The Parliament of the Commonwealth of Australia

THE OPPORTUNITIES AND CONSTRAINTS FOR AUSTRALIA TO BECOME A CENTRE FOR THE PROVISION OF GLOBAL FINANCIAL SERVICES

SENATE SELECT COMMITTEE ON

SUPERANNUATION AND FINANCIAL SERVICES

March 2001

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Secretariat

Secretary	Sue Morton
Principal Research Officer	Robyn Hardy (Inquiry Officer to 12/9/00)
A/Principal Research Officer	Loes Baker (Inquiry Officer from 12/9/00)
Executive Assistant	Jade Ricza

Address: Senate Select Committee on Superannuation and Financial Services
Parliament House
CANBERRA ACT 2600

Telephone: (02) 6277 3458
Facsimile: (02) 6277 3130
Email: super.sen@aph.gov.au
Internet: http://www.aph.gov.au/senate/committee/superfinan_ctte/index.htm

TERMS OF REFERENCE

On 22 September 1999 the Senate resolved that:

(1) A Select Committee on Superannuation and Financial Services be appointed with effect on and from 11 October 1999, with the same functions and powers as the Select Committee on Superannuation appointed by resolution of the Senate on 5 June 1991, and reappointed on 13 May 1993 and 29 May 1996, except as otherwise provided in this resolution.

(2) The committee inquire into matters pertaining to superannuation and financial services referred to it by the Senate and inquire initially into:

(a) prudential supervision and consumer protection for superannuation, banking and financial services;

(b) the opportunities and constraints for Australia to become a centre for the provision of global financial services; and

(c) enforcement of the Superannuation Guarantee Charge;

and report on paragraphs (a), (b) and (c) by the last day of sitting in June 2000.*

(3) The committee have power to consider and use for its purposes the minutes of evidence and records of the Select Committee on Superannuation appointed in the previous three Parliaments.

(4) The committee consist of seven senators, three nominated by the Leader of the Government in the Senate, two nominated by the Leader of the Opposition in the Senate and one nominated by other parties or independent senators.

(5) The nomination of the final member to be determined by agreement between the other parties and independent senators and, in the absence of agreement, duly notified to the President, the question of representation on the committee of other parties or independent senators be determined by the Senate.

(6) The Senate, by subsequent resolution, appoint a member of the committee as its chair.

*On 8 June 2000 the Senate granted an extension of time in which to report to 7 December. On 6 November 2000, the Senate granted a further extension of time in which to report to 15 March 2001. On 6 March the Senate granted a further extension of time in which to report to 24 May 2001.

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PREFACE

This is the first report of the Senate Select Committee on Superannuation and Financial Services to examine issues in the broader area of financial services, rather than examining issues associated specifically with superannuation. Coming to grips with this broader role has been a challenging experience. For this reason the Committee was deeply appreciative of the time given and the effort made by those, particularly in the industry, who contributed their views and shared their experiences with the Committee during the inquiry. Their evidence contributed greatly to the Committee's understanding of the complex issues associated with the provision of global financial services.

The increasing trend towards globalisation has created a climate in which there are many challenges and opportunities. Although Australia is a medium-sized player in the international marketplace, we have already achieved a degree of significance and international standing that is in excess of our size. Building on this, the Australian Government has made a commitment to promote Australia as a centre for global financial services and has established Axiss Australia to do this.

Australia has many advantages of a social, political, economic and geographic nature which enhance its credentials to become a global financial services centre. We need to overcome outdated perceptions of Australia and promote these advantages in more innovative ways.

Located as a gateway to the Asia–Pacific region, we are well placed to take advantage of the many opportunities which exist to provide services to meet niche market demands, especially at the value-added end of the financial services market.

To this end, the Committee has made recommendations aimed at promoting Australia's competitive advantages, maximising the opportunities for Australia to become a centre for the provision of global financial services, improving the efficiency with which Australian financial services can be delivered and so improving Australia's potential to become a global financial services centre.

I thank my colleagues on the Committee for their hard work during the inquiry. I also record my appreciation to the Secretariat for its involvement in what has proved to be a most interesting inquiry.

I commend the report to the Senate.

Senator John Watson

Committee Chair

GLOSSARY

ACCC	Australian Competition & Consumer Commission
ACGF	Australian Centre for Global Finance
AFMA	Australian Financial Markets Association
AFSTA	Australian Financial Services Training Alliance
ANTS	A New Tax System
ANU	Australian National University
APEC	Asia Pacific Economic Cooperation
APRA	Australian Prudential Regulation Authority
ASC	Australian Securities Commission
ASEAN	Association of South East Asian Nations
ASIC	Australian Securities & Investments Commission
ASMUG	Australian Securities Market User Group
ASX	Australian Stock Exchange
ATMs	Automatic Teller Machines
ATO	Australian Taxation Office
BAD	Bank Account Debits (Commonwealth tax)
BHP	Broken Hill Proprietary Company Ltd
CBD	Central business district
CEO	Chief Executive Officer
CER	Closer Economic Relations (Australia & New Zealand)
CGFS	Centre for Global Financial Services
CHESS	Clearing House Electronic Subregister System
CIV	Collective Investment Vehicle
CLERP	Corporate Law Economic Reform Program
DETYA	Department of Education, Training &Youth Affairs
DCITA	Department of Communications, Information Technology & the Arts
DDDA	Dublin Docklands Development Authority
E2B	Education to business portal
EC	European Commission/Community
EEC	European Economic Community
EFTPOS	Electronic Funds Transfer/Point of Sale
ESCB	European System of Central Banks
EU	European Union
EURO	Single European currency unit
FID	Financial Institutions Duty (State tax)
FIF	Foreign Investment Funds
FSR	Financial Services Reform (Bill)

GATT	General Agreement on Trade & Tariffs
GDP	Gross Domestic Product
GST	Goods & Services Tax
HKEx	Hong Kong Exchanges & Clearing Limited
IBSA	International Banks & Securities Association of Australia
ICT	Information & Communications Technology
IDA	Industry Development Authority
IFMS	Integrated Facility Management Services
IFSA	Investment & Financial Services Association
IFSC	International Financial Services Centre (Dublin, Ireland)
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IPOs	Japanese Initial Public Offer(ing)s—ie new stocks
ISC	Insurance & Superannuation Commission
IT	Information Technology
IT&T	Information Technology & Telecommunications
LIC	Listed Investment Company
NAFTA	North American Free Trade Agreement
NASDAQ	National Association of Security Dealers
NOIE	National Office for the Information Economy
OBU	Offshore Banking Unit
OECD	Organisation for Economic Cooperation & Development
PAYG	Pay as you go
RBA	Reserve Bank of Australia
RITS	Reserve Bank Information & Transfer System
RTGS	Real Time Gross Settlement System
SEHK	Stock Exchange of Hong Kong
SFE	Sydney Futures Exchange
SG	Superannuation Guarantee
SIRCA	Securities Industry Research Centre of the Asia Pacific
SRA	Single Regulatory Authority
UK	United Kingdom
UN	United Nations
US	United States of America
WTO	World Trade Organisations

EXECUTIVE SUMMARY

Globalisation

1. The Committee notes that globalisation has created a climate in which there are many challenges and opportunities. Driven by the increased interdependence of national economies, the liberalisation of domestic and international markets and continuing innovation in information technology, the financial services sector has been in the vanguard of the trend to globalisation of services. Financial centres in Europe, the Americas and the Asia–Pacific region have been adjusting to this trend by seeking strategic alliances in an effort to take a greater share of the world financial services business.

Australia's place in the international marketplace

2. The Committee also notes that, relative to the major international financial centres, Australia is a medium-sized player in the international marketplace. However, while Australia's financial sector does not have the mass of other major financial markets, it has depth, sophistication and liquidity, which has enabled Australia to achieve significance and international standing that is in excess of its total size.

Establishment of Axiss Australia

3. Within this context, the Australian Government has made a commitment to promote Australia as a centre for global financial services and allocated $7 million over two years to the project. Originally established in August 1999 as the Australian Centre for Global Finance, Axiss Australia (as it is now known) aims to enhance Australia's position as a global financial centre and so capture a greater share of the world's financial services business, particularly in the Asia–Pacific region.

Australia's competitive advantages

4. The Committee considers that Australia has many advantages of a social, political, economic and geographic nature which enhance its credentials to become a global financial services centre. Although there are differing views as to their relative advantages, these include:

   - a stable, growing economy with sophisticated financial markets and well-developed financial regulatory systems;
   - a diverse and well educated workforce;
   - time-zones that enable us to access not only markets in the Asia–Pacific region, but also markets in North America and Europe;
   - cost competitive lifestyle and operational costs;
   - a unique natural environment; and

- a commitment by Government to promoting Australia as a centre for the provision of global financial services.

5. The Committee sees potential for more integrated and wide-ranging promotional approaches to raise Australia's profile and advertise Australia's attractiveness as a place for investment. For this reason the Committee has made a recommendation that Axiss Australia continue to investigate innovative ways of promoting Australia's competitive advantages.

Australia's financial and regulatory framework

6. The Committee notes that Australia's financial and regulatory regime has undergone a period of deregulation, reform and review over the last two decades, with major changes to the regulatory framework and taxation regimes arising from the implementation of the Wallis reforms of Australian financial systems, the introduction of a new tax system, a further review of the taxation of business lines and a continuation of the ongoing review of Corporations Law.

7. The Committee notes that the Australian Government maintains that this comprehensive and ongoing program of restructuring and reform is making the Australian financial sector more competitive in the international marketplace. The Committee also notes that the Government believes that taxation reforms are a key component in engineering the success of the global financial services centre initiative.

8. However, as discussed below, the Committee considers that aspects of Australia's taxation regime, regulatory regime and some corporations law issues are actually constraining Australia's efforts to become a centre for the provision of global financial services.

Opportunities for Australia to become a global financial services centre

9. Although Australia has already achieved some recognition as a centre of world financial activity, the Committee considers that there are significant opportunities for Australia to strengthen its position as a global financial services centre. In particular, the Committee considers that positioning Australia as the financial gateway to the Asia–Pacific region can assist in the realisation of Australia's global financial services ambitions. The challenge is to ensure that in pursuing the 'gateway' objective Australia does not become just a branch office for multinational companies to channel their more productive investment into Asia.

10. To avoid this, the Committee considers that the Government should exploit opportunities existing in a number of other areas, especially by:

    - building on the range of opportunities arising from Australia's strong credentials in education and professional training to build expertise and innovation among professionals and educators as well as to export skills and financial expertise;
    - building on Australia's cultural diversity and linguistic skills, especially in Asian languages;

- sharing in the opportunities to provide backroom services in funds administration, investment management and information processing;
- promoting and making effective use of developments in e-commerce and telecommunications technologies; and
- taking advantage of Australia's competitive edge in the emerging areas of carbon and electricity trading.

11. The Committee notes that a theme underpinning the evidence to the inquiry was that, to ensure benefits arise, the Australian Government and the finance industry need to be responsive to evolving opportunities in the market place, particularly to developments in the Asia–Pacific region, and that activity should be directed at promoting development at the value-added end of the financial services market—in funds management, venture capital, and research and education.

12. The Committee has made some general recommendations designed to maximise the opportunities for Australia to become a centre for the provision of global financial services.

Addressing the constraints

13. A number of constraints hampering Australia’s goal to become a global financial services centre were drawn to the Committee’s attention during the course of the inquiry. These constraints primarily related to taxation matters, Australia's regulatory regime, some corporations law issues and the treatment of expatriate staff.

