23 October 2015

Committee Secretary
Senate Foreign Affairs, Defence and Trade Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

BY EMAIL: fadt.sen@aph.gov.au

Dear Committee Secretary

INQUIRY INTO THE CHINA AUSTRALIA FREE TRADE AGREEMENT IMPLEMENTATION BILLS

The Financial Services Council welcomes the opportunity to make a submission to the Senate Standing Committee on Foreign Affairs, Defence and Trade assist in its inquiry into the China Australia Free Trade Agreement (ChAFTA) Implementation Bills.

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The FSC has over 125 members who are responsible for investing more than $2.5 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

The FSC is a strong supporter of free trade and welcomes the commitments made under the ChAFTA. However, more is required in order to implement the agreement for the services sector. Please find our detailed submission below.

Should you wish to discuss this submission further please do not hesitate to contact me on
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Yours sincerely,

Andrew Bragg
Director of Policy

INTRODUCTION

The FSC is a strong supporter of free trade and in particular the export of Australia's expertise in financial services.

The FSC welcomes the China Australia Free Trade Agreement (ChAFTA), which provides increased access to China's market for Australian financial services firms and represents strong commitments from both parties.

Australia is a nation with open borders. The free trade deals allow Australia to create a level playing field with our trading partners.

The ChAFTA will increase economic growth and trade in Australia and will also have a positive impact on jobs, investment and business opportunities.

It provides Australian fund managers with a significant advantage which is not enjoyed by large competitors such as the United States.

It gives us a first mover advantage, one which we must utilise as soon as possible as China continues to open its market.

Any delay of this agreement would cost Australia jobs and growth.

Deloitte Access Economics estimated that if Australia's exports of funds management alone increased to the levels of Hong Kong, GDP would be $4.2 billion higher per annum by 2029-30[1] and 9,982 jobs (FTE) would be created. This would also result in Commonwealth tax revenue being $1.2 billion per annum higher by 2029-30 and state taxes being $61 billion higher.

This agreement is firmly in our national interest.

ChAFTA builds the architecture we need to compete in the Asian century. We recommend its swift implementation.

This inquiry is reviewing the CHAFTA implementation bills under Customs Amendments. There is no equivalent bill undertaken for the services sector. As such, the agreements are not 'implemented' to be able to be used by financial services firms.

This implementation would include mutual recognition between the Chinese and Australian regulators. This lack of implementation outlines the limited use of previous free trade agreements for financial services.

China Australia Free Trade Agreement

Overall ChAFTA delivers for the financial services sector.

While the technical barriers may not all be overcome by ChAFTA, the coveted 'much favoured nation' clause provides scope to ensure future benefits conferred to other country will automatically flow to the Australian financial services sector.

A financial services committee of each Party will provide regular engagement between Australian and Chinese financial regulators to further strengthen the agreement over time, and any issues can be overcome efficiently.

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[1] Deloitte Access Economics 'The economic impact of increasing Australian funds management exports' May 2014

It is imperative that the Australian committee includes the regulator as well as other government department representatives. Meetings of this committee should begin promptly and continue over time to maintain momentum.

For the financial services industry to take full advantage of the agreement, Australia's domestic policy settings need to be changed. In particular the taxation treatment of foreigner investors into Australian managed funds needs to be competitive with other financial services hubs in the region.

Further, mutual recognition agreements need to be formed between each Party's financial services regulators so that cross border trade can be undertaken by financial services providers. Without these changes the benefits of free trade agreements are limited.

The FSC is advocating for the remaining recommendations of the Johnson Review to be fully implemented to ensure Australia can take advantage of ChAFTA and other free trade agreements.

Australian Financial Services- Domestic Focus

Despite having an end-to-end financial services industry with scale, sophistication and a record of innovation and delivery of quality outcomes to clients, the industry is neither a major source of export income nor is Australia recognised as a major financial centre with export capability.

Less than 5 per cent of total funds under collective management in Australia are sourced from offshore. This compares unfavourably with regional financial centres in our time zone such as in Singapore with 80 per cent and Hong Kong with 60 per cent sourced offshore.

