Parliamentary Joint Committee on Corporations and Financial Services

Financial sector reform in China: the role of, and opportunities for, the Australian financial services sector

Report of the Parliamentary Joint Committee on Corporations and Financial Services: Delegation to China

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Members of the Committee

Ms Deborah O'Neill MP, **Chair**	NSW	ALP
Senator Sue Boyce, **Deputy Chair**	QLD	LP
Senator Mathias Cormann	WA	LP
Senator Anne Urquhart	TAS	ALP
Mr Paul Fletcher MP	NSW	LP
The Hon. Alan Griffin MP	VIC	ALP
The Hon. Tony Smith MP	VIC	LP
Ms Laura Smyth MP	VIC	ALP

MEMBERS OF THE DELEGATION

The Hon. Alan Griffin MP, **Delegation Leader**

Senator Sue Boyce

Ms Laura Smyth MP

Senator Anne Urquhart

SECRETARIAT

Dr Richard Grant, Acting Secretary

Mr Alistair Cadman, Principal Research Officer

Dr Patrick Hodder, Senior Research Officer

Ms Madeleine Willis, Administrative Officer

PO Box 6100
Parliament House
Canberra ACT 2600

T: +61 2 6277 3583
F: +61 2 6277 5719
E: corporations.joint@aph.gov.au
W: www.aph.gov.au/joint_corporations

Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

  (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

  (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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Abbreviations

APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
BOC	Bank of China
CBC	Central Bank of Taiwan
CBRC	China Banking Regulatory Commission
CDB	China Development Bank
CIRC	China Insurance Regulatory Commission
CLERP	Corporate Law Economic Reform Program
CNAPS	China National Advance Payments System
CSRC	China Securities Regulatory Commission
FDI	Foreign direct investment
FIRB	Foreign Investment Review Board
FTA	Free trade agreement
GDP	Gross domestic product
GFC	Global financial crisis
ICRO	International and Community Relations Office
IPO	Initial public offering
MOFCOM	Ministry of Commerce (China)
NAB	National Australia Bank
NPC	National People's Congress
PBOC	People's Bank of China
PJC	Parliamentary Joint Committee
QDII	Qualified Domestic Institutional Investor

QFII	Qualified Foreign Institutional Investor
RBA	Reserve Bank of Australia
REIT	Real estate investment trust
RMB	Renminbi
SAFE	State Administration of Foreign Exchange
SMEs	Small- and medium-sized enterprises
SOEs	State-owned enterprises

Chapter 1

The context for the delegation's discussions

> *Throughout history, financial depth has been a crucial element of industrialisation and sustained high-growth periods for all economies, western and eastern … It is somewhat unusual that China's period of high economic growth hasn't occurred with an accompanying financial "revolution".*[1]

> *Australia and China enjoy a very strong trade relationship … [A] strong trading relationship provides the basis for a strong financial relationship. As history shows, finance follows trade. As trade linkages increase, firms require an increasing array of financial services. And a strong trading relationship helps businesses in both countries identify and develop investment opportunities in the other.*[2]

Introduction

1.1 This report details the visit of the Parliamentary Joint Committee on Corporations and Financial Services ('the committee') to Beijing and Shanghai from 5 May to 11 May 2013. The purpose of the visit was to improve the committee's understanding of the Australia–China relationship in financial services and, in particular, the opportunities that exist to strengthen these ties and to address areas of bilateral concern.

1.2 The committee's visit was part of the annual parliamentary committee visit to the People's Republic of China. The visit operates on an annual rotational basis between standing and joint parliamentary committees. Nominations were accepted from standing committees in 2012 and from joint committees in 2013. The visit is awarded through a competitive nomination process, with a decision made by the President of the Senate and the Speaker of the House of Representatives.

1.3 The committee was notified on 4 March 2013 that its nomination was successful. Committee members lodged expressions of interest to travel, and arrangements for the visit were made through the International and Community Relations Office (ICRO). The Department of Finance and Deregulation funded the visit.

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1 Mr Mike Smith OBE, Chief Executive Office, ANZ Banking Group, 'Seizing Asian opportunity up to us', *Weekend Australian*, 13 April 2013, p. 31.

2 Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia, *The Journey of Financial Reform*, Address to the Australian Chamber of Commerce in Shanghai, Shanghai, 24 April 2013. http://www.rba.gov.au/speeches/2013/sp-dg-240413.html (accessed 17 May 2013).

Delegation members

1.4 The delegation was comprised of the following committee members:

- the Hon. Alan Griffin MP (Delegation Leader);
- Senator Sue Boyce (Deputy Chair of the Committee);
- Ms Laura Smyth MP; and
- Senator Anne Urquhart.

1.5 This was the Delegation Chair's fourth visit to China, having made two recent visits in August 2012 and March 2013. This was the first visit to China for the other three delegation members.

Acknowledgements

1.6 Overseas visits by official parliamentary delegations are made possible through the efforts of many dedicated and capable people. The delegation extends its sincere thanks to the following people who organised the visit to China:

- the Australian Ambassador in Beijing, Her Excellency Ms Frances Adamson;
- the Australian Consul-General in Shanghai, Ms Alice Cawte;
- the Visit Support Staff at the Australian Embassy in Beijing;
- Mr Justin Hayhurst, Deputy Head of Mission at the Australian Embassy in Beijing;
- Mr Brent Stewart, the Trade Commissioner in Austrade Shanghai;
- Dr Kylie Brown, the Post-Visit Coordinator at the Australian Embassy;
- Ms Ariane Sainsbury, the Visits and Events Manager at the Consulate in Shanghai;
- Mr Rex Chen, the delegation's interpreter in Beijing;
- Mr John Wu, the delegation's interpreter in Shanghai;
- Mr Li Hongwei from the Australian Consulate in Shanghai;
- Mr Bing Guo Xu, the delegation's driver in Shanghai; and
- officers of ICRO, particularly Ms Fiona Way.

The context for the visit

1.7 The committee's visit to China in May 2013 followed several significant developments in the process of Chinese economic reform, and opportunities to develop the Australia–China bilateral relationship in financial services. Three developments in particular were important to the context of the committee's discussions in China.

China's economic and financial sector reform plans

1.8 The first of these developments relates to China's plans to reform its economy and financial system. China's 12th Five-Year Plan, signed in October 2012, commits to rebalancing the economy to focus less on fixed asset investment and exports and more on domestic consumption. A less export-focused economy will reduce the current account surplus and the need to maintain an artificially weak currency. As has been well documented, claims that the renminbi (RMB) has been artificially devalued are a continuing point of tension in China's trade relationship with the United States. The plans to increase consumption rest on increasing household disposable income through higher minimum wages and transfer payments.[3]

1.9 Financial sector reform will assist the Chinese economy to make this economic adjustment.[4] The 12th Five-Year Plan commits to pursuing financial system reform, including:

- establishing a deposit insurance system;
- developing an 'over-the-counter' market and asset securitisation;
- improving the managed floating exchange rate regime;
- expanding cross-border yuan trade; and
- continuing RMB capital account convertibility.[5]

1.10 In 2012, the Chinese leadership made three significant moves to liberalise the capital account.[6] In February 2012, the People's Bank of China (PBOC) released a proposal signalling its intent to liberalise the capital account, the exchange rate and bank interest rates simultaneously. On 14 April 2012, the PBOC announced that it would widen the RMB's daily trading band (based on the US/RMB midrate) from 0.5 per cent to 1 per cent. In June 2012, the PBOC raised the cap on bank deposit rates from 100 per cent to 110 per cent of the corresponding benchmark rates.[7] It also

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3 See 'China's 12th Five Year Plan: How it actually works and what's in store for the next five years', *APCO Worldwide*, 10 December 2012, http://apcoworldwide.com/content/PDFs/Chinas_12th_Five-Year_Plan.pdf (accessed 17 May 2013).

4 See the comments of Mr Mike Smith OBE, 'Seizing Asian opportunity up to us', *Weekend Australian*, 13 April 2013, p. 31.

5 China's 12th Five Year Plan, Chapter 48, http://www.cbichina.org.cn/cbichina/upload/fckeditor/Full%20Translation%20of%20the%2012th%20Five-Year%20Plan.pdf (accessed 17 May 2013).

6 The capital account consists mainly of foreign direct investment, investment in equities and bank borrowing. Liberalising the capital account would enable foreigners to more readily invest in China's assets.

7 The benchmark rate is set by the PBOC.

lowered its bank lending rate floors from 90 per cent to 80 per cent and then, in July 2012, to 70 per cent.[8]

1.11 There has been considerable interest internationally in these plans and actions to ease restrictions on bank interest rates and to reform the exchange rate and China's state-owned enterprises (SOEs). There has also been considerable academic, financial sector and media commentary on China's plans to fully internationalise the RMB.

Agreements to strengthen Australia–China financial ties

1.12 The second key development that framed the committee's discussions in China was the series of agreements between Australia and China to strengthen the interdependence of the two nations' currencies and financial markets. In March 2012, the Reserve Bank of Australia (RBA) and the PBOC signed a currency swap agreement; in April 2013, a direct currency convertibility agreement was signed; the same month, Sydney hosted the inaugural Australia–Hong Kong Renminbi Trade and Investment Dialogue; and in May 2013, the RBA made a decision to invest some of Australia's foreign currency reserves in China.

The currency swap agreement and Australia's investment of currency reserves in China

1.13 The currency swap agreement allows for the exchange of local currencies between the two central banks of up to A$30 billion, or RMB 200 billion. This represents the fourth largest RMB swap agreement. Dr Lowe, the Deputy Governor of the RBA, told the Australian Chamber of Commerce in Shanghai in April 2013:

> We see this swap agreement as another important piece of the financial infrastructure supporting trade and investment between China and Australia. Its existence provides market participants with greater confidence regarding the availability of RMB liquidity in Australia, particularly during times of stressed market conditions. In turn, this greater confidence should help build a solid platform for the growth in the RMB market in Australia.[9]

Direct currency convertibility and the Australian Prime Minister's April 2013 visit

1.14 On 7 April 2013, the Australian Prime Minister, the Hon. Julia Gillard MP, met with China's new President, Xi Jinping, and Premier, Li Keqiang.[10] The visit was

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8 See Takeshi Jingu, 'China resumes interest rate liberalization', Nomura Research Institute, 2012, volume 148.

