



**Australian Government**

---

**Invest Australia**

---

**Axiss Australia**

**The House of Representatives Standing Committee on Economics,  
Finance and Public Administration**

**Inquiry into the current and future directions of Australia's service  
industries**

**Axiss Australia Submission**

**July 2006**

## **Background**

This paper has been prepared by Axiss Australia for submission to the House of Representative's *Inquiry into the Current and Future Directions of Australia's Service Industries*. Axiss Australia is a division of Invest Australia, the Australian Government's inward investment agency and has a mandate to promote Australia as a global financial services centre in the Asian time zone. The purpose of this submission is to highlight the importance of the Australian financial services industry, and its role in Australia's export and import competing environment.

## **Australia's financial services industry**

The Australian financial sector, while not large relative to global financial centres such as New York and London, is a sophisticated and significant financial market in many respects. It has achieved an importance and international standing in excess of its total size and in some areas represents the largest market in the Asia Pacific region.

Australia's financial services sector makes a significant contribution to the economy, generating A\$60 billion in 2005, a 146% increase since 1985. The financial and insurance sector makes up 7.6 per cent of Australia's real gross added by industry. With an annual growth rate of 5.3 per cent since 1984/85, the performance of the finance and insurance sector reflects the strength of Australia's service-based economy.<sup>1</sup>

In May 2005, there were 374,900 people employed by the Australian financial services industry, more than employed in the finance sectors of Singapore and Hong Kong combined.<sup>2</sup>

The financial services industry is one that has benefited from growth in other sectors of the economy, such as the resources boom. Australia's deep and liquid markets have allowed the industry to develop a range of sophisticated financial products, which in turn will encourage international players into the market, and an increase in the export of financial services from Australia.

Key elements of Australia's financial services industry are as follows:

### Financial Markets

Highly developed and sophisticated financial markets make Australia one of the major centres of capital markets activity in Asia. Annual turnover across Australian financial markets (encompassing both over-the-counter (OTC) and exchange traded markets) increased by 20 per cent to A\$82 trillion in the year to June 2005. The total market turnover in 2004-05 was more than triple that of 1994-95, an indication of the significant of growth in depth and sophistication of Australian financial markets in the last decade.

The Australian foreign exchange (FX) market, measured by turnover, is globally significant. Australia's foreign exchange (FX) market activity has expanded significantly over the past decade, with the Australian dollar (AUD/USD) now the sixth-most actively

---

<sup>1</sup> ABS 5206.0, National Income, Expenditure and Product, March quarter 2005

<sup>2</sup> ABS 6227.0, Education and Work, May 2005

traded currency in the world. In May 2006, the daily average value of turnover in all currencies (AUD and non-AUD) was over A\$210 billion (US\$161 billion), according to the latest data released by the RBA. Turnover in non-AUD transactions rose in value to about A\$120 billion (US\$91 billion) a day, bolstered by an increasing number of firms locating their Asian time zone FX business in Australia.<sup>3</sup>

According to FTSE All-World Review March 2006, Australia's stock market is now the 8th largest in the world and the second largest, in the Asia Pacific (after Japan), in terms of market capitalisation (US\$). To achieve the most accurate and neutral market representation possible, only share capital that is available for public investment is included in the index.

Australia's international securities market is the 13th largest in the world and the largest in the Asia Pacific, according to the latest data released by the Bank for International Settlements (BIS). Australia's total amount outstanding (by residence of issuer) was US\$319 billion in the December quarter 2005, accounting for 2.2 per cent of all international debt markets. The scale of Australia's international debt market is significant. It exceeds the combined market size of Japan (US\$141bn), South Korea (US\$76bn), Hong Kong (US\$51bn) and Singapore (US\$39bn).

#### Investment Funds Asset Pool

The size, sophistication and global significance of Australia's funds management industry is a key attraction for financial services organisations and a key area of potential for increased export of financial services from Australia.

Total consolidated assets under management reached A\$1 trillion (US\$750bn) in the March quarter 2006. Managed fund assets have more than quadrupled since 1991, an annual compound growth rate of 11 per cent. The rapid increase can be attributed to the government-mandated retirement income scheme, and the favourable tax treatment of superannuation.

Superannuation funds dominate the Australian investment funds industry, with a market share of 53 per cent. Total combined assets of superannuation funds, including funds held by Australian life insurance offices, were estimated at A\$730 billion (US\$540bn), or more than 70 per cent of Australian total investment funds.<sup>4</sup>

The continued growth in Australia's pool of investment funds has created strong demand for international funds products, with foreign assets making up 21.5 per cent of the assets held by Australian investment funds, up from 9.7 per cent in 1991.<sup>5</sup> This trend offers further opportunities for global funds management groups looking to use Australia as a hub for the region.