14. The Committee acknowledges that, for many in the industry, the constraints have been real and have hindered opportunities for investment and growth. Nevertheless, the Committee also notes that a number of the reported constraints appear to be more perceived than real, as many evolved out of a need to clarify uncertainties in the various regimes.

15. The Committee considers that Australia’s success depends on having an internationally competitive tax system and that there is an urgent need for Government to work towards this goal. Equally urgent is the need to ensure that Australia's regulatory framework is not overly burdensome and is responsive to developments underpinning the internationalisation of the market place, such as those in the telecommunications area. Uncertainties associated with Corporations Law must also be resolved if Australia’s attraction as a growth base for international and local businesses is to be consolidated.

16. In this regard, the Committee considers that problems arising from present arrangements for expatriate staff must also be addressed. Australia cannot afford to lose opportunities to be gained by welcoming foreign expertise to Australia, and by showcasing Australian expertise overseas.

17. The Committee accepts that there is a dilemma to be faced, in terms of balancing domestic policy with international ambitions, but with determination on the part of regulatory policy makers, working in conjunction with industry, the Committee considers that the constraints identified can be minimised, so that Australia can enhance its performance as a provider of global financial services.

Other issues

18. There are a number of other important factors or challenges which must be addressed if Australia is to achieve its goal of becoming a centre for the provision of global financial services. While Australia's physical location is seen by some to be a disadvantage, the Committee considers that there is scope for technology, and opportunities for person-to-person contact, especially in the Asia–Pacific region, to assist in overcoming this perceived disadvantage.

19. Similarly, while it is acknowledged that the size and scale of Australia's market has some limitations, the Committee considers that this can be overcome to some degree by the formation of strategic alliances, so long as those alliances enable Australia to maintain its financial system integrity and national sovereignty.

20. The Committee notes the calls for the rationalisation of clearing houses in Australia, in order to overcome the confusion surrounding the current arrangements. The Committee considers that there is scope to improve the efficiency with which services are delivered by consolidating and rationalising current players.

21. The Committee also notes calls for the rationalisation of industry representative bodies, as having too many points of contact between industry and government has not been conducive to efficient and effective policy development and implementation. While it is beyond the scope of the Committee's authority to require industry to consider these calls, the Committee would look favourably on any effort made by industry to rationalise industry representative bodies and has made a recommendation aimed at improving the efficiency with which Australian financial services can be delivered.

Improving Australia's potential as a global financial services centre

22. In the Committee's view, Australia has considerable competitive advantages which provide the country with a great opportunity to enhance its position as a global financial services centre. Gaining leverage from its advantages, Australia also has many opportunities to achieve this goal. Notwithstanding that there are a number of constraints and other issues to be addressed, the Committee considers that there are a number of other areas Australia could focus on to improve its attraction as a global financial services centre.

23. The Committee notes the calls for a **streamlined access point** for companies and others seeking to enter the Australian financial services market. In the view of the Committee, streamlining the access point can only enhance Australia's reputation as a country where a cohesive effort by the governments, regulators, and service providers facilitates entry to Australian markets.

24. The Committee also recognises the need to **brand Australia's financial services centre,** clarify its role and promote its identity. The Committee suggests that this is an area in which Axiss Australia must work more closely and vigorously with industry, so that the branding of the centre is achieved prior to the centre's activities being passed on to industry. The Committee is also aware that the branding issue will have to be kept under review by industry if niche opportunities for more than one city emerge.

25. The Committee notes that there are a number of Government initiatives in the area of Asian education and training. Nevertheless the Committee sees considerable merit in the Government **reaffirming Australia's commitment to Asia.**

26. The Committee notes the calls for Australia to form **strategic alliances** with other stockmarkets to give much needed mass to the Australian financial sector. However, the Committee urges caution with this approach in order to ensure that any strategic alliances are not achieved at the expense of Australia's financial system integrity and national sovereignty.

27. The Committee notes that other issues associated with giving mass to the Australian market and building international ties, are to be considered as part of the Government's comprehensive review of foreign source income rules and international taxation, as agreed in its response to the Ralph Review.

28. The Committee acknowledges that Australia already has a highly skilled workforce, but the challenge is to **ensure the supply of an educated workforce** continues to meet current as well as future needs. The Committee regards it as imperative to identify the skills required, develop a comprehensive education and training strategy and develop programs accordingly. Recognising that this requires programs to meet both global and local needs, the Committee considers that this is an area requiring extensive consultation with a range of educational bodies.

29. The Committee notes that Australia is suffering from a severe skills shortage in the IT industry, estimated to be around 30 000 jobs. The Morgan & Banks Job Index recently found that 47.8 per cent of companies reported that they were experiencing a major shortage of IT workers. The Committee is aware that, with the slow-down of the US economy, as evidenced by the severe downturn in the NASDAQ, there has been an impact on the IT industry, especially in Silicon Valley. The Committee considers that there may be opportunities for progressive Australian companies to begin selective recruitment campaigns in Silicon Valley to alleviate the IT shortage in Australia.

30. The Committee identified the difficulties it faced in obtaining appropriate **performance information** in relation to certain aspects which are essential to understand if we are to develop as a global financial services centre

31. The Committee regards it as imperative to **conduct appropriate research** in order to ascertain such critically important information as the reasons companies and other financial service providers come into and leave Australia and the reasons expatriates come into and leave Australia. The Committee notes that Axiss Australia is already doing some work in this area, but it does not appear to be sufficiently robust to advise Government.

32. The Committee is particularly concerned that Axiss should adopt a rigorous and systematic approach to investigate how Australia's taxation and regulatory regimes affect international competitiveness. This should complement the Government's commitment to conduct a comprehensive review of foreign source income rules and international taxation, but need not concentrate solely on those matters.

33. The Committee is also concerned to discover that Axiss Australia does not have indicators in place by which it can measure its performance in promoting the objective of

Australia as a global financial services centre. The Government has allocated some $7 million to the project, and has the right to be assured that the outputs of the centre and its contribution to outcomes can be demonstrated. The Committee recognises the difficulties associated with this task, and that some aspects of performance are likely to be beyond the control of Axiss. However, the Committee regards it as imperative for such performance measures to be in place to provide a guide to the success or otherwise of the centre.

34. To address these issues, the Committee has made a number of specific recommendations designed to improve Australia's potential as a global financial services centre.

RECOMMENDATIONS

Recommendation 1—Chapter 3, para. 3.64

The Committee recommends that Axiss Australia continue to investigate innovative ways of promoting Australia's competitive advantages to overseas investors and businesses by integrating messages about lifestyle and cultural advantages with financial and economic advantages.

Recommendation 2—Chapter 5, para. 5.69

The Committee recommends that Government and industry continue to monitor Australia's potential to develop niche markets in the Asia–Pacific region and work together to identify educational, IT and other initiatives which will generate opportunities for Australia and enhance Australia's reputation in the global financial services industry.

Recommendation 3—Chapter 5, para. 5.71

The Committee recommends that to support the global financial centre initiative a 'whole of government' approach should be adopted to promote development at the value-added end of the financial services market to maximise opportunities and build wealth for all Australians.

Recommendation 4—Chapter 6, para. 6.60

The Committee recommends that, in order to ensure that Australia has a competitive taxation regime, the Treasurer refer the taxation issues raised during the inquiry to the Board of Taxation for review and advice, and to take action as appropriate.

Recommendation 5—Chapter 6, para. 6.138

The Committee recommends that the Treasurer review the superannuation arrangements for expatriate staff, in order to ascertain whether:

a) Superannuation Guarantee arrangements can be streamlined; and

b) portability of funds for expatriate employees leaving the country could be effected more expeditiously through the present process of establishing bilateral agreements or through other, or interim measures.

Recommendation 6—Chapter 6, para. 6.139

The Committee recommends that the Board of Taxation review the arrangements for the taxation of salaries and remuneration for expatriate staff employed to work for varying periods of time in Australia and, within the limits and guides of the various international treaties, advise the Treasurer on whether or not:

a) **the systems or regimes are onerous or complicated making compliance by companies difficult;**

b) **the systems or regimes are fair with respect to the levels of taxation required;**

c) **the systems or regimes are sufficiently attractive so as to not unduly deter prospective employees from coming to Australia; and**

d) **the current system of electing to defer tax to the time of ultimate realisation of assets is fair and equitable.**

Recommendation 7—Chapter 6, para. 6.140

The Committee recommends that the Treasurer review the entitlements of expatriate staff to Medicare and consider ways to streamline the exemptions requirements.

Recommendation 8—Chapter 7, para. 7.45

The Committee recommends that the Government support and encourage industry groups to look at ways in which the Australian financial services industry can become more competitive and cost effective, including through consolidation and rationalisation of processes and activities within the industry.

Recommendation 9—Chapter 8, para. 8.42

The Committee recommends that the Commonwealth Government work with State Governments, regulators and service providers to provide a one-stop shop to streamline access to Australia for companies and others seeking to enter the Australian financial services market.

Recommendation 10—Chapter 8, para. 8.45

The Committee recommends that the Government make a statement which reaffirms Australia's commitment to Asia.

Recommendation 11—Chapter 8, para. 8.51

The Committee recommends that Axiss Australia work with the Department of Education, Training and Youth Affairs and other educational bodies to:

a) **consider the development of mechanisms for educating primary and secondary students about financial matters, including through IT initiatives;**

b) **develop a coordinated strategy to build and promote study of financial services skills along with Asian language and cultural studies in the tertiary sector, and within the Australian financial services industry; and**

c) **consider ways in which to foster and promote existing developments in financial services accreditation, education and training overseas.**

Recommendation 12—Chapter 8, para. 8.52

The Committee also recommends that, to enhance international recognition of Australia's status as a 'gateway' to the Asia–Pacific region, the Government should continue to consolidate Australia's reputation by forging productive engagement between Australian institutions and organisations and those in the region, through regional organisations such as APEC and bilaterally.

Recommendation 13—Chapter 8, para. 8.56

The Committee recommends that Axiss Australia develop and conduct an on-going research project so as to provide advice to Government on:

a) the reasons companies and other financial service providers come into and leave Australia; and

b) the reasons expatriate staff come to and leave Australia.

Recommendation 14—Chapter 8, para. 8.58

The Committee recommends that Axiss Australia, as a matter of priority, develop some meaningful indicators by which it can measure its performance in delivering the outcome of promoting Australia as a global financial services centre.

CHAPTER 1

INTRODUCTION

Background to the inquiry

1.1 On 22 September 1999, after considerable debate concerning the terms of reference, the Senate agreed to establish the Select Committee on Superannuation and Financial Services with effect on and from 11 October 1999. The Committee was given the same functions and powers as the previous select committees on superannuation, except that some further inquiry functions were added in relation to the financial services sector.

1.2 The Committee's terms of reference included inquiring into matters pertaining to superannuation and financial services referred to it by the Senate and, initially, inquiring into:

(a) prudential supervision and consumer protection for superannuation, banking and financial services;

(b) the opportunities and constraints for Australia to become a centre for the provision of global financial services; and

(c) enforcement of the Superannuation Guarantee Charge.

1.3 This report relates to term of reference (b). The Committee will report separately on the remaining terms of reference.

1.4 The Committee was originally required to report by the last sitting day in June 2000. However, because the Senate has also required the Committee to report on a large number of bills during this period, it has been unable to meet this deadline. On 8 June the Committee sought and was granted an extension of time in which to report to 7 December 2000. On 6 November the Committee sought and was granted an additional extension of time in which to report to 15 March 2001. On 6 March the Committee sought and was granted an additional extension of time in which to report to 24 May 2001.

Conduct of the inquiry

1.5 The three terms of reference for the inquiry were advertised in the *Australian* and the *Australian Financial Review* on 26 October 1999 and again on 25 and 28 February 2000, inviting submissions from interested organisations and individuals. A number of organisations were also contacted directly seeking submissions.