9 Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia, *The Journey of Financial Reform*, Address to the Australian Chamber of Commerce in Shanghai, Shanghai, 24 April 2013.

10 President Xi commenced office on 14 March 2013, while Premier Li commenced as Premier the following day.

the most senior Australian political delegation to visit China.[11] The Prime Minister was joined by the Minister for Foreign Affairs, Senator the Hon. Bob Carr, the Minister for Trade and Competitiveness, the Hon. Dr Craig Emerson MP, and the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP.

1.15 During this visit, the leaders announced the start of direct trading between the Australian dollar and the Chinese RMB. On 10 April 2013, Australia became only the third currency (joining the US dollar and Japanese yen) to have a direct currency exchange agreement with China. In simple terms, this means that Australian exporters dealing with their Chinese counterparts will be able to convert yuan directly into Australian dollars, without having first to convert into US dollars. The ANZ and Westpac have been given the rights to trade Australian dollars and Chinese yuan directly.

1.16 Dr Lowe of the RBA noted that the currency convertibility agreement 'should promote trade invoicing in RMB and facilitate bilateral trade and investment'.[12] Mr Mike Smith, Chief Executive Officer of the ANZ, welcomed the removal of current costs of intermediary conversions, indicating that the likely savings on transaction costs would be a few basis points.[13] There is a question, however, as to whether Chinese importers prefer to trade in US dollars.

Australia–Hong Kong Renminbi Trade and Investment Dialogue

1.17 In July 2012, the Australian Deputy Prime Minister, the Hon. Wayne Swan MP, and the Hong Kong Financial Secretary, Mr John Tsang, launched the Australia–Hong Kong Renminbi Trade and Investment Dialogue. The aim of the Dialogue is partly to raise awareness in the Australian private sector of RMB-denominated business opportunities.

1.18 On 12 April 2013, Sydney hosted the inaugural Australia–Hong Kong Renminbi Trade and Investment Dialogue. A paper presented at the Dialogue by the Australian Financial Centre Task Force concluded:

> The size of the Chinese economy and of its trading links with the rest of the world mean that, if it continues down the path of RMB internationalisation, the implications over time for global financial markets will be enormous.

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11 The Hon. Julia Gillard MP, Prime Minister of Australia, 'Prime Minister and Senior Ministers to visit China', *Media Release*, 31 March 2013, http://www.pm.gov.au/press-office/prime-minister-and-senior-minister-visit-china (accessed 24 June 2013).

12 Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia, *The Journey of Financial Reform*, Address to the Australian Chamber of Commerce in Shanghai, Shanghai, 24 April 2013.

13 Clancy Yeates, 'Currency deal to hasten $120 billion worth of trade', *Sydney Morning Herald*, 8 May 2013.

> Countries that have built up RMB liquidity and RMB related financial products and services early in this process, and have the right financial architecture in place, will be well positioned to benefit from these changes in financial markets. Through increased trade invoicing in RMB and — at an appropriate time, and with the agreement and encouragement of the Chinese authorities — some further policy changes, Australia has the opportunity to both participate in and benefit from the seismic changes in global financial markets that have just begun.[14]

1.19 However, another paper presented at the Dialogue reporting on corporate attitudes to RMB-denominated trade settlement and investment found that firms have a number of concerns.[15] These include uncertainty around the ability to hedge associated currency flows, the complexity and time delays in the settlement process, and the administrative burden from unclear procedures.

Investment of foreign currency reserves

1.20 Also in April 2013, the RBA announced that it will invest some of Australia's foreign currency reserves in China. The Bank's intention is to hold around five per cent of Australia's foreign currency assets in China. Dr Lowe explained that the decision:

> ... reflects the broader economic relationship between China and Australia and our increasing financial ties. It provides greater diversification of our investments and will help with our understanding of the Chinese financial markets. Over the long run, and particularly as capital account liberalisation occurs in China, the RMB is likely to become one of the major reserve currencies of the region.[16]

The free trade agreement and the Foreign Investment Review Board

1.21 The third context for the committee's visit relates to the Australia–China trade relationship more generally. In April 2013, Australia and China abandoned efforts to broker a full free trade agreement (FTA). After eight years and 18 rounds of trade

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14 Australian Financial Centre Task Force, 'RMB invoicing in a longer-run context: opportunities and opportunities for Australia ' http://www.treasury.gov.au/PublicationsAndMedia/Events/~/media/Treasury/Publications%20and%20Media/Events/RMB%20Dialogue/Documents/RMB_Internationalisation_Opportunities_and_Challenges_pdf.ashx (accessed 24 May 2013).

15 'Corporate attitudes toward renminbi trade settlement and investment', Document supplied by the Reserve Bank of Australia http://www.treasury.gov.au/PublicationsAndMedia/Events/~/media/Treasury/Publications%20and%20Media/Events/RMB%20Dialogue/Documents/Corporate_Attitudes_towards_Renminbi_Trade_Settlement_and_Investment.ashx (accessed 24 June 2013).

16 Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia, *The Journey of Financial Reform*, Address to the Australian Chamber of Commerce in Shanghai, Shanghai, 24 April 2013.

negotiations, the Australian Government announced that its focus would be on securing agreements with China on a regional and industry level.[17]

1.22 On 4–6 June 2013, the 19th round of FTA negotiations was held in Beijing, focusing on agricultural trade. The Department of Foreign Affairs and Trade summarised these negotiations in the following terms:

> Good progress was made on Sanitary and Phytosanitary (SPS), Technical Barriers to Trade (TBT), and Trade in Services chapters. Constructive discussions were also held on Trade in Goods, Rules of Origin, Customs Procedures, Investment, Dispute Settlement chapters and other issues. With strong commercial interests on both sides across a broad range of sectors, negotiators continued to define the scope of market access opportunities to be included in the agreement.[18]

1.23 Chinese foreign direct investment (FDI) in Australia has been an issue of some contention in both Australia and China in recent years. Australia's Foreign Investment Review Board (FIRB) is responsible for reviewing all proposed investment from foreign state-owned companies.[19] Chinese authorities have questioned the transparency of the FIRB process and, in particular, the components and application of the 'national interest' test.[20] Some Australian parliamentarians have raised concerns as to whether Australian agricultural and mining land should be sold to companies that are essentially controlled by the Chinese state. For the past two years, a Senate committee has examined FIRB's national interest test with particular reference to how the test is applied to purchases of Australian agri-businesses by foreign companies and foreign sovereign wealth funds.[21]

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17 *ABC News Business Today*, Transcript, 26 April 2013, http://www.trademinister.gov.au/transcripts/2013/ce_tr_130426.html (accessed 18 May 2013).

18 Department of Foreign Affairs and Trade, 'Australia–China Free Trade Agreement negotiations', June 2013, http://www.dfat.gov.au/fta/acfta/130606_subscriber_update.html (accessed 24 June 2013).

19 All foreign *government* investors must notify the Australian Government and get prior approval before making a direct investment in Australia, regardless of the value of the investment.

Foreign *persons* should notify the Government and get prior approval before acquiring a substantial interest in a corporation or control of an Australian business that is valued above A$248 million. This threshold does not apply to investors from New Zealand and the United States, except where the investment is in 'prescribed sensitive sectors'. Treasury, *Australia's Foreign Investment Policy*, 2013, pp 2–3.

20 Treasury, *Australia's Foreign Investment Policy*, 2013, http://www.firb.gov.au/content/_downloads/AFIP_2013.pdf (accessed 17 May 2013).

21 Senate Rural and Regional Affairs and Transport References Committee, *Examination of the Foreign Investment Review Board National Interest Test*, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=rrat_ctte/firb_2011/tor.htm (accessed 18 May 2013).

1.24 The Trade Minister noted that as part of a more focused Australia–China FTA, China had originally wanted its SOEs to be allowed to invest up to A$1 billion in Australia without needing approval from FIRB.[22] This proposal was not accepted. Currently, only investors from the United States and New Zealand have this exemption. As the Trade Minister told *ABC News Business* on 26 April 2013:

> The Chinese side at this point is requiring of Australia that we lift the threshold for the Foreign Investment Review Board's screening for state-owned enterprises from zero to $1 billion. The Australian community won't accept that. That's not Government policy.[23]

1.25 Since 2001, FIRB has blocked only two investment proposals: Shell/Woodside and ASX/SGX. The Board has accepted all 380 FDI proposals from Chinese companies since October 2007. Only six of these projects have had conditions placed on them. Notably, the buyout of Cubbie Station by a Chinese–Japanese–Australian consortium in 2012 and the state-owned subsidiary Yancoal's merger with Gloucester Coal in the same year both had ownership caps placed on them. More recently, however, FIRB accepted without condition Chengdu Tianqi's takeover of Talison Lithium, and sovereign wealth fund China Investment Corporation's bid for a 35 per cent stake in Chengdu Tianqi's bid vehicle.[24]

The delegation's meetings

1.26 The committee's nomination for the visit indicated its interest in holding meetings in China with the following organisations:

- members of the Joint Financial Services Working Group of the China–Australia Chamber of Commerce in Shanghai;
- Austrade representatives in Beijing and Shanghai;
- senior representatives of Australia's four major banks and Macquarie Group to discuss their experience establishing branches in China. Several of these representatives are members of the Australian Chamber of Commerce (AustCham) Beijing and Shanghai Financial Services Working Group;
- representatives of AustralianSuper;[25]

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22 The Hon. Craig Emerson MP, Minister for Trade, Interview with *ABC News Business Today*, Transcript, 26 April 2013.

23 The Hon. Craig Emerson MP, Minister for Trade, Interview with *ABC News Business Today*, Transcript, 26 April 2013.

24 Andrew Silberberg and Amelia Jamieson, 'Pessimistic outlook on FIRB Chinese decisions could prove unfounded', Arnold Bloch Liebler, http://www.abl.com.au/ablattach/ablarticle280313.pdf (accessed 17 May 2013).

25 AustralianSuper is a multi-industry employer superannuation fund.

- members of the China Banking Regulatory Commission (CBRC), the China Securities Regulatory Commission (CSRC) and the China Insurance Regulatory Commission (CIRC);
- representatives of the PBOC; and
- Chinese officials from the Ministry of Foreign Affairs and the Ministry of Commerce.

The Delegation Leader, the Hon. Alan Griffin MP, and Ms Wu Xiaoling, Vice Chair of the Financial and Economic Committee of the National People's Congress, meeting at the Macau Hall at the Great Hall of the People, Beijing, 6 May 2013.