The Asian region is expected to be a significant driver for growth of the global funds management industry in the future. This is due to economic and demographic changes that are occurring in the region:

- Asia's middle class is growing quickly – this will drive demand for funds management as investors look for opportunities to invest and grow wealth;
- Asia's population is ageing rapidly – hence a need for pension and retirement savings products; and
- many countries in the region do not yet have compulsory superannuation contribution systems for workers– again driving a need for individual savings plans.

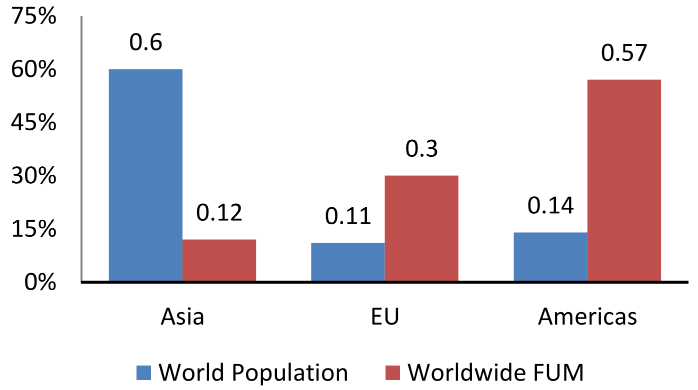
Funds under management (FUM) in the region is currently USD 3.4 trillion – this is only 12 per cent of world wide FUM, despite Asia's population sitting at 4.2 billion or 60 per cent of world's population.

By comparison, the US manages 57 per cent of worldwide FUM but only accounts for 14 per cent of the world's population. Thirty per cent of the world's FUM is managed out of Europe yet it accounts for only 11 per cent of world population (Chart 1).[2]

As such, the Asia region provides a significant opportunity for Australian fund managers. Korea, through its sovereign wealth fund and government pension system provides a specific opportunity.

[2] Source as per footnote 1

Chart 1: Population and Funds under Management – Asia, Europe and the Americas[3]



Benefits of increasing Australia's financial services exports

According to Deloitte[4], increasing exports of funds management services would have notable flow-on effects to the economy, increasing GDP and employment and adding to tax revenue. The increased supply of additional funds from overseas would also lower the cost of capital in Australia which in turn would have a positive impact on economic growth.

Chart 2: Funds under management sourced offshore

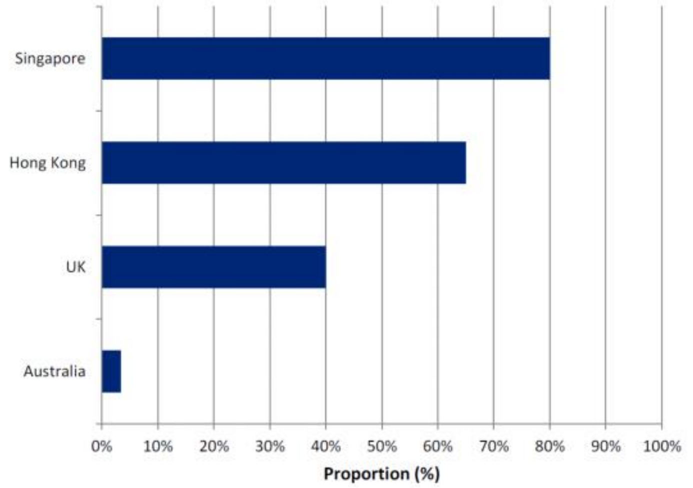


Chart 2 shows the proportion of funds sourced offshore in Singapore, Hong Kong, the UK and Australia and indicates the extent to which Australia's funds management exports lag our competitor markets.

Deloitte's analysis shows that the Australia's financial services industry has a relatively high level of direct value added as a proportion of revenue. This indicates the majority of revenue in the sector goes either to wages or gross operating surplus in the fund management firms themselves and remains in Australia. Including other indirect economic contributions and flow-on effects to other sectors of the economy, 98 per cent of industry revenue is converted to value added to GDP.

Deloitte's modelling shows that a doubling in the value of funds management exports is estimated to lead to GDP being $362 million per annum higher than the baseline case by 2029-30.

[3] Source as per footnote 1
[4] Deloitte Access Economics 'The economic impact of increasing Australian funds management exports' May 2014

If the level of funds management exports in Australia were to grow more rapidly such that they reached levels similar to those currently experienced in Hong Kong, GDP would be $4.2 billion higher per annum by 2029-30[5].