1.6 The Committee received submissions from a number of organisations and individuals on various aspects of the three terms of reference. Some organisations commented on more than one of the three references, whilst others commented only on the reference relating to the opportunities and constraints for Australia to become a centre for the provision of global financial services.

1.7 Including those submissions which addressed more than one of the terms of reference, the Committee received 38 submissions in relation to term of reference (b). A list of these submissions is at **Appendix 1**. Details of the submissions received in relation to the other terms of reference will be listed in a separate report.

1.8 The Committee conducted the inquiry into the three terms of reference concurrently, holding nine public hearings in the period May to October 2000. Although some issues relating to term of reference (b) were raised at nearly all of the hearings, three of the hearings were principally focused on the global financial services centre issue. These were the hearings conducted in Sydney, Melbourne and Canberra on Tuesday 16 May 2000; Friday 9 June 2000; and, Friday 14 July 2000 respectively. Details of all witnesses who gave evidence at the various public hearings is at **Appendix 2**. A list of all tabled documents and exhibits is at **Appendix 3**. As mentioned above, finalising the report has been delayed due to the extraordinarily high number of bills which the Senate required the Committee to report on.

1.9 In conducting the inquiry, the Committee was mindful of other parliamentary committee inquiries which were being conducted at the same time and which had some bearing on the Committee's inquiry. For example, the Joint Statutory Committee on Corporations and Securities conducted an inquiry into the Draft Financial Services Reform Bill; the House of Representatives Standing Committee on Economics, Finance and Public Administration conducted an inquiry into the international financial market effects on government policy and its Standing Committee on Employment, Education and Workplace Relations inquired into employee share ownership in Australian enterprises. Meanwhile, the Senate Select Committee on Information Technologies conducted an inquiry into e-privacy. Wherever possible the Committee sought to minimise duplication where there were issues in common.

Structure of the report

1.10 *Chapter Two* provides some background to the establishment of the Australian centre for global finance. It briefly describes the evolution of the global economy within which Australia must operate and defines what constitutes financial services within that market place. As a point of comparison to Australia's aspirations, the chapter then builds a model of a competitive financial services centre, based on features identified by industry players, and looks at some functioning world centres in both the northern and southern hemispheres. A case study of the Irish Financial Services Centre is at **Appendix 4.**

1.11 *Chapter Three* surveys the size and features of Australia's financial services sector relative to those in other economies in order to establish Australia's present, and potential, position within the global economy. The chapter then considers other attributes—social, political, economic and geographic—which inquiry evidence suggests are competitive advantages for Australia in realising its objectives. A breakdown of the relative competitiveness of individual markets within the Australian financial sector is at **Appendix 5.**

1.12 *Chapter Four* outlines the characteristics of Australia's financial regulatory regime. It traces the legislative path of reform which has structured Australia's financial marketplace and the regulatory framework which oversees it. **Appendix 6** provides background to this chapter by describing the responsibilities of each of the principal players within Australia's regulatory regime.

1.13 *Chapter Five* reports the opportunities that Australia can exploit in its bid to become a global financial services centre, as identified in evidence to the Committee. While Australia has many advantages and opportunities to achieve its goal as a centre for the provision of global financial services, a number of constraints were identified in evidence to the inquiry.

1.14 *Chapter Six* considers these constraints, including aspects of Australia's taxation and regulatory regimes, those aspects affecting foreign investment and expatriate staff, and developments in Corporations Law.

1.15 *Chapter Seven* identifies a number of additional issues that were raised at hearings, such as those relating to the physical location of Australia; the size and scale of the Australian market; the need to maintain financial system integrity and national sovereignty; and the possible need to rationalise the number of clearing houses and industry representative bodies.

1.16 *Chapter Eight* outlines some of the ways in which we can improve Australia's potential as a global financial services centre, including the need to conduct research into the reasons companies move into and out of Australia. A list of company movements into and out of Australia is at **Appendix 7.**

Acknowledgments

1.17 The Committee is grateful to the many individuals and organisations who took the time to write to the Committee to express their views, make submissions and/or who gave evidence at the public hearings. Their cooperation and willingness to provide additional information to the Committee to assist in its inquiry was much appreciated. Witnesses to the inquiry provided valuable and interesting information about the financial services industry and gave refreshing insights into the many issues facing Axiss Australia.

CHAPTER 2

BACKGROUND-GLOBALISATION & GLOBAL FINANCIAL SERVICE CENTRES

This chapter of the report provides a context for Australia's bid to establish itself as a global financial services centre. It briefly describes the history of the international monetary and trade system, which is the arena in which Australia must compete, and defines the nature of financial services within the modern market place. As a point of comparison to Australia's aspirations, the chapter then builds a model of a competitive financial services centre, based on features identified by industry players, and looks at some functioning world centres in both the northern and southern hemispheres.

Introduction

2.1 The advance of trade and investment liberalisation over the past fifty years has increased market openness significantly. The volume of world merchandise trade today is sixteen times what it was in 1950 and the international market's share of global GDP has almost tripled.[1] This process of internationalisation, complemented by developments in information technology, has provided opportunities for nations to participate in new ways in wealth generation—both through the establishment of value adding industries and through trading and service provision on a global scale.

2.2 The Australian Government has made a commitment to establish Australia as the location of a global financial services centre, believing that we have the credentials to do so. It has overseen the reform of Australia's tax system and the regulatory regime of the financial services sector with this in view. In 1996 it appointed a Minister of Financial Services and Regulation, the Hon. Joe Hockey MP, within the Treasury portfolio, to oversee ongoing reforms and, eventually, to act as an ambassador for Axiss Australia. The latter organisation was established in 1999, with the key objective of enhancing Australia's position as a global financial centre and so capturing a greater share of the world financial services business.[2]

Globalisation of the marketplace

Rise of the International Monetary and Trading System

2.3 The emergence of the economic phenomenon known as 'globalisation' coincides with the introduction of a new International Monetary System in 1944. The system aimed to prevent the formation of trade blocs and to promote free capital flows

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1 Ignazio Visco, Chief Economist OECD, 'Global Economic Integration: Opportunities and Challenges', Jackson Hole Symposium, 24–26 August 2000, p. 5.

2 Submission No 36, Attachment A, 'Overview of Axiss Australia'.

and international trade in goods and services. The ultimate objective was to achieve sustainable and real economic and employment growth on a global scale. This was to be supported by a stable price and balance of payments equilibria, overseen by the lending activities of the International Monetary Fund (IMF).[3]

2.4 To advance the global liberalisation of trade and investment it was essential that there should be cooperation between nations and a coordination of their policies on trade and trade related activities. In 1947 the General Agreement on Trade and Tariffs (GATT) was ratified to gain agreement on the reduction of tariffs and to break down non-tariff barriers to trade. Under its auspices eight rounds of multilateral trade negotiations took place with the last, the Uruguay Round of 1994, concluding almost ten years of negotiations.[4]

2.5 Meanwhile, parallel action was taken at the regional level. The European Community (EC) initiated its Single Market program to open markets in Europe. The United States negotiated the North American Free Trade Agreement with Canada (NAFTA) with Canada, and then extended it to Mexico. The Closer Economic Relations (CER) agreement was negotiated between Australia and New Zealand. Negotiations began for a similar agreement among the Association of South East Asian Nations (ASEAN) countries and for a common market, Mercosur, encompassing Argentina, Brazil, Uruguay and Paraguay.[5]

2.6 During the 1980s, these trade alignments were both promoted by, and productive of, a number of significant changes within world financial markets and resulting from trade liberalisation. Most significant was the rapid growth and internationalisation of private capital markets, as complemented by the widespread implementation of currency account convertibility in all industrial countries.

2.7 These changes, in turn, resulted from the relaxation of price and qualitative restrictions, and on limitations imposed on certain types of financial activities. An important measure was the liberalisation of exchange control in France, Japan and the UK. Restrictions imposed on the access of foreign borrowers to investment in foreign currencies were also relaxed in many countries, together with the restrictions imposed on the right of establishment of foreign financial institutions.[6]

Crisis and consolidation in the 1990s

2.8 In the 1990s, the integration of markets was accompanied by a massive increase in the volume of capital flows in many countries. In 1996, US$1.3 trillion was traded every day in world currency markets. This was more than 10 times the

3 G.A. Marzouk, 'The International Monetary and Trade System: Historical Introduction,' *Macquarie Economics Research Papers.* No 3/2000, February 2000, pp. 4, 9.

4 Marzouk, 'The International Monetary and Trade System: Historical Introduction,' p. 13.

5 Alan Oxley, 'The Ecotech Agenda', *Australian APEC Study Centre Issues Paper No 10*, *APEC Study Centre* internet site: http://www.arts.monash.edu.au/ausapec/iss10.htm

6 Marzouk, 'The International Monetary and Trade System: Historical Introduction,' p. 14.

amount needed to support the volume of world trade. More than 90 per cent of that activity was a manifestation of efficiency-seeking activity in the global market, or currency speculation.[7] The financial crises experienced by emergent economies in the mid to late nineties—in Mexico (1994–95), North and South East Asia (1997–98), Russia (1998) and Brazil (1999)—were widely attributed to market volatility resulting from the pace of capital flows between these countries. [8]

2.9 These developments resulted in an increased recognition that economic policymaking was not just a domestic matter, and emphasised the need for a coordinated approach across nations. Influential trade and development groups such as the Organisation for Economic Cooperation and Development (OECD), the United Nations (UN), the World Trade Organisations (WTO), the G7, G10 and now G20 groups, along with the world banks and regional groupings such as the Asia Pacific Economic Cooperation (APEC), the European Union (EU), ASEAN and NAFTA, are increasingly influential in determining how economic activity will take place in the global market place, negotiating over such issues as market deregulation.[9]

2.10 At the same time, individual nations recognised that domestic policymaking was increasingly subject to global influences and developments. Areas such as education and training, taxation, social protection, economic regulation, or labour legislation had now to be in harmony—more consistent or competitive—with that of major trading partners if nations were to remain competitive in the global market place.[10]

2.11 Harmonisation of international standards in all spheres of economic and related activity has thus become a major issue to be addressed by all governments and for labour, community, and industry bodies to negotiate. Inevitably, concerns are raised about whether national standards—in areas such as environmental protection or labour conditions—will be eroded by this process. Meanwhile, in the harmonisation of accounting standards or in gaining tax cooperation, for example, governments work to encourage a freer play of international investment and growth in a more transparent and fair trading environment.[11]

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7 'Globalisation: What Challenges and Opportunities for Governments?', 1996, *OECD* internet site: http://www.oecd.org (accessed 14 March 2000)

8 Andrés Solimano, *Globalisation and National Development at the End of the 20th Century: Tensions and Challenges*, Report for the World Bank Group, Publications, *World Bank Group* internet site: http://wbln00018.world bank.org (accessed 14 March 2000)

9 The G 10 is, in effect, the Basel Committee on Banking which laid down the international Basel Rules on Banking Capital. The G20, of which Australia is a member, was formed after the G22 was disbanded, in an effort to achieve greater consensus on evolving issues among a core group of countries following the Asia crisis. See 'Global Rules and the International Financial Architecture: Writing (and Righting) the Rules', Address by Dr SA Grenville, Deputy Governor of CEDA Gold Series Dinner, Sydney, 29 June 2000, *Reserve Bank of Australia* internet site, July 2000 (accessed 3 October 2000)

10 'Globalisation: What Challenges and Opportunities for Governments?', 1996, *OECD* internet site.