1.27 The delegation had the opportunity to meet and have discussions with all except two of these organisations.[26] In addition, the committee met with the following people and organisations:

- the Vice-Chair and other members of the Financial and Economic Committee of the National People's Congress and the Shanghai People's Congress;
- members of the Australia–China Friendship Group of the National People's Congress;
- the President of the Shanghai branch of the China Development Bank (CDP);

26 The committee's tight schedule did not allow time to meet with AustralianSuper representatives or officials from the Ministry of Commerce (MOFCOM).

- representatives of the Shanghai Stock Exchange; and
- representatives from the Australian Treasury and the Reserve Bank of Australia.

1.28 A full list of the committee's meetings, and the names of the people with whom it met, can be found in Appendix 1.

The AustCham Beijing and Shanghai Financial Services Working Group

1.29 The committee's nomination for the visit expressed interest in the work of the AustCham Beijing and Shanghai Financial Services Working Group. As noted earlier, the committee had the opportunity to meet with several members of the Working Group on 9 May 2013 at a lunch at the Consul-General's residence in Shanghai.

1.30 The Working Group was established in 2010 with a view to:

- raising awareness of strategic and emerging issues for Australian financial services firms operating in the Chinese market; and
- leveraging the strength and reputation of Australia's financial system to facilitate a dialogue with key officials and policy makers in China.[27]

1.31 The Working Group released an Issues Paper in 2011 and a White Paper in 2012, both of which made several recommendations towards meeting these objectives.[28] The committee understands that drafting is under way for the release of a further document to be published later this year.

1.32 The second and third chapters of this report refer to several of the recommendations raised in the Working Group's reports. Several of these ideas were raised in discussions that the delegation had with Australian and Chinese representative bodies during its visit.

Australian banks in China

1.33 The delegation met with representatives from all four major Australian banks in both Beijing and Shanghai, as well as a representative from AMP Capital in Beijing and Macquarie Capital in Shanghai (see Appendix 1).

1.34 It was explained to the delegation that Australia's banks have different objectives for their operations in China. The ANZ foresees a major presence in China

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27 Australian Chamber of Commerce Financial Services Working Group, *Australian Financial Service Business in China*, Issues Paper 2011.

28 Australian Chamber of Commerce Financial Services Working Group, *Australian Financial Service Business in China*, 2012 White Paper, http://www.austchamshanghai.com/ftp/event/AustCham%20White%20Paper%20ENlr.pdf (accessed 14 May 2013).

with a strong retail focus. The other three banks envisage more niche roles: the National Australia Bank (NAB), for example, is focusing on the agricultural market, while the Commonwealth Bank is focused on financing for small- and medium-sized enterprises (SMEs).[29]

1.35 While some Australian banks have had a business presence in China for decades, branch openings have occurred only in the past five years. The ANZ was the first Australian bank to invest in China and currently has branches in Shanghai, Beijing, Guangzhou, Chongqing and Hangzhou. In addition, the ANZ established the Chongqing Liangping ANZ Rural Bank Co Ltd in 2011, has an operations hub in Chengdu, and has a 20 per cent stake in both the Shanghai Rural Commercial Bank and Bank of Tianjin.[30] It has been reported that the ANZ plans to increase its network in China to 20 outlets over the next 10 years, subject to regulatory approval.[31]

1.36 The NAB opened its first Chinese branch in Shanghai in November 2011. It first established a business presence in China in 1982, opening a representative office in Beijing. Westpac also established a formal presence in China in 1982. It currently has two branches in China: one established in Shanghai in 2008 and another opened in Beijing in 2011. In March 2010, the Commonwealth Bank established its first Chinese branch in Shanghai. The following year, it opened a County Bank in Jiyuan in China's Henan province.[32] The Commonwealth Bank owns a 20 per cent stake in Qilu Bank and the Bank of Hangzhou.

1.37 Macquarie Bank has had a presence in China since 1995. It has one representative office in Beijing and another in Shanghai. Its Chinese operations focus on investment banking, corporate finance and advisory services, and corporate and asset finance.[33]

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29 Delegation's discussions with Australian bank representatives at the Australian Embassy in Beijing, 6 May 2013.

30 See 'ANZ continues China expansion with new branch in Hangzhou', AustCham, http://www.austcham.org/about-us/news/2013/jan/18/anz-continues-china-expansion-new-branch-hangzhou (accessed 19 May 2013).

31 Hannah Lynch, 'ANZ Bank investing $A300 million to expand China network', *The National Business Review*, 16 May 2012, http://www.nbr.co.nz/article/anz-bank-investing-a300m-expand-china-network-wb-118883 (accessed 20 May 2013).

32 Commonwealth Bank of Australia, 'Commonwealth Bank to open County Bank in China', 9 February 2011, http://www.commbank.com.au/about-us/news/media-releases/2011/090211-commonwealth-bank-to-open-county-bank-in-china.html (accessed 24 June 2013).

33 Australian Chamber of Commerce Financial Services Working Group, *Australian Financial Service Business in China*, 2012 White Paper, http://www.austchamshanghai.com/ftp/event/AustCham%20White%20Paper%20ENlr.pdf (accessed 14 May 2013).

China's banking system

1.38 China's financial system is dominated by its banking system and, in particular, the domestic loans and deposits of the large state-owned commercial banks. The debt securities market is comparatively undeveloped. The RBA estimates that domestic credit is equivalent to 145 per cent of gross domestic product (GDP). Debt securities and equity market capitalisation are each equivalent to around 30–40 per cent of GDP.

1.39 China's big four commercial banks are:

- the Industrial and Commercial Bank of China;
- the China Construction Bank;
- the Bank of China; and
- the Agricultural Bank of China.

1.40 The Australian Treasury has noted that in 2011, these banks accounted for about 40 per cent of the estimated RMB 80 trillion in banking assets.[34] The RBA has estimated that these banks, plus China's fifth largest bank—the state-owned Bank of Communications—account for around half of Chinese banking system assets and deposits.[35] The Chinese Government has an equity stake of between 60 per cent and 90 per cent in each of the five largest commercial banks.[36]

1.41 The rest of China's banking system is mostly accounted for by other domestically owned banks, which include:

- 12 smaller listed commercial banks;
- three 'policy' banks—the China Development Bank, the Import and Export Bank of China, and the Agricultural Development Bank of China—which are solely government-owned (see chapter 2);[37]
- a postal savings bank;
- more than 100 regional banks; and
- around 3000 small credit cooperatives and rural financial institutions.[38]

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34 Treasury briefing provided to delegation members, 'Chinese Financial System Overview', received 3 May 2013.

35 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 53.

36 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

37 The policy banks were separated from the commercial banks in the mid-1990s.

38 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

1.42 Foreign banks account for less than two per cent of total banking assets in China. At the end of 2011, there were 77 foreign banks operating under a branch licence in China, of which 37 were locally incorporated.[39] Chapter 2 of this report discusses some of the hurdles that foreign banks face in gaining entry to the market.

Government regulation of loan and deposit rates in China

1.43 The Chinese Government has considerable influence over banks' lending and deposit-taking activities.[40] While these controls have eased, they still restrict the rates that commercial banks can offer on loans and deposits. Lending rates are now bound by a floor of 30 per cent below the benchmark (official) rate; deposit rates are capped at 20 per cent above the benchmark rate. In theory, relaxing the lending floor and deposit ceiling should compress the banks' margins, enabling the banks to compete for cheaper loans and better deposit rates.

1.44 The delegation heard that government regulation of the banks' lending interest rates has created poor incentives. China's banks are constrained in how they price risk. Their exposure to investment risk is limited given their balance sheets are essentially backed by the central government, and their guaranteed interest margin discourages efficiency and product innovation.[41] Further, China's banks provide a significant and disproportionate share of credit to SOEs. The majority of banks' loans are to large- and medium-sized non-financial corporations.[42] Loans to small businesses account for around 20 per cent of loans, while loans to households account for less than one-quarter of total loans.[43]

1.45 China's banks are largely funded from domestic deposits, which account for around 70 per cent of liabilities. Half of banks' deposits are from non-financial corporations; households account for the other half.[44] The savings deposit interest rates of China's banks have often been set below the rate of inflation. Therefore, deposits are effectively a subsidy from households to banks.[45] If the Chinese

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39 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

40 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

41 Treasury briefing provided to delegation members, 'Chinese Financial System Overview', received 3 May 2013.

42 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

43 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 60.

44 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 59.

45 Treasury briefing provided to delegation members, 'Chinese Financial System Overview', received 3 May 2013.

Government's plan is to promote 'inclusive growth' and greater household wealth, it will be important to encourage greater competition in the savings deposit market.

1.46 Australian banks weathered the global financial crisis (GFC) through sound prudential regulation and limited exposure to the debt securitisation markets that affected American and European banks. China's banks remained stable during the GFC due to its largely closed capital account with limited exposure to overseas wholesale funding markets.[46]

1.47 The Chinese Government implemented a large stimulus package during the GFC. Seventy per cent of the RMB 4 trillion Chinese stimulus package was funded by local governments. By the end of 2010, local government debt in China accounted for approximately RMB 10.7 trillion, or over a quarter of total GDP.[47]

China's financial regulatory framework

1.48 The committee's visit was an opportunity for members to gain a better understanding of the regulatory framework governing China's financial system. While the following chapter examines aspects of this framework in more detail, it is useful here to outline the basic structure with reference to Australia's system of financial regulation.

1.49 The CSRC is the equivalent of the Australian Securities and Investments Commission (ASIC). Established in 1992, it was modelled on the United States Securities and Exchange Commission.

1.50 In May 1996, ASIC and the CSRC signed a Memorandum of Understanding, which created the basis for cooperation between the two authorities without creating binding international legal obligations.[48] The committee understands that during the ministerial visit to China in April 2013, ASIC Chairman Mr Greg Medcraft and CSRC Chairman Mr Xiao Gang agreed to second ASIC employees to the CSRC.[49] The committee strongly supports this initiative: it is an excellent opportunity for greater understanding of the two nations' corporate regulatory and financial systems.

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46 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 56.

47 Treasury briefing provided to Delegation members, 'Chinese Financial System Overview', received 3 May 2013.

48 Memorandum of Understanding regarding Securities and Futures regulatory cooperation between the Australian Securities and Investments Commission and the China Securities Regulatory Commission, May 1996, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/China_SRC_MOU_1996.pdf/$file/China_SRC_MOU_1996.pdf (accessed 18 May 2013).