#### Investment Banking

Australia's investment banking industry offers a variety of complex, sophisticated products and services to meet the financing needs of Australian and international companies, fund managers and high net-worth individuals. According to the latest

---

<sup>3</sup> Reserve Bank of Australia; (US\$/A\$ FX rate of 0.7636 at end May 2006)

<sup>4</sup> Reserve Bank of Australia

<sup>5</sup> ABS, Category 5655.0, Managed Funds, Australia; March quarter 2006

estimates of Freeman & Co, Australian banks, companies and partnerships generated about 3.0 per cent of the world's investment banking revenue.<sup>6</sup> In the Asia-Pacific region this equals one fifth of investment banking revenue, making Australia the second largest market after Japan.

Total revenue earned by the industry from traditional investment banking activities for 2005 is estimated to be more than \$US1.9 billion and has grown over the last five years by 102 per cent with a compounded annual growth rate of 19 per cent.

### Venture Capital and Private Equity

Australia's private equity and venture capital industry has grown strongly in recent years. This growth has been driven by demand from emerging and expanding businesses for equity funding and the increasing availability of institutional funding for investment.

Australia is the top destination for private equity funds invested in the Asia-Pacific region, accounting for 28 per cent (US\$618.5m) of funds invested in the region.

As at 30 June 2005, investors had A\$11.2 billion committed to venture capital investment vehicles, an increase of 25 per cent on the previous year.

### Hedge Funds

Australia is now the largest centre for hedge funds in Asia Pacific and the industry is growing at a rapid pace.

Australian hedge fund managers now directly control \$A23.41 billion (\$US17.10 bn) in assets, more than half of the total of key regional centres – \$A45.29 billion (\$US33.08 bn). When Australia's hedge fund of fund sector is included, the figure jumps even further to \$A35.35 billion (\$US27 bn).

Australia's 55 hedge fund managers also offer the largest range of products with a total of 111 funds, compared to 98 in Hong Kong, 63 in Japan and 62 in Singapore.

### Custody and Administration

As one of the most sophisticated funds management centres in the Asia-Pacific, Australia has become a major regional hub for global custodians.

Australia is an established market place for outsourcing custody and investment administration services. According to statistics published by the Australian Custodian Services Association (ACSA), total assets under administration stood at A\$1,026.9 billion as at December 2005.

The industry employs over 2,500 people and the market is comprised of over 15 custodians, 6 of which are global custodians.

---

<sup>6</sup> Revenue from Equity Capital Market, Debt Capital Market, Merger and Acquisitions, and Syndicated Loans

## Retail Banking

In February 2006, there were 53 authorised banks in Australia with total domestic assets of A\$1,402 billion (US\$1,035bn). Of these, 40 were foreign-owned. Retail banking is dominated by four major domestic banks, Commonwealth Bank of Australia, National Australia Bank, Westpac Banking Corporation, and ANZ Banking Group.

Together, these four banks have about A\$943 billion (US\$696 billion) of assets on their domestic books - accounting for about two thirds of totals assets of the Australian banking systems. In its March 2006 *Financial Stability Review*, the Reserve Bank of Australia said that the four major banks are reasonably large by international standards. By market capitalisation, all rank in the top 50 and in terms of consolidated group asset, all are among the top 80 globally.

There are also 39 foreign-owned banks operating in Australia. Having entered the market following the deregulation of the banking sector in the early 1980s, their focus for much of the 1990s was on wholesale business. More recently, a number of foreign banks (including ING, Citibank, HSBC and HBOS) have built up sizeable retail businesses, partly through being among the first to offer attractive deposit rates on internet-based savings accounts. Overall, foreign-owned financial institutions have recently come to recognise the opportunities available in the local marketplace and the advantages of using Australia as a base for expanding their Asian operations.

## Insurance

Australia's insurance market is the 12th largest in the world. Within the Asia-Pacific region it is the fourth largest, behind Japan, Korea and China. Australia's mature, innovative and well-regulated insurance industry, together with its strong legal, accounting, education, human resource and IT capacities underpins Australia's financial services industry – and strengthens its position as a financial services hub in the region.

Premium income from Australia was estimated to be US\$49.4 billion in 2004, an increase of almost 50 per cent since 1996. Premium income in Australia grew, on average, 5.9 per cent per annum from 1996 to 2004 (in local currency terms) or 5.7 per cent (in US\$). By comparison the average growth rate (in US\$), in the same period, was 4.9 per cent for the G7 countries.

## **Export of Financial Services**

Based on the available statistics from the Australian Bureau of Statistics, export of financial services from Australia is negligible. In the March quarter 2006, insurance and financial services exports totalled A\$427 million (A\$176 for insurance services and A\$251 for financial services), or 4.3 per cent of total services exports.<sup>7</sup>

This figure emphasises the fact that Australia's financial services industry continues to be dominated by its large domestic market, but may also indicate some discrepancies between data collection systems and actual business volumes. There is considerable anecdotal evidence that financial services exports are at a level higher than indicated by the ABS statistics.