11 Recent initiatives include the Basel Capital Accord on prudential regulation of banking and the release of the OECD report *Toward Global Tax Cooperation (2000).*

2000: competing in the 'new economy'

2.12 Most recently, world economic markets have become more integrated and open through dramatic improvements in telecommunications: exponential increases in computing power coupled with lower costs, and the development of electronic communications and information networks such as the Internet.[12] These communication technologies are helping to overcome the barriers of physical distance, allowing transactions to be both global and instant. At the same time, they have built a new value adding industrial base which has transformed economies as much as the industrial revolution did.

2.13 The current strength of the United States' economy has been explained by the growth of its information and communications technology (ICT) sector.[13] This growth has been accompanied by extensive discussion on changing growth dynamics in other sectors as a result of using ICT, particularly in the financial services area.[14] Consequent restructuring and rapid economic change has made the US a world leader in business-to-consumer electronic commerce.[15] The biggest gains in market share for US e-commerce have been in digitalised products: financial, investment and computer services, putting the US at the cutting edge of innovation in the provision of financial services.[16]

2.14 The US' achievement in building a 'new economy' out of ICT product development and its application in the market place, has driven a 'catch up' response in countries less developed in the information technology (IT) area. At the 'Lisbon Summit' in March 2000, European Union heads of state agreed to make entering the 'new economy' a top policy priority to stimulate economic dynamism in the EU. The Council set concrete goals to strengthen regulatory and technological infrastructure, and to bolster consumer confidence and competence, so as to fully enable cross border transactions by full EURO compliance in 2003.[17]

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12 'Globalisation: What Challenges and Opportunities for Governments?' 1996, *OECD* internet site.

13 Thomas Andersson, Directorate of Science, Technology and Industry, OECD, 'Seizing the Opportunities of a New Economy: Challenges for the European Union', p. 2, *OECD* internet site (accessed 26 September 2000).

14 See also Mr R Battellino, Assistant Governor (Financial Markets), 'Australian Financial Markets: Looking Back and Looking Ahead', *Reserve Bank of Australia Bulletin*, March 2000, p. 23.

15 The US Census Bureau reported retail e–commerce sales of US$5.2 billion for the last quarter of 1999, and US$5.3 billion for the first quarter of 2000. See Thomas Andersson, Directorate of Science, Technology and Industry, OECD, 'Seizing the Opportunities of a New Economy: Challenges for the European Union', p. 8.

16 Alan Mitchell, 'A Share of E-commerce Action', *Australian Financial Review*, 27 September 2000, p. 25.

17 These initiatives built on those arising from a series of international conferences and agreements, following on from the first Global Information Society Conference held in Brussels in 1995. At that conference, G7 countries initiated 11 international pilot projects designed to exploit the opportunities of the 'global information age'. See Andersson, 'Seizing the Opportunities of a New Economy: Challenges for the European Union', p. 8.

2.15 These developments underline the new degree of interconnectedness in the global economic system. To make gains within this increasingly dynamic marketplace, every nation, and every commercial sector within it, must respond promptly to the risks and opportunities, to trade on natural advantages, and to work strategically—often in partnership with other nations—to realise economic goals.

Financial services within the global economy

2.16 The financial services sector has been in the vanguard of the trend to globalisation of services, driven by the increased interdependence of national economies, the liberalisation of domestic and the international markets and continuing innovation in information technology, as described above.[18] Its responsiveness has significantly changed the structure and nature of financial service provision and markets.

2.17 Traditionally, the financial services sector was involved in the raising and investment of debt and equity, and the trading of related products. Traditional market participants were banks, stockbrokers, merchant banks and insurance companies. Financial services now cover a much wider range of products and services in crossover, rather than in exclusive, areas of the financial sector. These products and services are delivered by a diverse range of consulting or advisory firms, aided by support firms, including those associated with e-commerce and internet service delivery.[19]

2.18 Financial services consulting firms now cover exchange rating agencies and actuarial/consulting firms—which provide advice to the superannuation and funds management sector—as well as a wide range of other consulting services in financial planning, accounting, tax, legal, management, education and research. The sector's support services cover the back office administration and management operations which are integral to product delivery. Many of these activities are now outsourced by major international financial service providers, allowing them to take advantage of geographic competitive advantages and core competencies.[20]

2.19 While the full effects of the information and electronic commerce developments are yet to be felt within the global financial services sector, the sector has already expanded and developed distinctively in response to the changes of the late 1990s. A growing number of financial service providers use the internet and electronic commerce for global delivery of their services.

2.20 These changes in the scope and functions of the financial services industry, and in the infrastructure that supports its delivery, have provided opportunities and

18 Submission No 14, p. 1.

19 Submission No 1, p. 3.

20 Submission No 1, p. 3.

incentives for countries at disparate points of the globe, and in different time zones, to enter into competition with the world's traditional financial centres.

Model of a global financial services centre

2.21 In its submission to the Committee, the International Banks and Securities Association of Australia (IBSA) listed the characteristics of a global financial services centre which, to be competitive, should be:

- a centre from which international financial business can be conducted profitably, easily and efficiently;
- a centre with skilled management and intellectual talent covering finance and interdependent services, such as legal and accounting, to provide multi-disciplined teams that facilitate large cross-border transactions in the shortest possible time-frames;
- a centre with deep, liquid and sophisticated capital markets (both Australian dollar and foreign currency) and world competitive tax and regulatory regimes which attracts foreign investment and offshore business flows;
- a centre that can add significant value to financial services provided from it, through a workforce that can respond in an innovative manner to evolving business conditions;
- a centre where business can be done both onshore and offshore in all areas of financial services; banking, insurance, superannuation and funds management, capital and equities markets;
- a centre with the world's best telecommunications and IT capacity and a plentiful, well-educated, multilingual workforce;
- a centre that complements other Global Financial Centres in the era of 24 hour trading;
- a centre where all facets of financial services: CEOs and senior traders, regional headquarters, treasury operations, data processing, support functions and call centres, can be located efficiently;
- a centre with the requisite Government commitment and bureaucratic culture to support and manage the necessary tax and regulatory infrastructure for an efficient and open financial sector; and
- a centre that is forward looking with on-going strategic planning for the future.[21]

2.22 These criteria identify the synthesis of regulatory, technological and market features which emerging financial centres hope to foster to attract international business. They also set a benchmark for the world's most established financial

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21 Submission No 2, p. 2.

centres, which must adapt if they are to continue to capture and enhance their competitiveness in the global marketplace. A selective survey of the world's financial centres follows.

Financial centres—Europe and the Americas

2.23 London and New York, the world's premier financial centres, build on their traditions as points on the old trading routes traversed by traders, merchants and bankers over centuries. London is regarded as Europe's predominant centre and has the largest financial services sector in the world, with US$2.5 trillion funds under management in 1999. New York is the world's second largest centre for financial services and one of the most innovative technically. In 1999 it had US$2.4 trillion funds under management.[22]

2.24 **Table 1: World's top 10 financial management cities,** following, is based on a survey of 6 700 fund management organisations in 177 cities worldwide, ranked by the value of funds managed during 1998–1999.[23] According to the survey, the US dominates overall with six cities in the top ten list, accounting for some 53 per cent of in the world's funds under management in 1999. The top five cities, meanwhile, accounted for 54 per cent of global funds.[24]

2.25 London is often cited as the model global financial services centre for Australia to follow. Despite the comparative lack of scale of its banking and finance sector, London has retained its predominant position in Europe by building strategically on its traditions to expand the scope of its markets.[25]

2.26 The activities of the London Stock Exchange are demonstrative. Trading on London's attraction as an historic, transparent and well-regulated marketplace, the Exchange has worked to attract international investors by providing an innovative trading environment. Through diversifying markets to meet the requirements of a wide range of firms at different points of development, including e-commerce and information technology clients, the London Stock Exchange has become the largest share market in Europe. It is also the fourth largest equities exchange in the world by market capitalisation, and the third largest by value of trading, justifying its claims to be 'the world's most international stock exchange'.[26]

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22 Thomson Financial Investor Relations, *The 2000 International Target Cities Report,* New York, June 2000.

23 As drawn from above, *The 2000 International Target Cities Report*, ibid.

24 'New York City Trims London's Lead as Largest Global Equity Centre', *Press Release 13 June 2000*, New York, referring to Thomson Financial Investor Relations, *The 2000 International Target Cities Report,* New York, June 2000.

25 Submission No 1, p. 4.

26 'About Us—Exchange Activities', *London Stock Exchange* internet site: http://www.londonstockexchange.com (accessed 27 September 2000).

Table 1: World's top 10 financial management cities[27]

	1999	US$		1998	US$
1.	London	2.5 trillion	1	London	2.2 trillion
2.	New York	2.4 trillion	2.	New York	2.0 trillion
3.	Tokyo	2.1 trillion	3	Boston	1.5 trillion
4.	Boston	1.9 trillion	4.	Tokyo	1.1 billion
5.	San Francisco	726 billion	5.	San Francisco	615 billion
6.	Los Angeles	569 billion	6.	Zurich	491 billion
7.	Paris	458 billion	7.	Los Angeles	436 billion
8.	Philadelphia	419 billion	8.	Paris	420 billion
9.	Zurich	414 billion	9.	Philadelphia	314 billion
10.	Denver	340 billion	10.	Chicago	313 billion

2.27 The London Stock Exchange has also been at the forefront of the trend among stock exchanges and financial institutions to seek strategic alliances with other institutions around the world. In 1998 the London Stock Exchange established an alliance with Frankfurt's Deutsche Börse.[28] In May 2000 a proposed merger with Deutsche Börse to form a new pan-European market called iX-international Exchanges was announced.[29]

2.28 Other alliances have followed with a Memorandum of Cooperation being signed with the largest exchange in Latin America, Sãu Paulo Stock Exchange in Bovespa, in August 2000. The London exchange has recently made similar agreements with exchanges in Buenos Aires, Lithuania, Prague and India.[30] The Australian Stock Exchange predicts that the Deutsche Börse merger will pose a major challenge to the New York, and other stock exchanges, in North America.[31]

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27 Thomson Financial Investor Relations, *The 2000 International Target Cities Report,* New York, June 2000.

28 'About Us—History', *London Stock Exchange* internet site.

29 These proposals followed on from an agreement that the London Exchange would demutualise to better respond to the electronic marketplace. See 'About Us—Exchange Activities', *London Stock Exchange* internet site.

30 'Press and News', *London Stock Exchange* internet site.