49 Discussion with officials from the CSRC, 9 May 2013, Shanghai.

1.51 In Australia, banks and insurance companies are regulated by the prudential supervisor, the Australian Prudential Regulation Authority (APRA). The Chinese system has both a banking regulator—the CBRC—and an insurance regulator—the CIRC. The CIRC was established in 1998, while the CBRC was created in 2003.

1.52 The CBRC requires commercial banks to satisfy the following prudential requirements:

- a maximum loan-to-deposit ratio of 75 per cent;
- a minimum liquidity ratio of 25 per cent; and
- a minimum provision coverage ratio (provisions/non-performing loans) of 150 per cent.[50]

1.53 The CSRC, the CBRC and the CIRC report directly to the State Council. As with ASIC and APRA, they are regulatory rather than policy-making bodies. The Chairman of the CBRC, as a member of the Central Party Committee, has the highest political rank of the three regulators.

1.54 The PBOC is China's central bank. The State Administration of Foreign Exchange is an administrative agency under the PBOC tasked with drafting regulations on foreign exchange market activities, and managing the state's foreign exchange reserves. The following chapter discusses the role of both agencies in more detail.

The Financial and Economic Committee of the National People's Congress

1.55 On 6 May 2013, the delegation met with representatives from its counterpart in Beijing, the Financial and Economic Committee of the National People's Congress (NPC). This committee is one of nine special NPC committees that are each tasked with studying, examining and drafting bills related to their fields, and assisting the NPC and its Standing Committee in legislative and oversight work.[51] The Financial and Economic Committee has 17 members, including its Chairman, Mr Shi Xiushi, and five Vice Chairmen.

1.56 Chapter 2 of this report notes the Financial and Economic Committee's key interest in superannuation arrangements in Australia. The delegation draws particular attention to significant opportunities that will be presented to Australian superannuation funds to invest in the Chinese market in future years and for Chinese

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50 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 58.

51 The Standing Committee is responsible to the NPC and is the highest body of state power. Its five-year term coincides with that of the NPC and operates in a supervisory role when the NPC is not in session. See: National People's Congress, http://www.china.org.cn/english/27743.htm (accessed 18 May 2013).

fund managers to invest from the large and growing pool of Australian superannuation savings.

1.57 On 18 June 2013, members of the delegation that visited China met with several members of the Financial and Economic Committee of the NPC at Parliament House in Canberra. The delegation members were very pleased to reciprocate for these members some of the hospitality that the NPC Committee had shown the delegation during its recent visit.

1.58 The members of the NPC committee, led by Mr Wu Ritu, expressed particular interest in Australian initiatives to promote access to finance for small- and medium-sized enterprises. The Delegation Leader, Mr Griffin, directed NPC committee members' attention to the committee's 2011 report into these matters.[52] Ms Smyth noted recent government policies to increase the instant asset tax write-off threshold and loss carry-back for small businesses.[53] Moreover, the delegation members emphasised the importance of a competitive banking sector that is able to compete aggressively for credit demand in the SME market.

1.59 The delegation believes its discussions with the Financial and Economic Committee in Beijing and Canberra were extremely useful. It hopes that the Parliamentary Joint Committee on Corporations and Financial Services and the NPC's Financial and Economic Committee will have future opportunities to share ideas and concerns on these important issues of common interest.

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52 Parliamentary Joint Committee on Corporations and Financial Services, *Access to finance for small- and medium sized businesses*, April 2011.

53 These measures enable small businesses to immediately write off the cost of asset purchases under A$6,500 and enable companies to carry back up to A$1 million worth of losses to get a refund of tax paid in the previous year.

Chapter 2

The delegation's discussions on financial sector reform and market access

2.1 This chapter outlines the main themes and issues raised during the delegation's meetings in China. The delegation has been mindful not to breach confidences in recalling the evidence of these meetings. Although not stated, it is understood that Chatham House rules applied. Accordingly, while this chapter recalls the main themes and points of discussion, it avoids direct quotations or attributions.

Key areas of interest

2.2 The delegation's visit to China provided an opportunity to discuss the following areas of mutual interest for Australia and China:

- Australia's experience of economic reform, particularly its reform of the capital account and the development of a world-class superannuation system;
- China's approach to economic and financial system reform, including:
  - (i) liberalising interest rates;
  - (ii) liberalising the exchange rate;
  - (iii) internationalising the renminbi (RMB); and
  - (iv) standards of corporate governance;
- the regulatory barriers facing Australian corporations and financial service providers in gaining a foothold in the rapidly developing Chinese financial services market, including:
  - (i) the process for obtaining bank branch licences; and
  - (ii) the quota on domestic securities investments by qualified foreign institutional investors;
- Chinese investment in Australia and in particular:
  - (i) the role of the 'policy banks'; and
  - (ii) concerns that the 'national interest test' as applied by Australia's Foreign Investment Review Board (FIRB) is not discriminatory; and
- what Australia can offer China by way of developing China's financial services sector and deepening bond, equity and money markets.

2.3 The following sections give an overview of the delegation's discussions on these issues.

China's interest in Australia's experience of economic and financial reform

2.4 The delegation raised the issue of Australia's experience with economic and financial sector reform with its hosts on several occasions. It emphasised that the floating of the Australian dollar in 1983, the removal of barriers to the entry of foreign banks the following year and establishing the independence of the Reserve Bank of Australia (RBA) in 1996 were key reforms that have served the Australian economy particularly well.

2.5 The delegation told its hosts that the capital account and financial reform era in Australia was marked by significant and decisive actions to open up the economy. Prior to the mid-1980s, the Australian economy and the financial system were insular, heavily regulated and uncompetitive. In the years since, the reforms continue to reap benefits. For instance, the delegation explained that a floating Australian dollar has enabled Australia to cash in (on a high dollar) when international demand for raw materials was booming, and when demand fell in 2008, the dollar fell, cushioning the impact of the global financial crisis (GFC) for Australia's export industries.

2.6 The delegation observed that while the 'big four' Australian banks still dominate the Australian banking sector, allowing foreign entrants into the market improved the competitiveness of the domestic banking system.[1] It noted that in the 1980s, the issue of allowing foreign banks into a small domestic market was a cause of some concern. Would Australia's banks be able to match foreign competitors with the foreign banks' economies of scale?

2.7 In 1994, a decade after the reforms, the then Governor of the RBA, Mr Bernie Fraser, gave the following answer:

> In the event, the major Australian banks had to work hard but they successfully defended their retail businesses. The experience of the past decade confirms that winning over a critical mass of retail customers in a foreign country is an extraordinarily difficult – if not impossible – task. For most banks, the only real prospect would be to buy that critical mass, through the purchase of a significant Australian retail bank.[2]

2.8 This observation of the challenges facing foreign banks is raised later in the chapter.

Australia's superannuation system

2.9 Australia's superannuation system was also discussed during the visit, particularly with the Financial and Economic Committee of the National People's Congress in Beijing. The delegation emphasised the following points:

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1 Discussion with Financial and Economic Committee of the National People's Congress, Beijing, 6 May 2013.

2 Mr Bernie Fraser, 'Foreign banks in Australia', *Reserve Bank Bulletin*, September 1994, p. 17.

- Australia has a means-tested old-age pension system, with the eligible age to increase from 65 to 67 between 2017 and 2023;
- Australia has had a compulsory system of superannuation savings since 1992;
- employers are currently required to pay nine per cent of an employee's salary and wage into a superannuation fund, with encouragement for people to put aside additional funds. This employer contribution will increase to 12 per cent in future years;
- Australia has approximately A$1.5 trillion in superannuation savings invested, making it one of the largest pools of retirement savings in the world;
- these savings have been a significant source of investment for, and impetus for the development of, Australia's managed funds sector; and
- the delegation foresees significant opportunities for Australian superannuation funds and managed investment schemes to invest in the Chinese financial markets.[3]

China's approach to economic reform

2.10 While expressing interest in these reforms, several of the organisations with which the delegation met emphasised the need for China to manage its process of economic reform cautiously and prudently. Further, they argued that the sequence of the reforms is important.

2.11 In discussions with Chinese academic economists, there was a general view that China's priority must be to focus on interest rate and exchange rate reform: the internationalisation of the renminbi (RMB) was seen as a second-order issue.[4] They did recognise that given the gradual pace of reform on interest and exchange rates, RMB internationalisation should proceed concurrently. The Secretary of the Australian Treasury, Dr Martin Parkinson, recently observed:

> Conventional wisdom around reform paths has been that full internationalisation of the RMB cannot happen without greater flexibility and convertibility in the currency, and that fundamental reforms to exchange rate and interest rate formulation must come before loosening of capital account controls. While this approach is grounded in past experience, we need to put it in the context of the size of China's reform task and the reasons for China's more gradual and multi-track approach to reform to date.[5]

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3 Discussion with members of the Financial and Economic Committee of the National People's Congress, Beijing, 6 May 2013.

4 Discussion with Chinese academic economists, Shanghai, 10 May 2013.

5 Dr Martin Parkinson, *Address to Australia–Hong Kong Renminbi Trade and Investment Dialogue,* 12 April 2013, http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2013/Australias-place-in-the-new-global-economy (accessed 24 May 2013).

2.12 The delegation recognises that the bold and sweeping reforms made by Australian governments to liberalise the economy in the 1980s and 1990s may not be appropriate for China at this stage of its reforms. Nonetheless, the delegation had the sense from those with whom it met that there is a need to progress the economic reforms that have commenced in China.[6] There was general agreement that having taken steps to liberalise its economy, the Chinese leadership will be keen to continue down this path. Indeed, since the delegation's visit, the Chinese Government has issued a directive with a set of proposals that include taking gradual steps to allow market forces to determine bank interest rates and more opportunities for foreign investors to invest in finance.[7] The same day, the People's Bank of China (PBOC) released a statement promising to loosen foreign exchange controls.[8]

Liberalising interest rates

2.13 As chapter 1 noted, in June last year the PBOC gave China's banks greater freedom to set their own lending and deposit rates. To encourage competition, lenders could set their rates 30 per cent below the benchmark rate while the banks could offer depositors a rate 20 per cent above the benchmark.