Increasing exports of funds management would also have positive implications for tax revenue for the Australian and state governments. An increase in exports to levels similar to Hong Kong would result in Commonwealth tax revenue being $1.2 billion per annum higher by 2029-30 and state taxes being $61 billion higher.

The potential benefits of increasing financial services exports for Australia are therefore significant. For this to be realised greater access to markets in Asia is one of several steps the government needs to take.

WHY CHINA?

China is the market that Australia's financial services industry wants to access. The IMF now cites China as the largest economy. As of last year China knocked the U.S. of a mantel it has held since 1872.

China is also a nation with a household savings pool of about $US8 trillion and growing.

The predictions are for one billion people to move into the Chinese middle class by 2030 (which will be 70% of the Chinese population).

This growing middle class in China will increasingly want to invest beyond China's borders. But Australia cannot export to this market unless a regulatory structure such as this free trade agreement is in place.

Similarly, Australian fund managers are looking to meet their client demand for exposure to the growth within China. The FTA secures the ability for this exposure.

China is starting from a relatively low base of capability - only 3% of the 145 trillion Renminbi (RMB) Chinese finance sector are assets are held in managed funds.

Australian managers will be able to access this market if the ChAFTA is entered into force, to the huge benefit of our financial services sector and the economy.

CHINA AUSTRALIA FREE TRADE AGREEMENT COMMITMENTS

FSC commissioned ITS Global to undertake a report on the extent to which ChAFTA has benefited the Australian wealth management industry. The following sections are based on ITS Global analysis.

The ChAFTA agreement represents a significant step forward in China's liberalisation of its financial sector and internationalisation of the renminbi (RMB). In addition to the agreement, China announced that an official RMB clearing bank will be established in Sydney. This will further support flows of trade and investment between China and Australia.

[5] Deloitte Access Economics 'The economic impact of increasing Australian funds management exports' May 2014

A key aspect of ChAFTA for the financial services industry, including superannuation funds and fund managers, is that it allows Australian financial institutions to invest RMB in China's onshore securities markets. Australia is one of the few countries who have the ability to do this.

With the growing demand by Australian investors to invest offshore and particularly capitalise on growth markets such as China, this provides Australian fund managers with a significant advantage.

As discussed above, the 'most favoured nation' clause was included in the ChAFTA, meaning Australia is ensured that future benefits conferred to other nations will automatically flow to Australia.

A financial services committee of each Party will provide regular engagement between Chinese and Australian financial regulators that allows issues of mutual interest to be addressed quickly and efficiently.

Like Australia's other FTAs, the benefits of ChAFTA are assessed in broad terms as policy instruments to:

I. Promote open financial services markets in the parties to the FTA;
II. Improve market access for service suppliers and investors;
III. Remove or reduce 'beyond the border' regulatory constraints;
IV. Facilitate recognition of regulatory practices and qualifications of business and practitioners and permit temporary movement of personnel;
V. Align with broader initiatives to increase competition in regional financial markets such as the Asia Region Funds Passport.

REGULATORY INTEGRATION

The ChAFTA is a major step forward, sending a strong message that China and Australia are committed to developing a deeper engagement with each other – economically, politically and socially.

It is imperative that the agreement is implemented by regulators and mutual recognition is achieved. The regulators will need to review the nature and extent of barriers to the industry that still remain from a licencing perspective and proactively engage with each other to explore opportunities for integrated partnership and recognition.

We welcome the commitment of Chinese and Australian regulators to strengthen cooperation and improve mutual understanding of their respective regulatory frameworks. As noted above, China's restrictions on licencing are solely prudential.

Table 3: ChAFTA provisions to promote regulatory integration[6]

Commitment	ChAFTA
Recognition of licensing and qualifications,	In order to better facilitate the temporary entry of workers associated with trade and investment, Australia and China will increase cooperation in the areas of skills recognition and licensing, including through encouraging the streamlining of relevant licensing procedures and improving access to skills assessments.
Institutional framework	A financial services committee of each Party will provide regular engagement between Chinese and Australian financial regulators that allows issues of mutual interest to be addressed quickly and efficiently.