31 Committee Hansard, p. 108.

2.29 Over the last two decades, Ireland has capitalised on its proximity to London, and on cultural and investment connections with the United States, to establish its credentials as a major player in the international provision of financial services. It has founded an International Financial Services Centre (IFSC) in Dublin, which combines the key advantages of geography, thriving economy and attractive tax and other incentives within a well regulated system, to offer financial services at a single location, on-line, internationally. Recently, however, the Irish Government attracted criticism from the European Commission (EC) for its 2001 budget, which the EC judged to be inflationary.[32]

2.30 Given these developments, Ireland's experiences in establishing its credentials as an IFSC-and in maintaining that status-may be more instructive for Australia than the model provided by London, given the latter's long established status as a global financial centre. A case study of the Irish IFSC is at **Appendix 4.**

Financial centres of the Asia–Pacific region

2.31 Japan’s financial services sector dominates the Asia–Pacific region, with its centre, Tokyo, having US$2.1 trillion under funds management.[33] While Japan’s potential as a global financial service provider has been judged as limited (due to the outmoded and uncompetitive cost structures of its large domestic financial markets), Japan is at present undergoing deregulation. A number of its already huge financial institutions are merging, as in the case of Dai-Ichi Kangyo Bank, Industrial Bank of Japan and Fuji Banks with Normura Securities and Dai Ichi Mutual Life Insurance. The resulting conglomerate will have 32 per cent of all Japanese firms as customers and will command one third of the market in traded securities on the Tokyo and Osaka Stock Exchanges.[34]

2.32 Tokyo Stock Exchange, the world’s second largest Bourse by market capitalisation, has also announced plans to list itself. The proceeds from the float will fund a new computer system to speed up decision-making processes, further internationalising trading. Responding to this, the US-based National Association of Security Dealers (NASDAQ) has negotiated an agreement with the Osaka Stock Exchange to launch as NASDAQ Japan. The deal will allow Japanese Initial Public Offer(ing)s (IPOs) and US companies with Japanese subsidiaries to list on the new Bourse, which will then become a direct competitor with Tokyo Stock Exchange.[35]

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32 See 'Republic of Ireland: Ireland Economy-Commission Demands Budgetary Restraint'. Country Briefing, the Economist Intelligence Unit, 29 January 2001, *Reuters Business Briefing* 2 February 2001 and **Appendix 4.**

33 Thomson Financial Investor Relations, *The 2000 International Target Cities Report,* New York, June 2000.

34 Submission No 1, pp. 5–6.

35 Submission No 1, p. 6.

2.33 Elsewhere within the region, Singapore and Hong Kong are acknowledged financial service centres.[36] Hong Kong is the second largest centre for funds management in the Asia-Pacific, with shares totalling US$100.4 billion.[37] In terms of sophistication of product service and delivery, Taipei is thought to occupy an equivalent position with Hong Kong and Singapore, while a second tier of centres would include: Seoul, Shanghai, Kuala Lumpur, Bangkok, Manilla and Jakarta.[38] India, too, which has a recognised capacity as a developer of information technology, is acknowledged as one of the world's most important bases for offshore IT services.[39]

2.34 According to finance industry advisors with interests in the Asia–Pacific region, most of these centres aspire to take a greater share of the world financial services business.[40] In support of these aspirations, their governments have been active in implementing reforms and other initiatives to promote internationalisation of their financial services markets. [41]

2.35 In 1999, for example, the Hong Kong Government undertook a comprehensive market reform for the securities and futures markets. Under the reform, the Hong Kong Stock Exchange and Futures Exchange were demutualised and merged with the Hong Kong Clearing Company Limited, to form a single holding company the Hong Kong Exchanges and Clearing Limited (HKEx). On 6 March 2000, the Stock Exchange of Hong Kong (SEHK) became a wholly owned subsidiary of HKEx. At the end of June 2000, the SEHK was the eleventh largest stock market in the world in terms of market capitalisation and the second largest territorial in Asia.[42]

2.36 Singapore has approached the task by adopting an integrated program aimed at engineering social and economic change. The Singapore Government has focussed on attracting venture capital and has started programs targeting: regulatory reform; industry startups (funding £700 million); building industry 'incubators' and establishing a science park for 'techno-entrepreneurs'.[43] Its Economic Development Board has developed partnering arrangements with Philips Electronics, Hewlett Packard and Ericsson, and recently launched a Philips Innovation Campus.[44] To

36 Submission No 2, pp. 2–3.

37 Thomson Financial Investor Relations, *The 2000 International Target Cities Report,* New York, June 2000.

38 Submission No 1, p. 7.

39 'Executive Summary', *Emerging Opportunities in Information Technology for Australia and India*, March 2000, jointly prepared by Austrade and Ernst and Young, 1999, p. 1.

40 Submission No 1, p. 9.

41 Submission No 16, p. 2.

42 'About the Exchange' *Stock Exchange of Hong Kong* internet site: http://www.sehk.com.hk/ (accessed 27 September 2000).

43 Sheila McNulty, 'Embracing the 'New Economy', *FT. Com., Financial Times*, 13 September 2000, *Singapore* internet site (accessed 27 September 2000)

44 Bill Robinson, 'Singapore Small But Strong', *Upside Magazine*, October 2000, *Singapore* internet site.

further build competitiveness, the Government has plans to set up an Asian studies centre.[45]

Conclusion

2.37 The Committee notes that globalisation has created a climate in which there are many challenges and opportunities. Driven by the increased interdependence of national economies, the liberalisation of domestic and international markets and continuing innovation in information technology, the financial services sector has been in the vanguard of the trend to globalisation of services. Financial centres in Europe, the Americas and the Asia–Pacific region have been adjusting to this trend by seeking strategic alliances in an effort to take a greater share of the world financial services business.

2.38 The next chapter of the report will ascertain Australia's present position within the global financial environment and provide an overview of relative strengths that might support the global financial centre initiative.

45 Committee Hansard, p. 559.

CHAPTER 3

AUSTRALIA'S FINANCIAL SECTOR—THE STATE OF PLAY & SOME COMPETITIVE ADVANTAGES

This chapter of the report assesses the relative strengths of Australia's financial markets and surveys the size and features of Australia's financial services sector in order to establish its present, and potential, position within the global economy. The chapter then considers other attributes of the Australian scene—social, political, economic and geographic—which inquiry evidence suggests should support Australia's bid to become a global centre for the provision of financial services.

Australia's financial markets

Market mass

3.1 Relative to the other financial centres outlined in the previous chapter, Australia is a medium-sized player in the international marketplace.[1] However, while Australia's financial sector does not have the mass of other major financial markets, it has depth, sophistication and liquidity—qualities confirmed in the volume and nature of growth recorded over recent years. The Committee heard that this means that Australia's financial sector has, in some areas, achieved significance and international standing that is in excess of its total size.[2]

3.2 On estimates provided by the Department of the Treasury, the Australian financial sector had a turnover rising 11 per cent to more than A$38 400 billion in 1998–99.[3] Australia's finance and insurance industry contributed 6.2 per cent of Gross Domestic Product (GDP), 1.4 per cent of total exports and employs over 340 000 people. Australia's exports of financial services (including insurance) in 1998–99 were valued at A$1.6 billion or 0.3 per cent of GDP. As at December 1999, the value of Australia's funds under management was A$646 billion.[4]

3.3 Compared with other financial markets, the Reserve Bank of Australia (RBA) judges that Australia ranks above its economic size in foreign exchange and some derivatives markets (in terms of size measured by turnover) and is broadly in line with its economic size in equity and fixed-interest markets. On other measures of financial development, such as in the overall size of financial assets relative to nominal GDP,

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1 Department of the Treasury, Submission No 12, p. 3.

2 Submission No 12, p. 3.

3 Submission No 12, Attachment A, p. 22.

4 Submission No 12, p. 3.

Australia is seen to be similar to countries like Canada and Japan, but below the large European countries, and well below the US.[5]

3.4 Within the Asia–Pacific region, the Australian financial services sector is very much overshadowed by the size and scale of the Japanese financial services sector.[6] However, in some areas, such as in the futures market, Australia's market share is the largest in the Asia-Pacific. Australia also has strengths regionally in funds management, with the size of its holdings substantially exceeding those in Hong Kong and Singapore. [7]

3.5 **Table 2: Financial markets—world rankings** shows Australia's position relative to other countries. A breakdown of the relative competitiveness of individual markets within the Australian financial services sector is at **Appendix 5**.

Market centres

3.6 Australia's centres for financial activity are Melbourne and Sydney. On employment basis they represent about 90 per cent of Australia's financial services industry.[8] Melbourne and Sydney are also roughly equal in terms of the volume of funds under management and are seen as complementary markets in this area.[9]

3.7 Sydney is the most readily recognised centre by international market participants and is pre-eminent is some financial activities, such as foreign exchange and bond trading. It is the regional headquarters for 64 per cent of multinational companies in Australia, for 33 of the 36 foreign banking groups in Australia and for 70 per cent of Australia's financial services markets.[10]

Australia's financial services sector—present profile

Changing demographics

3.8 Over the last fifteen years Australia's financial institutions have taken the opportunity to develop new markets and introduce new products—their responsiveness to changing customer demands and new opportunities in the evolving international marketplace has given Australian financial markets size and diversity so, as noted above, they are now regarded as both sophisticated and deep.[11]

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5 R.A. Battellino, RBA Assistant Governor (Financial Markets), 'Australian Financial Markets: Looking Back and Looking Ahead', *Reserve Bank of Australia Bulletin*, March 2000, p. 22.

6 Submission No 1, p. 5.

7 Submission No 12, Attachment A, pp. 3, 22.

8 Submission No 1, p. 2.

9 Submission No 28, p. [2].

10 *1999 Australian Financial Markets Report, Overview*, Australian Financial Market Services Association, p. 2.

11 I. J MacFarlane, Governor, 'Opening Address to Euromoney Australasian Capital Markets Forum', Sydney, 14 March 2000, *Reserve Bank of Australia* internet site: http://www.rba.gov.au/speech/sp_sp_bu_gov_140300.html (accessed 22 March 2000)

Table 2: Financial markets—world rankings[12]

Gross domestic product[13]	Foreign exchange turnover [14]		Equity market turnover		Fixed-interest market turnover	
	By market	By currency	Physical market	Futures market[15]	Physical market[16]	Futures market[17]
US	UK	US dollar	US	US	US	US
Japan	US	Euro	Taiwan	Germany	Japan	UK
Germany	Japan	Japanese yen	Germany	Japan	Germany	Germany
France	Singapore	Pound sterling	UK	France	Italy	Japan
UK	Germany	Swiss franc	Japan	Italy	France	Singapore
Italy	Switzerland	Canadian dollar	Switzerland	UK	UK	**Australia**
China	Hong Kong	**Aust dollar**	Hong Kong	Korea	Canada	
Brazil	France		Spain	Spain	Netherlands	
Canada	**Australia**		France	Hong Kong	Belgium	
Spain			Canada	Singapore	Denmark	
Mexico			Netherlands	Switzerland	Spain	
Netherlands			Italy	**Australia**	Switzerland	
India			**Australia**		Sweden	
Australia					**Australia**	

12 Table sourced: Battellino, 'Australian Financial Markets: Looking Back and Looking Ahead', p. 17. The following annotations are drawn from the original.

13 Nominal GDP, 1998. Source: 'World Financial Markets', *J P Morgan*, January 2000.

14 Source: *Central bank Survey of Foreign Exchange and Derivatives Markets Activity,* BIS, 1998.

15 Share market index futures. Source: Various exchanges, Futures and *OTC World magazine*.

16 Bond market outstanding (total publicly listed). Source: 'How Big is the World Bond Market?', Salomon Smith Barney, July 1999.

17 Includes money market futures contacts. Source: Various exchanges, Futures and *OTC World Magazine*.

3.9 Within Australia's domestic markets demographic and technological developments have also encouraged significant change in the structure and type of services delivered by the sector. Like many developed nations, Australia has an ageing population. In recognition of demographic trends, in 1986 the Government introduced compulsory superannuation, followed by the Superannuation Guarantee in 1992. These measures were designed to encourage savings and so reduce dependence upon the age pension in retirement.[18] This brought about a significant shift in equity holdings of most Australian households—superannuation grew to be the second-largest financial asset of most families in Australia, after the family home. Correspondingly, the size and structure of Australia's fund management industry changed dramatically.[19]

3.10 In addition to creating a larger aggregate of funds for investment, Australian households now bear a more significant investment risk than in the past, having a greater proportion of their assets in market-linked investments. This situation has increased the demand for improved financial advisory services and for increased efficiency of funds management, driving the industry in this direction to meet customer demands.[20]

3.11 The changing work patterns of Australians have also affected customer needs. Extended working hours mean customers have less time to manage their financial affairs and need financial products which offer convenience and are easier to access. Longer periods spent in education, the movement to early retirement, and periods spent unemployed have created a greater need for financial products that will regulate cash flows.[21]

Diversity of services and products

3.12 These trends have restructured Australia's financial services markets prompting them to become more dynamic, to offer a wider diversity of products and to utilise technology in new ways to improve customer service. The capacity for information networking, for example, supported the shift to electronic retail transactions, with the expansion of Automatic Teller Machines (ATMs) and Electronic Funds Transfer/Point of Sale (EFTPOS), and opened electronic channels for payments and financial service delivery, such as in telephone banking.[22]

18 See 'About Super', Super Facts Sheets 1 and 5, *ASFA, the Voice of Super* internet site: http://www.superannuation.asn.au (accessed 22 February 2001).