2.14 There was some discussion during the visit on the effect that the interest rate restrictions have had, and continue to have, on China's economy. Australian bank representatives told the delegation that these restrictions mean that investment risk is not being priced appropriately. Accordingly, the banks tend to lend principally to the large and inefficient state-owned enterprises (SOEs) on generous terms, leaving the lending market for small- and medium-sized enterprises (SMEs) undeveloped.[9] Several Australian bank representatives made the comment that the banking system in China has essentially served the state and the SOEs.[10]

2.15 Several people with whom the delegation met identified liberalising interest rates as a key area of reform.[11] They argued that deregulating interest rate movements is

6 Discussion with the China Securities Regulatory Commission, Beijing, 7 May 2013; Discussion with the China Banking Regulatory Commission, Shanghai, 10 May 2013.

7 David Barboza and Chris Buckley, 'China Plans to reduce state's role in economy', *New York Times*, 24 May 2013. A copy of the directive from the Chinese Government (in Mandarin) can be found at the following site: http://www.gov.cn/zwgk/2013-05/24/content_2410444.htm (accessed 29 May 2013).

8 David Barboza and Chris Buckley, 'China Plans to reduce state's role in economy', *New York Times*, 24 May 2013.

9 Discussion with Australian banks and Macquarie Wealth at the Australian Consulate in Shanghai, 9 May 2013.

10 Discussions with Australian bank representatives in Beijing on 6 May 2013 and in Shanghai on 9 May 2013.

11 Discussions with academic economists, Shanghai, 10 May 2013; discussions with Australian bank representatives in Beijing on 6 May and in Shanghai on 9 May 2013; discussions with Australian banks and Macquarie Wealth at the Australian Consulate in Shanghai, 9 May 2013.

necessary if China is to liberalise its capital account and have a fully convertible currency. They were encouraged that the Governor of the PBOC, Mr Zhou Xiaochuan, had recently been reappointed given the progress he has made to date on interest rate liberalisation.

Liberalising the exchange rate

2.16 The delegation also discussed the issue of China's regulation of the exchange rate. Currently, the PBOC sets a daily fixing rate that is based on an average of market-makers' quotes to the central bank. This is the starting point for each day's trading. The exchange rate is allowed to move within a band around the daily fixing rate. Chapter 1 noted that in June 2012, this band was broadened from 0.5 per cent to 1 per cent of the US/RMB midrate.

2.17 The delegation heard that the trading band may be further widened later this year, possibly to two per cent of the US/RMB midrate. This is consistent with comments made by the Deputy Governor of the PBOC at the International Monetary Fund Annual Meetings in April this year.[12]

2.18 The delegation encourages moves to continue liberalising the exchange rate regime. If China's foreign exchange market is to develop, it is important that exchange rate movements are allowed to reflect market movements, rather than be constrained by the central bank's trading band.

2.19 The delegation notes the proposal of Mr He Fan, the Deputy Director of the Institute of World Economics and Politics at the Chinese Academy of Social Sciences. His suggestion was that the PBOC should not intervene in the market unless the RMB exchange rate moves up or down by more than 7.5 per cent annually. The figure of 7.5 per cent is chosen on the basis that 'it should be large enough to convince the investors, but not too large to scare the market'.[13]

Internationalisation of the RMB—pilots and opportunities for Australia

2.20 The delegation notes that in its 2012 White Paper, the AustCham Beijing and Shanghai Financial Services Working Group commended 'the ongoing and dynamic progress being achieved on the internationalisation of the RMB'.[14] In its discussions, the delegation was told of China's liking for test cases or 'pilots' in pursuing its reforms.[15] There have been some important pilot programs designed to internationalise the use of the RMB.

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12 Mr Yi Gang, Deputy Governor, People's Bank of China, *IMF Annual Meetings*, 17 April 2013.

13 'China must push ahead with exchange rate reforms', *East Asia Forum*, 29 April 2013.

14 Australian Chamber of Commerce Financial Services Working Group, *Australian Financial Services Business in China*, 2012 White Paper, p. 7.

15 Discussion with the Australian Consul-General and Consulate staff in Shanghai, 9 May 2013.

2.21 In 2012, China announced a pilot program called the Qinghai–Shenzhen–Hong Kong Modern Service Industry Cooperation Zone, whereby RMB funds from Hong Kong banks finance construction projects in Qinghai. Significantly, interest rates on these RMB-denominated loans will be set independently (rather than on the PBOC's benchmark).[16]

2.22 In August 2012, the PBOC and the Central Bank of Taiwan (CBC) signed a Memorandum of Understanding on cross-strait currency clearing. This agreement enables Taiwanese banks to take RMB-denominated deposits, as well as to engage in trade, corporate and customer finance in RMB. Taiwan was the third jurisdiction, after Hong Kong and Macau, to be able to clear RMB-denominated transactions outside mainland China.[17] In March 2013, Singapore was accorded the same status as an RMB clearing centre, with the Industrial and Commercial Bank of China appointed as Singapore's official RMB clearing bank.

2.23 The delegation draws attention to the need for Australian firms to be aware of business opportunities to use RMB and to be aware of the RMB-denominated trade settlement process. It understands that a working group has been established from the banking, business and government sectors in Australia to investigate the benefits of RMB use.

Corporate governance in China

2.24 The delegation did not focus on matters of corporate governance in any great detail during its meetings. It did hear that China has broadly similar principles of corporate governance to those that operate in Australia. These include defining the rights of shareholders and the role and responsibilities of directors and boards, timely and accurate disclosure of information to the market, and requiring companies to implement effective systems of risk management and performance evaluation of senior management.

2.25 In 2006, China introduced the *Company Law* and the revised *Securities Law*, which together established the modern corporate governance framework. The *Company Law*:

- improved companies' governance structure and mechanisms to protect shareholders;
- highlighted the legal obligations and responsibilities of those in actual control of the company;
- improved companies' financing and financial accounting systems; and

16 Confidential document provided to the committee, Australian Treasury, February 2013.

17 Confidential document provided to the committee, Australian Treasury, February 2013.

- improved the framework governing corporate mergers and liquidations.[18]

2.26 The revised *Securities Law*:

- improved the supervision of listed companies;
- enhanced the transparency of the issuance process;
- established a mechanism of introducing a system for recommending/sponsoring listing;
- increased the legal responsibilities of directors, supervisors and senior management of listed companies;
- strengthened investor protection, especially for minority investors; and
- established a securities investor protection fund, and defined the system of civil responsibility to compensate for damages to investors.[19]

2.27 The delegation notes that there is a marked contrast between the application and the enforcement of corporate governance principles between Australia and China. This is an area of ongoing focus for the regulatory bodies. Ensuring that corporate governance principles are rigorously enforced is a challenge for any corporate regulator, but it presents particular hurdles in China given the relative newness of its financial system and the dominance of the SOEs. As the Organisation for Economic Cooperation and Development observed in 2011:

> China – like all other countries around the world – faces the continuous challenge of ensuring that its corporate governance laws and regulations are translated into good corporate practice. Ultimately, the rules and laws on paper must be effectively implemented in order to make a difference. This is a long-term commitment that will benefit from constant attention to the quality of the legal system; the presence of self regulatory organizations and cooperation with international institutions. For China, priority areas for attention may include: curbing abusive related party transactions, enhancing the quality of boards, improving shareholder protection and curbing market abuse. It may also be useful to devote special attention to the all-important issue of how to improve effective implementation and enforcement.[20]

18 Organisation for Economic Cooperation and Development, *Corporate Governance of Listed Companies in China*, 2011, p. 16.

19 Organisation for Economic Cooperation and Development, *Corporate Governance of Listed Companies in China*, 2011, p. 16.

20 Organisation for Economic Cooperation and Development, *Corporate Governance of Listed Companies in China*, 2011, p. 16.

Australia's corporate governance reforms

2.28 The delegation told its hosts that Australia has implemented a series of corporate governance reforms over the past 15 years, beginning with the Corporate Law Economic Reform Program, or CLERP (1998–2004). The CLERP reforms:

- strengthened the continuous disclosure regime to ensure that investors have timely and equal access to materially price-sensitive information in trading securities on secondary markets;
- made access to capital easier for SMEs;
- provided greater commercial and international focus to the making of accounting standards;
- improved takeovers regulation to promote a more competitive market for corporate control; and
- facilitated the more widespread use of electronic commerce.[21]

Change of leadership at CSRC

2.29 The delegation was informed that the CSRC changed leadership in March 2013. The previous Chairman, Mr Guo Shuqing, was appointed as the new Governor of Shandong. Mr Guo was replaced by Mr Xiao Gang. The delegation understands that Mr Xiao is particularly well credentialed for the role, having had senior roles with the PBOC and the BOC.[22] It hopes that Mr Xiao continues the measures initiated by his predecessor, particularly in promoting the use of stocks and bonds as an alternative to bank credit.

2.30 During Mr Guo's 18-month tenure as Chairman of the CSRC, there was a focus on addressing insider trading and reforming the initial public offering (IPO) process. The CSRC told the delegation that there had also been a high-profile prosecution of a family for insider trading.[23]

2.31 In December last year, the CSRC issued an order requiring IPO intermediaries to carry out self-reviews to improve underwriting quality and ensure accurate disclosure of information to the market.[24] Brokerage firms were required to file self-review reports to

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21 Australian Securities and Investments Commission, *Corporate Law Economic Reform Program*, http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/CLERP (accessed 24 June 2013).

22 China Securities Regulatory Commission, Mr Xiao Gang, Biography, http://www.csrc.gov.cn/pub/csrc_en/about/who/xiaogang/ (accessed 24 June 2013).