---

<sup>7</sup> ABS, International Trade in Goods and Services, 5368.0, May 2006

## **Government Policies Facilitating the Export of Financial Services**

There are a number of Australia Government policies that have recently been put in place to remove impediments that could inhibit Australia's role as a global financial services centre in the region. In particular, the policies aim to reduce impediments that may prevent Australian financial services providers successfully competing for the business of non-residents.

### **International Tax Arrangements**

As part of the Review of Australia's International Tax Arrangements (RITA) conducted in 2003, a number of changes to Australia's international taxation arrangements have been made, or are proposed to be made. Some of these changes were of particular interest to Australia's financial services industry, as they are designed to maintain Australia's competitiveness in a global economy, cut tax compliance costs, stimulate business efficiency and enhance Australia's attractiveness as a funds management hub for the Asia-Pacific region. Particular reforms of significance to the export of financial services are:

#### Capital Gains Tax (CGT)

Changes to Australia's Capital Gains Tax (CGT) arrangements are contained in the New International Tax Arrangements (Managed Funds and Other Measures) Bill 2004, which received Royal Assent on 21 March 2005.

The capital gains tax reforms exempt non-residents from Australian CGT when investing in foreign assets via an Australian managed fund; and certain Australian assets via an Australian managed fund (in those cases where CGT would not be imposed if the assets were held directly).

### **Axiss Australia**

The Australian Government established Axiss Australia in 1999 to position Australia as a global financial services centre in the Asian time zone. Axiss Australia was part of the Department of the Treasury until July 2003, when the organisation merged with Invest Australia, a division of the Department of Industry, Tourism and Resources.

Axiss assists financial services companies who are considering establishing or expanding their activities in Australia, provides advice to Government on policy, regulatory and market structure issues, and acts as a conduit between the private and public sectors on matters affecting Australia's development as a global financial services centre.

Axiss also acts as a one-stop reference point for information on Australia's financial services industry, researching and compiling data and publishing benchmark studies on key business location determinants such as workforce, infrastructure and regulation.

## **Australia as a Global Financial Services Centre**

In order for Australia's financial services market to continue to attract and cater to international business, it is important for the country to leverage its key advantages as a financial services centre for the region. The challenge for Australia is to grow its financial services exports, while supporting the continued growth of the domestic market.

Australia's role as a global financial services centre in the Asia-Pacific region is one that the Australian Government has supported through the establishment and continued funding of Axiss Australia.

A global financial centre is characterised by cost effective, innovative and sophisticated financial services provided to both domestic and offshore clients in areas such as banking, insurance, foreign exchange, commodities, equities and funds management by a wide range of financial service providers. These services are supported by a high standard of information technology; accounting and legal support arrangements as well as secure and efficient custodial, clearance and settlements systems.

Australia's role as a global financial centre in the Asia-Pacific region is of benefit not only to the financial services sector, but also other related sectors including accounting, information technology and legal services and, indeed, the economy more generally through employment and other effects. More broadly, Australian industry benefits from reductions in the cost of financing capital as a result of greater financial market liquidity, market depth, greater competition and operational efficiencies.

## **Australia's Advantages as a Global Financial Services Centre**

Australian financial markets are likely to continue to deepen and expand. In addition to the support provided by a strongly performing economy and sound policy framework, the following factors are relevant:

- **Sophisticated financial markets** – The Australian financial services markets offer an exceptionally high standard of transparency, security and service within the Asia-Pacific region across a wide range of sophisticated products including equities, bonds, synthetics and managed funds.
- **World-class telecommunications and information technology markets and infrastructure** – Australia's sophisticated telecommunications and IT industries are of great importance to its role as a financial services hub for the region. Information technology is a key driver for international companies making location decisions.
- **A low cost, highly skilled and multilingual workforce** – Australia's well-priced, skilled and multi-lingual workforce is key to its position as a financial services centre in the region. In order for Australia to continue to compete with other centres, the country must continue to attract and retain highly skilled personnel. It is important that government policies support the continued expansion of this highly skilled workforce. In particular, Australia must recognise and develop areas of particular expertise within the industry. Axiss Australia is currently undertaking research into Australia's workforce strengths, but reliable statistical information in this area is difficult to obtain.
- **Democratic and stable environment** - Australia offers a secure business environment with a stable political system, strong economic performance and world class prudential and regulatory policy framework. Australia's government and regulatory institutions must continue to offer financial services providers a reliable, transparent and internationally competitive environment.

- **Strategic time zone** – Australia’s position within the Asia-Pacific time zone allows Asian markets to be serviced quickly and cost-effectively. Australia spans the close of business in the United States and the opening of Europe’s trading day.
- **Quality of life** - Australia is the number one place in the world where expatriate staff want to live and work, according to the Economist Intelligence Unit. Australia’s cost of living is significantly lower than that of many other countries, including the United States, China, Hong Kong, Singapore and Canada.