19 Ms Philippa Smith, ASFA, in Alison Kahler, 'Super Growth Yields $45 Billion in Earnings', *Australian Financial Review*, 24 August 2000.

20 *Reserve Bank of Australia Report and Financial Statements—2000*, p. 33.

21 Noted in Phil Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique', Department of the Parliamentary Library, *Research Paper 16, 1996–97*, 23 June 1997.

22 ibid, p. 6.

3.13 While there is no doubt that there is greater provision of electronic financial services, the cost and accessibility of financial services has become a significant issue for many consumers. Since 1993 over 2 000 bank branches have closed. This has affected many Australians, particularly the elderly who rely on over the counter service from a bank branch.

3.14 The cost of banking services has increased significantly for many consumers. According to the Reserve Bank's Report *Notes on Bank Fees in Australia* produced in May 2000, banks earned fee income of $1.8 billion from households in 1999. Some fees, such as over-the-counter transactions in a bank branch have increased by up to 400 per cent in the last few years.

3.15 In the 1990s, more affluent households have shifted their assets towards more risky market-linked investments, which yield higher returns. This trend has overseen a corresponding increase in Australians holding shares on the stock market, with 54 per cent of Australians now holding shares up from 22 per cent in 1991.[23]

3.16 Responding to the new environment, financial conglomerates, such as banks offering insurance services, are further diversifying services and working towards more efficient cost structures. As a result, financial conglomerates have emerged as the key organisational form in the Australian banking system, encompassing traditional retail banking, wholesale (institutional) banking and traded market activities, life and general insurance, stockbroking, funds management and superannuation.[24] Greater diversification of product services is aided by product innovation where products are designed to be offered by a range of financial entities, and by commercial strategies.[25]

3.17 Financial markets are thus increasingly challenging financial intermediaries for the provision of finance and the management of risk. Large corporations have direct access to financial markets for debt and equity fundraising. Developments in 'securitisation' (the bundling of loan assets and their sale as marketable securities) now allows markets to provide finance to retail borrowers. An increasing range of risks can be managed through an array of market-based 'derivative' financial instruments (such as options, swaps and futures contracts), while the needs of savers are also increasingly being met through financial market products.[26]

Increasingly global

3.18 Australian markets have now also attained a relatively high level of integration with international markets. Corporations and institutions increasingly

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23 Survey by the Australian Stock Exchange cited in Battellino, 'Australian Financial Markets: Looking Back and Looking Ahead', p. 18.

24 *APRA Annual Report 2000*, p. 23.

25 Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique', p. 8.

26 See foreign exchange swaps in *Reserve Bank of Australia Report and Financial Statements— 2000*, pp. 6–8.

source funds globally; foreign inward and outward investment are both growing; and trading on share, bond and foreign exchange markets is becoming increasingly more international.[27]

3.19 The integrity and responsiveness of Australia's domestic systems underpins these developments. In the case of payment and settlement systems, Austclear and the RBA's Reserve Bank Information and Transfer System (RITS), which introduced delivery-versus-payment, and then the Australian Stock Exchange's Clearing House Electronic Subregister System (CHESS) for equities were important steps forward. Interlinked with the Real Time Gross Settlement System (RTGS), they provide an efficient payments and settlement infrastructure. The RBA's Governor has observed that Australia's RTGS system is among the most advanced in the world because of the way it closely links to securities settlements, giving it a very high coverage of high value transactions.[28]

3.20 While the integrity of Australia's domestic payment system is noted, the Committee also notes that the Australian Competition and Consumer Commission (ACCC), together with the newly created Payments System Board, recently completed an inquiry into interchange fees. The ACCC and RBA report, *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access* revealed inefficiency in Australia's payments system and that banks were in some cases earning fees that were double the cost of providing services.

Prospects for growth

3.21 The robustness and diversity of Australia's financial services sector as outlined has prompted industry analysts to consider that the sector has strong prospects for future growth. In March 2000 market projections for the sector as a whole over the next ten years predicted that the total financial services market in Australia would increase in size from A$549.7 billion at the end of 1999 to A$1.247 trillion at 2009.[29]

3.22 The RBA estimates that Australia's financial markets will continue to grow faster than its GDP.[30] If the Australian market were to develop relative to GDP as has happened in the United States during the past fifteen years (given current levels of savings and realistic rates of interest are maintained), the RBA predicts that, over the same period, Australia's financial markets might look something like that charted on the following table:

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27 Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique', passim, pp. 1 –8.

28 With over 90 per cent of transactions by value are settled on a real time gross basis. See I. J MacFarlane, Governor, 'Opening Address to Euromoney Australasian Capital Markets Forum', Sydney, 14 March 2000, *Reserve Bank of Australia* internet site, p. 3.

29 'Market Projections of the Australian Financial Services Industry', *Rice Kachor Research Press Release, 23 May 2000.*

30 Battellino, 'Australian Financial Markets: Looking Back and Looking Ahead', p. 23.

Table 3: Australian financial sector—growth potential [31]

Year	Assets held with inter-mediaries $bn	Assets held with funds managers $bn	$bn	Total Per cent of GDP(a)
2000	810	520	1 330	225
2015	2150	2350	4500	310
Average annual growth rates (per cent)	%	%	%	
1985-1999	11	16	12	
2000-2015	7	11	9	

(a) Nominal GDP assumed to grow by 6 per cent a year

3.23 This would mean that, within fifteen years, Australian financial markets would match the US financial market's present size. The United States' financial markets are seen as the leading edge of financial development and innovation, so the cue for Australia is to see if it can trade on its advantages to attract international interest and gain a stronger ranking in the global financial marketplace.

Competitive advantages

3.24 Australian financial markets now exhibit the diversity and global competitiveness illustrated in the depiction of the Australian market's components in **Appendix 5**. Given the present size and features of Australia's financial services sector, what is the likelihood that Australia could be the location of a global financial services centre?

3.25 The success of other countries suggests that their attractiveness to investors is built on a harmony of features which make their financial service sectors both robust and innovative. The Committee heard that Australia's success or failure also rests on its ability to build on a broad range of other attributes which give Australia a competitive edge.

3.26 The International Banks and Securities Association of Australia (IBSA), which compiled the list of desirable characteristics to establish a global financial centre cited in Chapter 2, also provided the Committee with a comprehensive assessment of what it judges to be Australia's present advantages:

- a multilingual professional financial services workforce that can flexibly respond to changing business conditions and independently add value to services provided through Australia;
- a time zone location that spans New York, London and Tokyo;

31 Sourced from Battellino, 'Australian Financial Markets: Looking Back and Looking Ahead', p. 24.

- a strong, stable and transparent legal and regulatory system;
- low cost and efficient communications and information systems;
- political and economic stability;
- the most sophisticated and deregulated domestic banking system in the region;
- leading international stock exchange, futures exchange and clearing houses;
- competitive costs, including general living expenses, commercial rents and a high quality social infrastructure;
- world's best practice regulatory system following the Wallis Report induced financial sector reforms;
- regional leadership in finance education and training;
- stated strong commitment by Federal and State Governments to promoting Australia as a Global Financial Centre;
- tax reform including a commitment to staged abolition of FID, BAD and Stamp Duty on securities and new rules that potentially improve the efficiency of financial arrangements taxation;
- a commitment to business tax reform, with cuts in the corporate tax rate to 30 per cent and capital gains tax initiatives; and
- the establishment of an Australian Centre for Global Finance [later known as Axiss Australia] to implement the Government's commitment to create a Global Financial Centre.[32]

3.27 There was overall agreement in evidence to the inquiry that Australia can claim strengths, to a greater or lesser degree, in these areas. Other attributes expanding on those listed, were the generally high standard of education of the Australian population, the high quality of life in Australia and Australia's regional defence security.

3.28 These advantages can be grouped into four areas:

- those that secure the Australian business environment;
- those that are demographic and knowledge-based;
- those that relate to location and infrastructure; and
- those that relate to the degree of Government support for the proposal.

[32] Submission No 13, p. 3.

3.29 Pre-eminent in the first group is the strength and transparency of the prudential and regulatory framework and institutions; the strength of the Australian legal system; the responsiveness of the taxation system; the robustness of the economy; and, the stability of Australia's political system as a parliamentary democracy.

3.30 The second group would include Australia's education achievements and the professionalism and diversity of the multilingual workforce, while the third group would cover regional advantages, such as time-zone, and Australia's social, telecommunications and built infrastructure plus relative cost advantages.

3.31 The last is attitudinal and includes the Government's willingness to implement appropriate reforms and to support initiatives, such as the establishment of Axiss Australia, in an effort to drive the agenda of business and the public sector towards the goal. A brief analysis follows.

Securing Australia's business environment

3.32 The integration of Australia's features as a stable, growing economy with sophisticated financial markets and well-developed financial regulatory systems has been seen as the key-stone in the architecture needed for Australia to assume a premier position in the global financial services market. The characteristics of Australia's current financial and regulatory regime are described in detail in Chapter 4. Here it suffices to give a sketch of some significant developments.

3.33 Recent OECD analysis shows that the growth rate of Australia's economy has been higher than for any other comparable country, excluding Ireland, over the last decade. This growth has been encouraged by a range of initiatives which have increased flexibility and competitiveness in the Australian market: further tariff reductions; financial deregulation; labour market deregulation; privatisation; and, a more stringent regime of competition policy.[33]

3.34 The Australian Financial Markets Association (AFMA) told the Committee that the overall strength and transparency of Australia's financial and regulatory systems are remarked internationally, and that the process of regulatory reform has attracted attention as a model for other countries.[34] Following the recommendations of the Australian Financial Systems Inquiry in the Wallis report, all policymaking in this area was centralised in the Department of the Treasury.[35] Principal players in the regulatory regime became the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), and the Australian Competition and Consumer Commission (ACCC).

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33 I. J MacFarlane, Governor, Reserve Bank of Australia, 'Talk to the World Economic Forum Asia Pacific Economic Summit', Melbourne, 11 September 2000.

34 Committee Hansard, p. 134.

35 Details of the Wallis Report follow in Chapter 4.

3.35 These organisations are responsible, among other things, for ensuring that the Australian stock and futures markets retain investor confidence by running efficient and transparent markets. In May 1999, the then Chairman of ASIC, Mr Alan Cameron, observed that many more Australians now invested in the sharemarket, with 28 per cent of the population participating at the end of 1998 compared with only 4 per cent during the previous decade. He saw this as a good indication that investor confidence in the rule of law is well guarded by the current regime.[36]

3.36 Meanwhile, the RBA told the Committee that Australia's financial regime is respected among international decision-making bodies in the financial community, where Australia plays a role in the determination of international financial architecture.[37]

3.37 Dr George Gilligan, Logan Research Fellow at Monash University, stated that Australia can stand on its international reputation as one of the least corrupt countries in the world Australia and, as such, has 'a distinguished record for honest and open government at both state and federal levels'.[38] This provides the stability for the type of reforms recorded above, and those which will build market liquidity and attract the investment that will foster Australia's ambitions.