23 Meeting with Mr Zeng Jifeng and Mr Wu Meng, China Securities Regulatory Commission, Shanghai Bureau, 9 May 2013.

24 China Securities Regulatory Commission, 'CSRC issues the notice on conducting a special inspection of IPO companies' 2012 reports', 28 December 2012 http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/201301/t20130109_220240.htm (accessed 25 June 2013).

the CSRC by 31 March 2013.[25] On 24 May 2013, the CSRC announced that since launching an overall investigation into the financial conditions of A-share listing applicants, it has terminated the review of applications from 200 companies.[26] As of June 2013, the IPO reform process was ongoing, with the CSRC seeking feedback from stakeholders on proposals to restrict share issuers from selling stock at below the IPO price.[27]

Regulatory barriers facing Australian banks and fund managers in China

The concerns of Australian banks operating in China

2.32 An area of significant discussion during the delegation's visit related to the requirements for Australian banks to gain a licence in China. The representatives of the major Australian banks, some of whom are closely involved with the Financial Services Working Group, put a strong view that the process for gaining a branch licence in China is unduly lengthy and onerous. They made the following points:

- banks need to apply for licences for each branch;
- the waiting time for these licences can be lengthy;
- there is a policy of 'one licence at a time', meaning multiple branches cannot be applied for at the same time;
- there is a 6 to 12 month observation period following the granting of a licence; and
- for some licences, such as a derivative licence, there is a separate approval process involving both the CBRC and the State Administration of Foreign Exchange (SAFE).[28]

2.33 The 2012 Australian Financial Services Business in China White Paper made several recommendations to simplify the operating environment for foreign banks. Some of these recommendations related to improving market access for foreign banks, such as:

- removing the 'one licence at a time' and 'observation period' restrictions on foreign banks;
- amending the time limit on obtaining RMB licences, so that those foreign banks that meet the regulatory criteria and perform above industry average have priority;

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25 Cong Mu, 'New IPO experts better than nothing: expert', *Global Times*, 4 February 2013.

26 'CSRC terminates review of 200 listing application', *ChinaScope Financial*, 24 May 2013, http://www.chinascopefinancial.com/en/news/post/26405.html (accessed 25 June 2013).

27 See 'CSRC releases stringent IPO rules as Xiao tackles fraud', Bloomberg, 8 June 2013, http://www.bloomberg.com/news/2013-06-07/csrc-releases-stringent-ipo-rules-as-xiao-tackles-fraud.html (accessed 25 June 2013).

28 Discussion with Australian bank representatives, Australian Consulate in Shanghai, 9 May 2013.

- lifting the investment ceiling on foreign banks from two to three;
- increasing the cap on equity investment from 20 per cent to a more reasonable level (e.g. 49 per cent) to increase investment and benefits for less-developed regions of China;
- for foreign-funded branches where a banking licence is held, allowing an expansion of Representative Office activities to include basic banking services to customers; and
- allowing all banks to access the PBOC Credit System to ensure all available information is used in making credit risk decisions.[29]

2.34 Other recommendations in the White Paper were focused on improving the transparency of existing processes within which the foreign banks operate. This included proposals to:

- establish greater uniformity in China's tax regimes;
- introduce a more consistent and transparent methodology for the allocation of foreign debt ratios;
- allow statutory deposits to be treated as current assets regardless of the term of deposit;
- establish regular communication and engagement between the Chinese Government and domestic and foreign-funded banks with the aim of working through the operational impacts of proposed and draft regulations;
- establish clear guidelines for allowing capital injections, including limits and process, which would be applicable to any foreign entity such as a bank or wholly owned foreign enterprise; and
- review the volume and frequency of regulatory reporting, especially the need to submit reports for products/services not included in the bank's Banking Licence.[30]

2.35 The Working Group also emphasised the need for China to liberalise both its capital account and its interest rate regime. It noted that further liberalising the capital account would provide greater funding options for all banks operating in China. Liberalising the interest rate regime would create a more level playing field between domestic and foreign banks. Currently, the domestic banks attract large deposits and are able to apply a fixed margin on deposits and loans.[31]

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29 Australian Chamber of Commerce, Beijing and Shanghai, Financial Services Working Group, *Australian Financial Services Business in China*, 2012 White Paper, pp 7–11.

30 Australian Chamber of Commerce, Beijing and Shanghai, Financial Services Working Group, *Australian Financial Services Business in China*, 2012 White Paper, pp 7–11.

31 Australian Chamber of Commerce, Beijing and Shanghai, Financial Services Working Group, *Australian Financial Services Business in China*, 2012 White Paper, pp 7–11.

The concerns of Australian fund managers operating in China

2.36 Another area of discussion during the visit related to foreign financial services companies gaining access to China's growing asset and funds management market. As noted earlier, the delegation had the opportunity during its visit to talk to senior representatives from AMP Capital and Macquarie Capital. During the discussions, these representatives noted the opportunities for Australian fund managers to invest in public-private partnerships in China and in real estate investment trusts (REITs). However, they shared the Australian banks' concerns with the complexity and lack of transparency and consistency in the regulatory environment in China.

The delegation visited the trading floor of the Shanghai Stock Exchange on 10 May 2013. Red numbers on the board signify trading gains; green numbers signify trading losses. The Exchange was established in 1990. All trading is now done electronically and it is proposed that the floor be set up as a museum.

2.37 In 2002, the Qualified Foreign Institutional Investor (QFII) program was introduced to allow foreign investors, approved by the CSRC, to buy and sell RMB-denominated shares in China's mainland stock exchanges. SAFE decides the size of each investment quota. A QFII applying for an investment quota must supply SAFE with various documents, including a written application that sets out the source of funds, an investment plan and a commitment of no repatriation of investment during the 'lock-up' period.[32] The regulations also require that an application for a single QFII investment quota 'shall not be less than an amount equivalent to USD 50 million', 'but not more than an amount equivalent to a total of USD 1 billion'. Further, a QFII is not allowed to increase this investment quota within a year of the approval of the previous investment quota.[33]

2.38 There are also experience and liquidity requirements governing QFIIs, although these were relaxed by the CSRC in July 2012. For fund management firms, there is a requirement of more than two years' experience and assets under management of more than US$500 million. Previously (2006–2012), the threshold was for more than five years' experience and more than US$5 billion in securities assets under management. In July 2012, there was also some relaxation of restrictions on investment options for QFIIs, with domestic fund management companies allowed to provide specific asset management services for QFIIs.[34] QFIIs were also allowed to expand their investment vehicles to include stock-index futures and bonds traded on the interbank bond market.

2.39 The delegation notes that the regulations governing the conduct of QFIIs remain highly restrictive. It agrees with the observation in the AustCham Beijing and Shanghai Financial Services Working Group's White Paper that:

> Opening up the funds management sector to an equal level participation by Chinese state-owned institutions and other Qualified Foreign Institutional Investors (QFIIs) and Qualified Domestic Institutional Investors (QDIIs) will result in a more competitive, liquid and high growth sector, with the added benefit of flow-on impact to the overall Chinese financial sector.[35]

2.40 The complementarity of Australian and Chinese interests in a more open and efficient financial services regulatory framework is a theme developed in chapter 3.

32 Article 6(1), *Provisions of the Administration of Foreign Exchange in Domestic Securities Investments of Qualified Foreign Institutional Investors*. Article 9 sets the 'lock-up' period for pension funds, insurance funds, common funds, donation funds, and government and currency administration at three months. For other types of QFII, the lock-up period is one year.

33 Article 7, *Provisions of the Administration of Foreign Exchange in Domestic Securities Investments of Qualified Foreign Institutional Investors*.

34 Keith Robinson, Karl Egbert, Jingzhou Tao and Gregory Louvel, 'The Qualified Foreign Institutional Investor Program in China – Recent Developments, New Opportunities and Ongoing Challenges', *The Investment Lawyer*, February 2013, p. 4, http://www.dechert.com/files/Publication/a07259f1-1fd6-4283-8ad2-858483a5b595/Presentation/PublicationAttachment/fdf9e573-daa7-49b7-9a4d-793810efe4e9/IL%20Feb%202013%20Robinson%20article.pdf (accessed 25 June 2013).

35 Australian Chamber of Commerce, Beijing and Shanghai, Financial Services Working Group, *Australian Financial Services Business in China*, 2012 White Paper, p. 12.

Chinese investment in Australia

2.41 The issue of Chinese investment in Australia was not discussed in great detail during the delegation's visit. However, the delegation did hear from the Shanghai branch of the China Development Bank (CDB) of the significant investment that the 'policy bank' was making in Australia. The President of the Branch told the delegation that there is currently eight staff representing the CDB's interests in Australia. He noted that the Bank has provided commitment for 39 projects in Australia, with a value of US$35 billion.[36] The CDB has a number of clients in Australia including:

- Chalco;
- Boasteel;
- Hunan Nonferrous Metals Holding Group;
- Minmetals;
- Meridan Minerals Limited;
- Citic Pacific; and
- Yanzhou Coal Mining Company Limited.[37]

2.42 The CDB is the largest of China's three policy banks. The delegation heard that as of December 2012, the Bank had RMB 7520 billion in assets and made profits in 2012 totalling RMB 63.1 billion.[38] This asset base is more than three times that of the other two policy banks. In 2012, the profits of the Agricultural Development Bank of China and the Export–Import Bank of China were RMB 7.8 billion and RMB 14.3 billion respectively.[39]

2.43 The CDB was the only institution to raise with the delegation the matter of FIRB processes. While the delegation understands there is some concern within China about the nature of FIRB's processes and outcomes, it makes the following points:

- between 2006–07 and 2011–12, the Board considered a total of 48 382 applications of which it rejected only 115 (0.2 per cent);[40]
- since October 2007, FIRB has accepted all 380 foreign direct investment proposals from Chinese companies; only six of these projects have had conditions placed on them;

36 China Development Bank, *Powerpoint presentation*, 10 May 2013, Slide 18.

37 China Development Bank, *Powerpoint presentation*, 10 May 2013, Slide 19.

38 China Development Bank, *Powerpoint presentation*, 10 May 2013, Slide 5.

39 China Development Bank, *Powerpoint presentation*, 10 May 2013, Slide 5.

40 Foreign Investment Review Board, *Annual Report 2011–12*, p. 20.

- in 2011–12, FIRB approved 4752 applications from Chinese investors, totalling A$16.2 billion in value. Mining applications accounted for 65 per cent of this value;[41]
- between 2008–09 and 2011–12, China was ranked in the top three sources of proposed investment (in terms of the value of approvals);[42]
  - the value of projects from China approved by FIRB has increased substantially over the past eight years. In 2004–05, this value was only A$264 million. It peaked in 2008–09 at A$26.5 billion, before falling to A$16.3 billion, A$15 billion and A$16.2 billion in the 2009–10, 2010–11 and 2011–12 financial years respectively.[43]

2.44 Above all, the delegation emphasises that the Australian Government's approach of reviewing foreign investment proposals against the national interest on a case-by-case basis is sensible and prudent. This flexibility maximises investment flows, while protecting Australia's interests. It is also appropriate that the foreign investment review process recognises the importance of Australia's market-based system which makes companies responsive to shareholders and investment decisions based on market forces 'rather than external strategic or non-commercial considerations'.[44] In this context, the delegation agrees with the view that there is an important role for routine consultation between Australian and Chinese authorities to facilitate scrutiny of competition, corporate governance and financial transparency issues.[45]

41 Foreign Investment Review Board, *Annual Report 2011–12*, p. 30.

42 Foreign Investment Review Board, *Annual Report 2011–12*, p. 20; Foreign Investment Review Board, *Annual Report 2010–11*, p. iii.

