new FIF rules apply, subject to a number of exemptions, to investments of less than 10% in the shares of foreign companies. The primary income calculation method, the FDRM, is intended to approximate a reasonable dividend yield on interests held in foreign companies. Under the FDRM, tax is payable on income calculated as 5% of the opening market value of the foreign share portfolio at the start of the income year, with adjustment for shares purchased and sold within the same income year. Dividends are not taxed separately, but foreign tax credits for foreign withholding tax on dividends are still available. For

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The current exemption for investments in companies resident in 'grey list' countries (Australia, Canada, Germany, Japan, Norway, Spain, the UK and the USA) does not exist for portfolio share investments under the new FIF rules.

individuals and family trusts, if their return is less than the 5% FDRM, they can pay tax on their actual return (although losses cannot be carried forward). Other methods such as the cost, comparative value, deemed rate of return, accounting profits and branch equivalent methods are available in certain circumstances to certain types of entities.

The current exemption for investments in companies resident in 'grey list' countries (Australia, Canada, Germany, Japan, Norway, Spain, the UK and the USA) does not exist for portfolio share investments under the new FIF rules. However, in general, an interest in a company that is resident in a grey list country is still subject to the exemption if the rights are a direct income interest of 10% or more (as such interests remain subject to existing FIF rules and, where applicable, the controlled foreign company (CFC) rules).

The de minimus exclusion from the rules remains in a modified form, such that the rules do not apply to shares in companies outside Australasia (i.e. New Zealand companies and listed Australian resident companies which are required to maintain franking credit accounts) costing NZ\$50,000 or less in aggregate and held by individuals and limited types of trusts (i.e. not including ordinary family trusts). The calculation is based on the actual cost of the investments or, if not available for investments acquired before January 2000, calculated as 50% of the value of the holding as at 1 April 2007.

Exemptions from the new rules

The new FIF rules contain a number of exemptions, which are explained in more detail in other briefings available from our Tax team.



Andrew Ryan, Partner and Joanne Dunne, Partner

Keynote article (2) – AIMA's guide to sound practices for hedge fund valuation

In 2005, the Alternative Investment Management Association (AIMA) published research on Asset Pricing and Fund Valuation Practices in the Hedge Fund Industry (April 2005, available at www.aima.org under Knowledge Centre/Research). Following on from this, AIMA brought together a broad working party of experts to streamline AIMA's original 20 Recommendations to reflect more detailed representations from stakeholders and take full account of ongoing developments, including the increasing use of side pockets. AIMA's new 15 Recommendations are reproduced below.

We think it is worth quoting these underlying principles in some length (and even more so to read the full document which is not in itself lengthy) as any fund manager in the alternative investment space in New Zealand will have to deal with similar issues and/or present appropriate credentials and evidence of compliance with these or similar structures when seeking capital from funds of funds or other sources outside New Zealand.

Governance

- All hedge funds should have in place a detailed Valuation Policy Document, approved by the governing body after consultation with other stakeholders.
- Conflicts of interest in the valuation process are usually best managed by the appointment of an independent and competent Valuation Service Provider.
- If the Investment Manager is responsible for valuation and/or governance, robust controls over conflicts of interest should be established.

Transparency

- Investors have the right to expect disclosure of any material involvement by the Investment Manager in the production of a fund's formal NAV.

Procedures, processes and systems

- The parties controlling a Fund's valuation process should be segregated from the parties involved in the Fund's investment process.
- Procedures should be capable of practical implementation and consistent application by the Valuation Service Provider.

Sources, models and methodology

- Wherever possible multiple price sources should be used to verify the valuation of each position in a Fund's portfolio.
- The use of broker quotations and pricing models for formal valuation purposes should be sufficiently tested and controlled.
- Any decision to allow the side-pocketing of illiquid/hard-to-value positions should be taken only after careful consideration by a Fund's Governing Body, who should then ensure that side-pocket policies are properly communicated and consistently applied.



Jeremy Muir, Senior Associate and Brendan Kevany, Solicitor

Minters team

Profiles:

To highlight our trans-Tasman, strength and experience in this sector, in this edition of Alpha Investor we profile two key experts in our Sydney office.

John Elias - Partner, Structured Finance



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Further information

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John has strong global finance and investment law experience having practised in Australia, United Kingdom and Hong Kong. He has extensive securitisation and structured finance experience having worked on synthetic and funded transactions in Australia and offshore including for clients such as Barclays Global Investors, Everest Babcock & Brown and Ellerston Capital.

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Nathan Cahill - Senior Associate, Corporate and Commercial



Nathan comes from a background in the financial services industry including venture capital and stockbroking. Nathan has strong interest and experience in local and offshore alternative investment products and private equity funds. He advises some of Australia's leading fund managers and financial services providers in relation to product structuring, IPOs, fund raisings, the investment and divestment process and offshore products. He is also a participant in the Alternative Investment Management Association.

Nathan acts for clients which include Everest Babcock & Brown, Ellerston Capital, Goldlink, Helmsman Capital, Macquarie Bank and van Eyk.

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If you would like to contact John or Nathan about Australian issues, please feel free to do so through the details above, or speak to your usual Minters contact and we will put you in touch.

How we can help you

If you would like to speak to us with respect to any of the issues noted in this newsletter or with regard to new absolute return or alternative investment products, please feel free to contact any of the people listed in the margins of this newsletter.

Minter Ellison Rudd Watts acts for numerous participants in the alternative investments industry, from providing tax advice to hedge fund managers to setting up New Zealand domiciled funds. We also act on the mechanics of investment by funds in New Zealand and documentation of finance and derivative arrangements. Our Corporate, Banking and Tax teams have experience in these areas gained in New Zealand, Australia, London, Guernsey, Jersey, Cayman and other financial centres.

The Minter Ellison group can provide a seamless service for alternative investment businesses in New Zealand, Australia and through our offices in Asia, USA and the UK. We also have strong links with law firms and individuals in the major offshore finance centres.

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