3.38 In this regard, the Department of the Treasury reported that recent reforms in taxation—including business tax, capital gains, and the implementation of exemptions on withholding tax—will, respectively, improve Australia's competitiveness, remove impediments to efficient asset management and improve capital mobility, and attract foreign investment.[39] Meanwhile, changes in progress to corporations law, under the Corporate Law Economic Reform Program (CLERP), aim to install consistent regulation across financial products, financial service providers, markets and clearance settlement facilities, while upholding market integrity and investor protection.[40] This will allow cross-selling of products and encourage continuing and expanding growth in the industry, as well as making it internet friendly.[41]

3.39 Implementation of policy on compulsory superannuation has seen the superannuation industry grow to become highly developed, providing a steady flow of capital and continuing business management opportunities.[42] The relaxation of withholding taxes cited above has already brought benefits, with Australia's corporate bond market now more integrated into the global bond market. Another indication is

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36 Mr Alan Cameron, AM, Chairman, ASIC, 'Major Challenges in Financial Regulation at the end of the Decade', Speech to the Monash Law School Foundation Lecture, Melbourne, 6 May 1999, pp. 8–9.

37 Committee Hansard, p. 254.

38 Submission No 14, p. 2.

39 Submission No 12, p. 2.

40 Submission No 12, p. 9.

41 Committee Hansard, p. 120.

42 Submission No 20, p. 2.

of the increasing sophistication and deepening liquidity of Australian markets, is the rise of 'kangaroo issues' where multinational and supranationals issue debt in the Australian market to diversify their funding sources making the market more attractive to overseas investors.[43]

A diverse and well educated workforce

3.40 Dr George Gilligan, among a number of witnesses, judged that Australia has an edge over competitors in having 'a highly educated multicultural workforce with diverse sets of professional, technical and language skills'.[44] This combination of professional, language and cultural skills was seen as a particular advantage where the object is becoming a regional threshold for the global financial services industry.

3.41 Australia has a more skilled workforce compared with other nations in the region. In its submission, the Department of the Treasury cited a number of surveys which indicate that a larger percentage of young Australians (42 per cent) enrolled in higher education than in Singapore (38 per cent), Japan (30 per cent) and Hong Kong (21 per cent). Surveys conducted in 1998 also indicated that the quality of skilled labour was rated at roughly 2 points higher (on a scale of 1 to 10) than in those countries, while the availability of skilled labour was marginally higher.[45]

3.42 The Committee heard that Australia's cultural diversity allows for doors to be opened that might otherwise be closed in the business sector. CPA Australia and the Department of the Treasury reported that Australia benefits from having English—which has become the international language of business—as its first language, and over 2.4 million Australians who speak a language other than English at home, with more than 800 000 Australians speaking an Asian language.[46] Professor Peter Drysdale of the Asia Pacific School of Economics and Management, Australian National University (ANU) saw that Sydney, as a multicultural centre with all Asian languages represented, would be a competitive base to provide services on a scale that would considerably enhance Australia's share in the markets of the region.[47]

3.43 Professor Milner, Dean of Asian Studies, reported that the ANU has the largest single concentration of Asian studies experts in the world. He said that the university produces an elite of Asian studies experts, many of whom are employed in companies overseas; in Japan, Singapore and Hong Kong.[48] Australia has also established a reputation for excellence as a provider of education to the region. The International Banks and Securities Association, for example, reported that university

43 Submission No 6, p. 56.

44 Submission No 14, p. 6.

45 First survey covered Australians between 20 and 24 years. See Submission No 12, p. 29.

46 Submission No 5, p. 2 and Submission No 12, p. 28.

47 Committee Hansard, p. 556.

48 Committee Hansard, p. 557.

and professional education in accountancy, business and finance are highly sought in East Asia.[49]

Time-zones, infrastructure and environment

3.44 As indicated above, there is a body of opinion that sees Australia's location in relation to Asia, in sharing time zones and being in effect 'belly to belly' geographically to markets in the region, to greatly advantage Australia's potential to trade regionally in financial services.[50]

3.45 Other witnesses saw Australia's location as an advantage relative to the United States or European markets. The Reserve Bank of Australia thought that Australia, being a couple of hours ahead of Asia, could better link in with North American markets.[51] The Finance and Treasury Association submitted that Australia was well suited as a global centre because Australia's business day opens when US markets close, and the day closes as Europe's commences.[52]

3.46 The National Office for the Information Economy (NOIE) noted, however, that location ceases to be an issue as people work with electronically connected systems. It reported that the finance sector is rated as the highest in Australia in terms of the proportion of IT & T skills.[53] The Office further stated that there is now a significant transformation in the broking sector of the Australian financial services market, with 25 per cent of all trades now undertaken over the Internet. Australia also has the highest saturation of electronic brokers in the Asian region.[54]

3.47 Department of Communications, Information Technology and the Arts (DCITA) representatives told the Committee that the most important thing, in the current environment, is to attract venture capital to the IT market. The Department noted that this market had expanded rapidly in recent times in terms of the availability of capital for all parts of the IT industry from start-ups to longer term financing.[55] NOIE estimated that the total annual income of the Australia's IT&T industry is now in the order of A$60 billion per year, and that Australia has the second largest market in the Asia–Pacific region, behind Japan.[56]

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49 Submission No 5, p. 2.

50 Professor Drysdale, Committee Hansard, pp. 558–59.

51 Committee Hansard, p. 255.

52 Submission No 6, pp. 2–3.

53 Committee Hansard, p. 571. NOIE, now established as an executive agency, was at the time of hearings located within the Department of Communications, Information, Technology and the Arts (DCITA).

54 Committee Hansard, p. 564.

55 Committee Hansard, pp. 571–72.

56 At the same time, the OECD recently gauged that Australia ranked third in terms of its IT expenditure as a proportion of GDP, ahead of both the US and Japan. On the IDC/World Times Information Society Index, Australia was ranked ninth in terms of its communications infrastructure (including computer and

3.48 Another advantage is Australia's cost competitiveness, in terms of lifestyle and operational costs. Australian cities are urbane, offering social and cultural diversity—both ease and sophistication—and professional work environments at a moderate cost compared with London, New York and Tokyo.[57] The salaries of executive staff—lower, middle and top management staff—in Australia are much lower than those on Hong Kong, Japan, Singapore, the US, the UK or Germany. Similarly, Australian CBD office space rental is a fraction of the costs of those in Tokyo, Hong Kong or Singapore.

3.49 At the same time, Australia's unique natural environment, high quality housing and education and medical facilities are seen as drawcards to overseas executives and organisations seeking to establish new branches or businesses in the service industry.[58]

Government support—establishment of Axiss Australia

3.50 An important determinant in the success of Ireland's International Financial Services Centre in Dublin has been the long-term commitment of successive Irish governments to see the project through. This commitment involved a willingness to implement an integrated program of reform which involved reviewing legislation in number of areas and providing a range of other incentives to stimulate industry and attract investment. Ireland, like Israel and India, has also benefited from steady and substantial investment from the United States, which in turn has attracted investment from other countries in the European Union (EU) and elsewhere. Membership of the EU has also brought the opportunity of trading in a vast single market, under a unified monetary policy.[59]

3.51 The Department of the Treasury submits that the Australian Government has aimed to enhance Australia's profile in the international services sector by implementing a range of macro and microeconomic reforms in key areas, a number of which are touched upon above and are elaborated in Chapter 4. The Government has also sought to build links with financial sectors in the region and to establish a strong domestic economy which will support the growth of crucial industries such as the IT & T industry and will attract foreign investment.[60]

3.52 Acting on the belief that Australia has the credentials to take a higher profile in the provision of financial services internationally, on 17 May 1999 the Government announced the details of a budget initiative to promote Australia as a centre for global

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Internet infrastructure), behind the Northern American and Scandinavian countries but ahead of Japan at 10, Singapore at 11, the UK at 12, Germany at 13 and Hong Kong at 14. See Committee Hansard, pp. 566 and 567.

57 Submission No 12, pp. 28–29.

58 Submission No 12, p. 6.

59 'Israel and Ireland Show the Way', *Australian Financial Review*, 4 October 2000, p. 35.

60 Submission No 12, passim.

financial services (CGFS). A joint statement by the Prime Minister, the Hon. John Howard, MP, and the Minister for Financial Services and Regulation, the Hon. Joe Hockey, MP, said:

> Australia has the potential to develop further as a CGFS and to gain a greater share of world financial services business. That potential rests on a number of Australia's advantages including an open and stable financial system; a highly skilled workforce; cost-competitive business conditions; sound macroeconomic fundamentals and a time zone advantage over other major regional markets which flows from Australia's earlier market opening time. The intense international competition for financial services business means, however, that Australia needs to pursue more actively its role as a CGFS.[61]

3.53 In order to do so, the Government announced that an International Financial Centre Task Force would be established within the Department of the Treasury but would be located in Sydney. Its role would be to develop and implement a coordinated GCFS promotional campaign and to advise Government on this initiative. The project would attract A$7 million funding over two years, which would be allocated in the 1999–2000 Budget, and was planned to be operational on 1 July 1999.[62] The Government envisaged that, after this two-year period, the GCFS initiative would be taken over by the private sector.

3.54 The press release also articulated what the Government saw as its pre-eminent role in building Australia's prospects :

> The Government's key role in promoting Australia as a CGFS is to ensure that the overall economic and regulatory framework continues to be of international best practice. The implementation of the *A New Tax System* reform proposals, the progression of business tax reform in the context of the Ralph Review of Business Taxation, and the maintenance of sound macroeconomic policy settings are crucial elements in that framework.[63]

3.55 To facilitate this, the Government announced the establishment of a Committee of Regulators to assist the Task Force. This Committee, to be chaired by Treasury, would comprise the Reserve Bank of Australia, the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission, the Australian Competition and Consumer Commission and the Australian Taxation Office. It would meet on a regular basis and a report to the Treasurer and to Minister Hockey.[64]

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61 'Strategy to Promote Australia as a Centre for Global Financial Services', The Rt Hon John Howard, MP, Prime Minister, *Press Release*, 17 May 1999.

62 ibid.

63 ibid.

64 In addition, the Government announced it would improve data collection to benchmark Australia's performance; implement initiatives to help Australia become a key training ground for the financial

3.56 Soon after, in August 1999, the Australian Centre for Global Finance (ACGF) was founded on the recommendation of the Task Force. It was to be established within Government and would work closely with Minister Hockey to 'deliver outcomes that will attract the world's capital to Australia'.[65] Mr Les Hosking, formerly CEO of the Sydney Futures Exchange, would head up the new body. In June 2000, the ACGF changed its name to Axiss Australia.[66]

3.57 The objective of both the former Centre and Axiss Australia is to make Australia a leading financial services in the Asia–Pacific time-zone and to maintain Australia's position as a key centre to generate wealth, adding to the world's capital. As indicated above, the Government sees that the key component within this, outside of the promotional element, is ensuring Australia has a financial and regulatory regime which is competitive globally—that ensures transparency and reliability in markets, and yet offers an attractive trading and investment environment for business.

3.58 The next chapter of the report will survey the characteristics of Australia's current financial regulatory regime, and identify some initiatives designed by Government to consolidate Australia's attractiveness as a sound, safe and profitable place to do business.

Conclusion

3.59 The Committee notes that, relative to the major international financial centres Australia is a medium-sized player in the international marketplace. However, while Australia's financial sector does not have the mass of other major financial markets, it has depth, sophistication and liquidity, which has enabled Australia to achieve significance and international standing that is in excess of its total size.