43 Foreign Investment Review Board, *Annual Reports 2004–05 to 2011–12*.

44 Australian Treasury, *Australia's Foreign Investment Policy*, 2013, http://www.firb.gov.au/content/_downloads/AFIP_2013.pdf (accessed 25 June 2013).

45 This view was put by Professor Peter Drysdale and Professor Christopher Findlay, 'Chinese foreign direct investment in the Australian resource sector', *China's New Place in a World in Crisis*, Ross Garnaut, Ligang Song, Wing Thye Woo (eds.), 2009, p. 380.

Chapter 3

The delegation's views and recommendations

3.1 As the previous two chapters of this report have emphasised, the delegation visited China at an important time for China's financial and economic reforms. China's 12th Five-Year Plan (2011–2015) identified liberalising the capital account and developing a sophisticated financial services sector as key priorities. There are emerging opportunities for Australian banks and financial services companies to benefit from these reforms. The recent Australian White Paper *Australia in the Asian Century* identified the importance of continuing to advocate open financial markets in Asia and promoting complementarity of financial market regulations within the region.[1]

3.2 It is fitting, therefore, that the delegation's visit to China in May 2013 and the Financial and Economic Committee of the National People's Congress' (NPC) visit to Australia in June 2013 were the first parliamentary committee visits to Australia and China since the 12th Five-Year Plan was signed in October last year.

3.3 This chapter presents the delegation's position on how it believes the Australia–China dialogue on financial services should be advanced. The focus is on how Australian banks and financial services companies can gain greater market access in China and operate within a more efficient regulatory system. The delegation's recommendations respond to the following inter-related questions:

(a) How can the regulatory concerns of Australia's banks and financial services companies operating in China be addressed most effectively?

(b) What can Australian banks and financial services companies offer China's financial sector if the goals of greater market access and a streamlined regulatory system are realised?

(c) What are the key messages and forums in which the Australian government and Australian companies must engage to ensure that:

(i) these regulatory concerns are addressed; and

(ii) China realises the benefits from greater Australian involvement in China's financial services sector?

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1 Australian Government, *Australia in the Asian Century*, October 2012, p. 21. http://asiancentury.dpmc.gov.au/sites/default/files/white-paper/australia-in-the-asian-century-white-paper.pdf (accessed 24 June 2013).

Setting out the issues, and the problems

3.4 Fundamental to efforts to gain greater access to China's financial services market is to clearly set out the barriers that currently exist. The delegation believes that to this end, the 2012 AustCham Beijing and Shanghai Financial Services Working Group's White Paper is an important document. It identifies several challenges for Australian financial institutions in China which can, and should, form the basis for discussions with Chinese policy makers.

3.5 However, the delegation believes that subsequent versions of this document should contain more detail. As this report has discussed, China is progressing with its economic and financial reforms on a number of fronts. A future AustCham financial services document should devote more attention to these efforts and the progress made. The document should also have a more substantive discussion of developments in the Australia–China financial services bilateral relationship and identify potential and evolving areas of investment opportunity for Australian banks and financial services companies in China.

3.6 The delegation urges AustCham to elaborate on the nature of the problems that it identifies in its 2012 White Paper. For example:

- 'observation 2' identifies the banks' difficulties with 'very short' implementation timelines for new regulations, but no examples are given. Examples would help to show not only the difficulty in meeting these tight timeframes but the benefits of longer lead-in times for both compliance and a better quality of service to customers;
- 'observation 4' notes the lack of uniformity in the taxation code across various cities and regions in China. The paper would benefit from some examples of this inconsistency and how it inconveniences Australian financial institutions with operations in multiple regions of China;
- 'observation 5' states that 'the trained talent pool is limited' and 'for some specialist roles, it is increasingly difficult to recruit and train staff'. It would be useful to have examples of the areas in which the Working Group believes there is limited talent in China's banking and financial services sector, and possible reasons for this, such as a lack of relevant education and on-the-job training opportunities; and
- 'observation 6' notes that most foreign banks operating in China are unable to access the RMB settlements system directly. It notes that the China National Advance Payments System Framework is causing settlement delays and price impacts. Again, more detail is needed on the nature and extent of the problem.

Recommendation 1

3.7 The delegation recommends that the AustCham Beijing and Shanghai Financial Services Working Group develop a document that provides detailed examples based on the observations in its 2012 White Paper. The purpose of

these examples should be to illustrate the nature of the problem and, in particular, how current regulatory settings affect the ability of a foreign financial institution to deliver a reliable and competitive service for Chinese companies and investors.

Identifying the solutions and the benefits

3.8 An obvious strength of the AustCham White Paper is that it sets out possible solutions to these problems, and the likely benefits from these solutions. Indeed, the paper contains 35 recommendations: six new recommendations relating to the banks; a further six bank-related recommendations from previous AustCham documents; seven 'other banking recommendations'; nine recommendations relating to the funds management sector; two each relating to trust companies, private equity companies and insurance firms; and one recommendation relating to advisory services for the financial sector. This represents a substantial future work plan for AustCham's Financial Services Working Group.

3.9 The delegation emphasises that Australian stakeholders should discuss with Chinese regulators and policy makers solutions to problems that are principles-based and that emphasise the complementarity of objectives. AustCham's White Paper provides recommendations that make frequent reference to the principles of clarity, consistency and efficiency in making regulations. However, these principles should frame the discussion around the paper itself.

3.10 The AustCham Financial Services Working Group should also emphasise that Australia's interest in holding discussions with China's regulators is not to gain preferential treatment, but to operate under the same rules as other foreign financial institutions and Chinese banks and financial services providers. The broader point must be that competitive advantage in China's financial services market should not be based on preferential treatment or regulatory arbitrage, but on providing competitive and innovative services to customers through a sound corporate governance framework.

Recommendation 2

3.11 The delegation recommends that Austrade work closely with AustCham Beijing and Shanghai Financial Services Working Group to deliver a focused message to China's policy makers that is based on:

- **the overarching importance of the principles of clarity, consistency and efficiency in guiding regulatory reforms to China's financial services framework; and**
- **the complementarity of Australian and Chinese objectives in this reform process. It must be emphasised that reforms that serve these principles will assist Australian institutions to make a greater contribution to the growth, knowledge and sophistication of China's financial services sector.**

3.12 Indeed, this point of the complementarity of Chinese and Australian interests in a more efficient financial services framework in China is emphasised throughout the AustCham White Paper. The Working Group envisaged several mutual benefits from regulatory reform in China:

- Streamlining the bank licence application process would result in an increased willingness of foreign banks to invest in China, and increased opportunity for Chinese banks and regulators to access first-hand international financial market knowledge. Chinese banks would accelerate their understanding of international standards on derivative products which might positively impact their international expansion goals. Chinese financial institutions would benefit from greater customer satisfaction, as well as being able to provide greater flexibility for customers when choosing financial products and services.[2]
- Increasing the uniformity of the tax regimes across regions in China will encourage greater investment by foreign-funded banks in diverse areas, as well as increasing the operational cost effectiveness of the Chinese banking sector, thereby encouraging additional foreign participants to enter the Chinese financial services market.[3]
- Providing direct access to the China National Advance Payments System will benefit the Chinese customer by obtaining the best settlement price at the right time, without market disadvantage. This will also drive further efficiency and contribute to a more balanced, equitable financial system.[4]
- Opening up the funds management sector to an equal level of participation by Chinese state-owned institutions and other Qualified Foreign Institutional Investors (QFIIs) and Qualified Domestic Institutional Investors (QDIIs) will result in a more competitive, liquid and high-growth sector, with the added benefit of flow-on impact to the overall Chinese financial sector.[5]
- Clear protocols around the administration of the QDII scheme would encourage further growth in the funds management sector, encouraging greater participation by Chinese investors, Chinese fund managers and Australian fund managers. Building the capability of Chinese participants through engagement with their Australian counterparts will boost the development of the sector.[6]

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2 Australian Chamber of Commerce, Beijing and Shanghai, Financial Services Working Group, *Australian Financial Services Business in China*, 2012 White Paper, p. 7.

3 *Australian Financial Services Business in China*, 2012 White Paper, p. 9.

4 *Australian Financial Services Business in China*, 2012 White Paper, p. 10.

5 *Australian Financial Services Business in China*, 2012 White Paper, p. 12.

6 *Australian Financial Services Business in China*, 2012 White Paper, p. 14.

- Australian fund managers can share their expertise in fund distribution business with the Chinese market and offer Chinese investors a wider range of investment options. Additionally, foreign fund managers will be encouraged to stabilise their holdings in the Chinese investment management industry.[7]
- With the support of the mature Australian funds management sector, China's transition to these more sophisticated financial instruments can be managed in a smooth, planned manner, minimising risk and applying the controls and incentives to instigate growth.[8]
- By engaging with foreign private equity participants on reform, China's private equity sector would benefit from greater internationalisation of investment processes and financial reporting standards. The open dialogue of expertise and know-how between Chinese, Australian and foreign private equity fund managers would accelerate the overall development plan for the sector, and would increase expansion opportunities for Chinese and foreign private equity investors.[9]

3.13 These comments make clear that the Working Group foresees several qualitative benefits from greater engagement of Australian financial institutions in the Chinese market. The delegation strongly agrees. China's broad goal of deeper bond and equity markets and a more sophisticated financial services sector is consistent with a range of regulatory reforms that would allow Australian financial services providers to deepen and broaden their participation in China.

3.14 It is important that the Working Group explains the case for these wide-ranging regulatory reforms which would enable Australian financial institutions to make these qualitative contributions to China's financial services sector. As reforms occur, Chinese policy makers and regulators must be made aware of examples where greater clarity and consistency in regulations has benefitted both Australian financial institutions operating in China and Chinese institutions and investors. This link is crucial, as it will encourage a more liberal regime for foreign firms and build trust between Australian and Chinese financial institutions and regulators. To this end, the delegation believes that Austrade has an important role in assisting AustCham.