[6] ITS Global Report for FSC on the China Australia Free Trade Agreement

	The Australian authorities responsible for financial services are the Treasury and the Department of Foreign Affairs and Trade and, as necessary, officials from the relevant regulatory authorities including the Australian Prudential Regulation Authority, Reserve Bank of Australia and Australian Securities and Investment Commission. The committee shall consider issues regarding financial services that are referred to it by a Party, including ways for the Parties to incorporate into this Agreement development in their markets for financial services and to cooperate more effectively in the financial services sector.

AUSTRALIA'S DOMESTIC POLICY

Australia has many advantages – including a stable economy, expertise in financial services, a sophisticated market and we are in the Asian time zone.

Australia's advantages in terms of China -

- Australia is the 6th largest offshore Renminbi (RMB) centre;
- our regulators and central banks have strong relationships – RMB clearing facilities will be operated from Sydney;
- China is our number one trading partner; and
- we have a disproportionately large asset management industry – the third largest in the world.

However, our lack of competitiveness in funds management regulation is holding us back. This can be solved.

Opening access for Australian financial services in China or any other market requires Australia's regulatory and tax system to be competitive to facilitate such exports. Without further domestic policy reforms, Australia will not be in a position to take full advantage of ChAFTA.

Mark Johnson provided us a reform blueprint in his 2009 review of 'Australia as a Financial Centre'. Many of his recommendations have not yet been implemented.

The *'Australia as a Financial Centre: Building on our strengths'* report ("Johnson Report") handed down in January 2010 concluded that Australia has arguably the most efficient and competitive financial sector in the Asia-Pacific region and that there are significant opportunities to expand our exports to the region from a very low base. The Report stated:

> "*Australia has arguably the most sophisticated and advanced financial sector in the region. However, while Australia is a very open trading economy overall, our exports and imports of financial services as a percentage of GDP are, by international standards, low. The opportunities for leveraging off our financial services skills and expertise, in the region and beyond, are potentially enormous, and have been fully recognised by the Government.*"

While parts of the Johnson Report have been implemented and others are currently being implemented, many remain outstanding. At the same time competitor economies remain very focused on maintaining their position as leading financial centres in the region. We note the government remains committed to continue working on implementing the Johnson Report's recommendations.

Some progress has been made, including the newly introduced Investment Manager Regime, which will provide taxation certainty to offshore investors.

There is much more to do. The taxation and funds management collective investment regulations must change for Australia to take advantage of ChAFTA and Australia's other free trade agreements.

The three priorities for the Government are:

1. Implement a range of collective investment vehicles – as Australian unit trusts are very unfamiliar to overseas investors;
2. Competitive tax rates - our withholding tax rates are extremely complex and uncompetitive compared with nations such as Singapore; and
3. Multi-currency class funds- this will be imperative for managers to be able to issue Chinese funds in their home currency.

These Johnson recommendations will boost the usefulness of CHAFTA and our competitiveness in general and should be progressed as soon as possible.

CONCLUSION AND RECOMMENDATIONS

FSC is supportive of ChAFTA and the benefits it will bring to Australia's financial services industry and the economy. It is a high quality agreement which has the potential to increase economic growth broadly and increase exports of Australia's largest industry, financial services.

ChAFTA is not an end-point, but rather a base from which to build on. As China continues to push ahead with planned market reforms, ChAFTA will offer a much broader set of opportunities for Australia's financial service providers.

The FSC makes **three** recommendations below to ensure CHAFTA is implemented for the services sector and in particular, the financial services sector:

1. The FSC's long run expectation is that a licensed Australian fund manager must be permitted to access the Chinese market through a mutual recognition arrangement. It is essential that ChAFTA ultimately result in true mutual recognition between Australian and Chinese regulators. A roadmap should be developed on how market access (through licensing and mutual recognition) will be facilitated by the regulators.

2. ASIC should take an active role in this process, including involvement in the financial services committee. We note the commitment of the two regulators to strengthen cooperation and we welcome this.
3. To ensure Australian financial services companies can take the greatest advantage of ChAFTA, the government should complete implementation of the Johnson Review recommendations. For the moment, competitors from other developed financial markets such as the United States, Europe or Japan cannot match this access. This creates a window for Australian businesses to

find a foothold in the home marketplace of the worlds' fastest growing middle class. This includes:

a. A range of collective investment vehicles;
b. Competitive taxation rates; and
c. Multi-currency class funds.