Recommendation 3

3.15 The delegation recommends that Austrade assist the AustCham Beijing and Shanghai Financial Services Working Group to collate and publicise examples of where regulatory reform in China has enabled Australian financial services providers operating in China to:

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7 *Australian Financial Services Business in China*, 2012 White Paper, p. 14.

8 Australian Chamber of Commerce, Beijing and Shanghai, Financial Services Working Group, *Australian Financial Services Business in China*, 2012 White Paper, p. 15.

9 Australian Chamber of Commerce, Beijing and Shanghai, Financial Services Working Group, *Australian Financial Services Business in China*, 2012 White Paper, p. 18.

- **transfer knowledge to local financial institutions in the banking, private equity, insurance, funds management, financial advice, trusts and bond markets;**
- **invest in China in these markets;**
- **streamline processes, which in turn benefits Chinese investors and consumers; and**
- **bring foreign liquidity into China.**

3.16 As they arise, these examples should frame the ongoing dialogue between the Australian Working Group and China's policy-makers and financial regulators. The discussions should explain, as clearly as possible, the change in behaviour allowed by the regulatory reform and the direct benefit to Chinese institutions, investors and consumers.

3.17 To this end, it will be important for the Working Group to be continually aware of the Chinese Government's challenges and priorities in developing and managing its banking and financial services sectors. For example, in an environment of tightening liquidity and less lending between China's domestic banks, the benefit of reforms that increase foreign liquidity must be emphasised.

3.18 It was noted during the visit to China that Australian financial services account for only a small percentage of the (roughly) two per cent market share held by foreign financial institutions in the Chinese market. Australia's influence and contribution should not in any way be viewed as a threat to the overwhelming dominance of China's local providers. As chapter 1 noted, this did not even happen when foreign banks entered the small Australian market.

3.19 Rather, the contribution of Australian financial services firms in China should be seen as a way to provide high-quality and sophisticated knowledge, expertise and technology in niche areas. The delegation spoke with several Australian financial sector representatives in China who understood their contribution to the local market in terms of applying best-practice technology and standards of corporate governance. In this context, they argued, Australian financial services providers could play an important role in the development of Shanghai as an international financial centre.[10]

Selling the message in the right forum(s)

3.20 In addition to articulating current problems and selling the benefits of financial services regulatory reform in China, these messages need the right platform. One Australian banking representative told the delegation that the imperative of greater market access in China would only be realised if at every opportunity, foreign financial services providers gave China's decision-makers a clear and consistent

10 Discussion with Australian banks and Macquarie Wealth at the Australian Consulate in Shanghai, 9 May 2013.

message.[11] While this is important, it is also necessary to have a strategic approach where this message is given.

3.21 The delegation believes that the G20 Leaders' Summit in Brisbane in November next year is an important opportunity for Australia and the international community to impress on China the benefits of an open and competitive financial system. Australia has already played an influential role in financial services reform through the G20 process. The Department of Foreign Affairs and Trade has noted that Australia's 'effective system of financial regulation' has allowed it to make a 'useful contribution to discussions in G20 forums aimed at improving international financial standards'.[12] As Chair of the G20 in 2014, Australia will have no better opportunity to shape and advance the debate on financial services reform.

Recommendation 4

3.22 The delegation recommends that the Australian Government establish financial sector reform as one of the key priority areas of its G20 Presidency. The focus must be on:

- **improving market access in banking and financial services; and**
- **promoting complementarity of financial market regulations within the region, particularly in the area of corporate governance.**

Concluding comment

3.23 Australian banks and financial services companies seeking to establish and expand their operations in China will support the growth and development of China's financial services sector and its economy. It is not a zero-sum game: the participation of Australian banks and financial services providers in China will not reduce opportunities for Chinese financiers. Rather, Australian involvement can provide China with best practice in technology, process and regulation, and insights on how to improve systems of corporate governance, risk management and internal control.

3.24 As China's banking and financial services sectors continue to develop and progressively open to foreign competition, there will be important opportunities for Australia's financial services sector. Australia should not sit back and wait for this to happen. While the delegation commends the AustCham Beijing and Shanghai Financial Services Working Group for its initiatives to date, the Group must continue to identify and communicate the harm of current regulatory restrictions in China, and sell the mutual benefits of future reforms. Multilateral reform efforts will also be

11 Discussion with Australian banks and Macquarie Wealth at the Australian Consulate in Shanghai, 9 May 2013.

12 Department of Foreign Affairs and Trade, *The G20*, http://www.dfat.gov.au/trade/g20/ (accessed 24 June 2013).

important, and Australia is well placed through the G20 process to make strong representations to China and other G20 members.

The Hon. Alan Griffin MP
Delegation Leader

APPENDIX 1

Delegation's meetings

<u>6 May 2013, Beijing, China</u>

Meeting 1: Australian Embassy, Beijing

- Her Excellency Ms Frances Adamson, Ambassador
- Mr Justin Hayhurst, Deputy Head of Mission
- Mr Adam McKissack, Minister-Counsellor, Australian Treasury
- Mr Alan Morrell, Senior Trade Commissioner, Austrade
- Mr Ivan Roberts, Counsellor, Reserve Bank of Australia
- Mr Lachlan Crews, Counsellor (Economic)
- Dr Kylie Brown, Post-Visit Coordinator, Australian Embassy

Meeting 2: Lunch at the Australian Embassy, Beijing

- Her Excellency Ms Frances Adamson, Ambassador
- Mr Adam McKissack, Minister-Counsellor, Australian Treasury
- Mr Alan Morrell, Senior Trade Commissioner, Austrade
- Dr Kylie Brown, Post-Visit Coordinator, Australian Embassy
- Mr Gareth Maguire, Co-Chair, AustCham Financial Services Working Group, Vice President Macquarie Investment (Beijing)
- Mr Tony Zhang, Chief Representative and General Manager, Commonwealth Bank of Australia (Beijing)
- Mr Vincent Lo, Chief Representative and General Manager, National Australia Bank (Beijing)
- Ms Christine Zhou, Deputy General Manager, Westpac Corporation (Beijing)
- Mr Beng Neoh, Head of Asia, AMP Capital (Beijing)

Meeting 3: Macau Hall at the Great Hall of the People, Beijing

- Ms Wu Xiaoling, Vice Chair, Financial and Economic Committee of the National People's Congress
- Mr Justin Hayhurst, Deputy Head of Mission
- Dr Kylie Brown, Post-Visit Coordinator, Australian Embassy

<u>7 May 2013, Beijing</u>

Meeting 1: China-Australia Friendship Group at the National People's Congress

- General Liu Dongdong, Vice Chairman, Foreign Affairs Committee of the 11th National People's Congress
- Mr Justin Hayhurst, Deputy Head of Mission
- Dr Kylie Brown, Post-Visit Coordinator, Australian Embassy

Meeting 2: China Securities Regulatory Commission, Xi Cheng District, Beijing

- Dr Tong Daochi, Director-General, International Department, China Securities Regulatory Commission
- Mr Ou Yang Changqiong, Deputy Director-General, Department of Intermediary Supervision, China Securities Regulatory Commission
- Mr Adam McKissack, Minister-Counsellor, Australian Treasury
- Dr Kylie Brown, Post-Visit Coordinator, Australian Embassy

<u>9 May 2013, Shanghai</u>

Meeting 1: Australian Consulate-General Shanghai, Level 22, Citic Square

- Ms Alice Cawte, Consul-General in Shanghai
- Mr Brent Stewart, Trade Commissioner, Austrade Shanghai

Meeting 2: China Securities Regulatory Commission, Pudong, Shanghai

- Mr Zeng Jifeng, Chief, Information and Research Division, China Securities Regulatory Commission, Shanghai Regulatory Bureau
- Mr Wu Meng, Division Director, General Office, China Securities Regulatory Commission, Shanghai Regulatory Bureau
- Ms Mu Jing, Information and Research Division, China Securities Regulatory Commission, Shanghai Regulatory Bureau

Meeting 3: Consul-General’s Residence, Anfu Road, Shanghai

- Dr Charles Li, China Chief Executive Officer and President, ANZ Shanghai
- Ms Karen Chen, Chief Executive Officer, Commonwealth Bank of Australia, China
- Mr Danny Armstrong, General Manager, China Banking; Country Head, China, National Australia Bank

- Ms Grace Zhou, Deputy Branch Manager, Westpac Bank, Shanghai Branch
- Mr Richard Young, Managing Director, Macquarie Capital, Shanghai
- Mr Michael Wadley, Senior Partner, Ashurst
- Ms Joanne Wood, Chairman, Capital Eight
- Mr Jack Wang, Head of Banking, King & Wood Mallesons
- Mr Peter Markey, China and Mongolia Mining and Metals Leader, Ernst & Young
- Mr Brent Stewart, Trade Commissioner, Austrade, Shanghai

Meeting 4: Financial and Economic Committee, Shanghai Municipal People's Government, People's Avenue

- Mr Pan Zhichun, Director, Financial and Economic Affairs Committee, Shanghai People's Congress

10 May 2013, Shanghai

Meeting 1: China Development Bank, Pudong

- Mr Guo Lian, President, China Development Bank, Shanghai Branch
- Mr Chen Hong, Head, Australian Regional Group, China Development Bank, Shanghai Branch
- Mr Weijun Xu, Director, Planning and Development Department, China Development Bank, Shanghai Branch
- Mr Chen Yu, Deputy Director, International Business Department, China Development Bank, Shanghai Branch

Meeting 2: People's Bank of China, China Shipping Mansion, Pudong Avenue

- Mr Feng Runxiang, Deputy Director, International Department, People's Bank of China, Shanghai

Meeting 3: Lunch with Chinese academic economists, Shanghai IFC Mall

- Professor Pan Jia, School of Economics, Fudan University
- Professor Xu Mingqi, Deputy Director, Institute of World Economy, Shanghai Academy of Social Sciences
- Dr Zha Xiaogang, Research Fellow, Institute for World Economy Studies, Shanghai Institute of International Studies

Meeting 4: Shanghai Stock Exchange, South Pudong Road, Shanghai

- Mr Berton Yan, Global Business Development, Shanghai Stock Exchange
- Mr Lin Sheng, Global Business Development, Shanghai Stock Exchange

Meeting 5: China Banking Regulatory Commission, Shanghai

- Mr Liao Min, Director-General, China Banking Regulatory Commission, Shanghai Branch