3.60 The Committee also notes that Australia has many other advantages of a social, political, economic and geographic nature which enhance its credentials to become a global financial services centre. Although there are differing views as to their relative advantages, Australia's attributes include:

- a stable, growing economy with sophisticated financial markets and well-developed financial regulatory systems;
- a diverse and well educated workforce;
- time-zones that enable us to access not only markets in the Asia–Pacific region, but also markets in North America and Europe;

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sector; and re-open of Treasury's regional office in Singapore to improve the quality of advice to the Government on regional economic and financial developments. 'Strategy to Promote Australia as a Centre for Global Financial Services', ibid.

65 'About Axiss Australia', Axiss internet site: http://www.axiss.com.au/about/about.htm (accessed 13 October 2000)

66 The name Axiss is a combination of the words 'access' and 'axis' —Australia offers 'access' to financial markets in the Asia–Pacific region; while 'axis' denotes the hub around which regional markets rotate.

- cost competitive lifestyle and operational costs;
- a unique natural environment; and
- a commitment by Government to promoting Australia as a centre for the provision of global financial services.

3.61 The Committee considers that there is merit in Australia pursuing the objective of establishing Australia as a global financial services centre, as this has the potential to capture a greater share of the world's financial services business and generate wealth for Australians.

3.62 The Committee observes that Australia appears to have a number of competitive advantages which should enable it to enhance its share of global financial business, if it can raise greater awareness of those advantages within the global financial services industry.

3.63 The Committee notes that the Government's promotional initiatives appear, overall, to have the support of industry representatives who made submissions to this inquiry. However, taking into account the broader range of factors which they suggest might raise Australia's profile and advertise Australia's attractiveness as a place for investment, the Committee sees potential for more integrated and wide ranging promotional approaches. Conduits for this could include existing government internet sites, trade fairs and the encouragement of Australian businesses overseas to be active cultural and multicultural trade ambassadors for Australian industry.

Recommendation 1

3.64 The Committee recommends that Axiss Australia continue to investigate innovative ways of promoting Australia's competitive advantages to overseas investors and businesses by integrating messages about lifestyle and cultural advantages with financial and economic advantages.

CHAPTER 4

CHARACTERISTICS OF AUSTRALIA'S FINANCIAL REGULATORY REGIME

The previous chapter of the report described the structure of the Australian financial sector and its transformation over the last two decades. This chapter tracks the reforms and legislative change supporting that transformation. It then describes the regulatory regime that has been established to oversee it.

A record of change

4.1 The Reserve Bank of Australia (RBA) has observed that Australian financial markets are distinctive among world markets in having developed in a balanced way in all sectors—with foreign exchange, fixed interest, money and equity markets increasing at broadly similar rates—during the last fifteen years of deregulation. This balanced development, it is thought, reflects both a lack of regulatory distortions (or incentives) and the fact that Australian markets have developed primarily to service the domestic economy, which is in itself quite large and diversified.[1]

4.2 During the last two decades Australia's financial sector has undergone a period of deregulation, reform and review. The process of market deregulation began in the 1970s with the gradual removal of controls over bank interest rates. During the early 1980s a number of significant steps were taken, with other controls on banks being removed, interest rates on government securities being freed up (by adopting tender arrangements for new issues), and the exchange rate being floated. In the mid-1980s the banking system was opened up to foreign competition.[2]

4.3 These innovations were in part predicted by a number of major public inquiries into the financial sector which were held throughout the eighties and on into the next decade. In 1981 the Campbell Committee advocated substantial financial deregulation. The Committee's conclusions were largely validated by the inquiry conducted by the Australian Financial System Review Group during 1983. Financial deregulation, and its effects on banking, was reviewed by the House of Representatives Standing Committee on Finance and Public Administration (the Martin Committee) in 1991, and, in the same year, the Industry Commission examined the financial system in terms of the availability of capital for investment.[3]

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1 See R.A. Battellino, RBA Assistant Governor (Financial Markets), 'Australian Financial Markets: Looking Back and Looking Ahead', *Reserve Bank of Australia Bulletin*, March 2000, p. 17.

2 Battellino, 'Australian Financial Markets: Looking Back and Looking Ahead', p. 16.

3 *Final Report* (Campbell Report), Australian Financial System Inquiry, Canberra: Australian Government Publishing Service, 1981; *Report* (Martin Review Report), Australian Financial System Review Group, Canberra: Australian Government Publishing Service, 1984; *A Pocket Full of Change: Banking and Deregulation,* Report of the House of Representatives Standing Committee on Finance and Public

4.4 In the 1990s two influential reviews introduced major changes to Australia's financial and regulatory regime. In 1997 the Australian Financial System Inquiry's *Final Report*, known as the Wallis Report, led to a major program of restructuring and rationalisation in the regulation of the Australian financial sector.[4] In August 1998 the Government announced a proposal for A New Tax System (ANTS), which aimed to simplify the existing scheme for business and included the introduction of a Goods and Services Tax (GST). At the same time, the Treasurer announced that the Government would undertake a comprehensive review of the taxation of business lines. The resulting review, known as the Ralph Review, submitted *A Tax System Redesigned* to the Treasurer on 30 July 1999. An overview of the reforms initiated by these reports follows.

The Wallis Report—a new regulatory structure

4.5 The Australian Financial System Inquiry identified four main drivers of change in Australian financial markets: demographic change; technological change; regulation reform; and, internationalisation of the financial landscape. To meet the challenges arising from these changes a radical restructuring of the Australia's financial regulatory system was proposed.[5]

4.6 The Review recommended that a single prudential regulator for the entire financial system should be established, the idea being that such a body would provide: integrated and consistent supervision; regulatory neutrality; economies of scale and lower costs in regulation; and, more flexibility to cope with likely future changes in the financial system. Another new regulatory body was to be formed to oversee regulation of corporations, financial market integrity and financial consumer protection, and its powers supported by changed legislation. The former Australian Securities Commission (ASC) was to be abolished and its current functions folded into the new body which would also assume responsibility for the administration of financial consumer protection from the Australian Competition and Consumer Commission (ACCC) and take some functions of the Insurance and Superannuation Commission (ISC).

4.7 These recommendations were adopted by Government resulting in the tripartite regulatory arrangement consisting of the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC)

Administration (Martin Report), Canberra: Australian Government Publishing Service, November 1991; Industry Commission, *Availability of Capital*, Report No 18. Canberra: Australian Government Publishing Service, December 1991. See Phil Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique', Department of the Parliamentary Library, Research Paper 16, 1996–97, 23 June 1997, pp. 5 and 31.

4 Australian Financial System Inquiry, *Final Report* (Wallis Report), Canberra: Australian Government Publishing Service, March 1997.

5 Information in this section from Phil Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique', Department of the Parliamentary Library, *Research Paper 16, 1996–97*, 23 June 1997.

and the Australian Competition and Consumer Commission (ACCC). Under the new regime, which came into effect from 1 July 1998, policymaking for financial services moved to the Department of the Treasury, APRA became the new prudential supervisory body and assumed responsibility for policy implementation while ASIC took on responsibilities for regulation, consumer protection for financial services and enforcement. The ACCC continued to cover overall consumer protection and some aspects of financial service regulation.

4.8 A number of significant changes to the banking sector were also proposed. The supervision of all banks would be taken from the Reserve Bank of Australia (RBA) and given to the new single regulator, APRA. This proposal was adopted by Government, but recommendations dismantling the 'six pillars' policy—prohibiting mergers between the four largest banks and the two largest life offices—along with those which placed a blanket prohibition on foreign takeovers of the four largest banks were not.

4.9 While the new regulatory agencies were designed to have substantial operational autonomy under a clear charter of objectives, the Government determined that there would be close cooperation between them. This would occur bilaterally and through their participation in the Council of Financial Regulators, established to be responsible for the coordination of their activities across a wide range of issues.[6]

4.10 A diagrammatic representation of the new regulatory framework, identifying key functions held by the three principal regulatory bodies, the Australian Taxation Office, the Department of the Treasury and the Reserve Bank of Australia is at **Figure 1,** overleaf. A brief description of the functions and responsibilities of each, including their relationships with other domestic and international bodies, is at **Appendix 6.**

The Ralph Review report—a new tax system

4.11 The Ralph Review report was released on 29 September 1999. The Treasurer stated that the Government's adoption of the report's recommendations would provide Australia 'with internationally competitive business tax arrangements'.[7] The Government announced that it would undergo a two-phased implementation of the changes proposed by the report. Key changes to business tax for implementation in the first phase were:

- the lowering of company tax rate from 36 per cent to 34 per cent for the 2000–01, and to 30 per cent thereafter;

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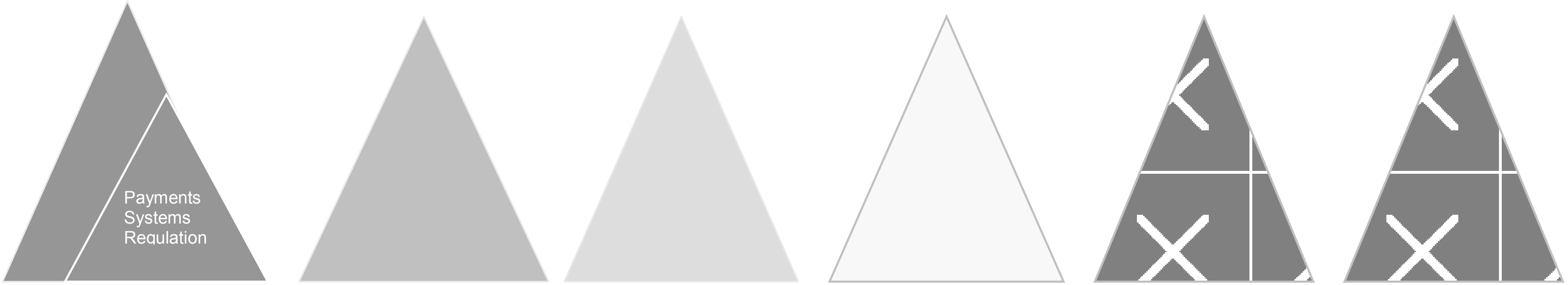
6 'Reform of the Australian Financial System', Statement by the Treasurer, the Hon. Peter Costello, MP, House of Representatives, 2 September 1997,the *Treasurer Press Release No 102*, p. 3.

7 'The New Business Tax System', the *Treasurer*, *Press Release No 058*, 29 September 1999, *Treasurer* internet site: http://www.treasurer/pressreleases/199/085.asp (accessed 20 October 2000)

Figure 1: Overview of regulatory framework

	Reserve Bank of Australia	Australian Prudential Regulation Authority	Australian Securities & Investments Commission	Australian Competition & Consumer Commission	Australian Taxation Office	Treasury



	Reserve Bank of Australia	Australian Prudential Regulation Authority	Australian Securities & Investments Commission	Australian Competition & Consumer Commission	Australian Taxation Office	Treasury
Key roles	▪ Monetary policy ▪ Systemic stability ▪ Payments systems regulation	• Prudential regulation of: ~ Deposit taking institutions ~ life and general insurance ~ superannuation	• Market integrity • Consumer protection • Corporations	• Enforcement of: ~ Competitive conduct rules • Administration of: ~ Authorisation of anti-competitive conduct ~ Accessed to essential facilities ~ Prices surveillance	• Enforcement of: ~ Taxation regulations	• Enforcement of: ~ Foreign Acquisition and Takeovers Act by Foreign Investment Review Board

Source: Adapted from table, additional documentation tabled in association with the Statement by the Treasurer, The Hon Peter Costello, MP, House of Representatives, 2 September 1997.

- reducing capital gains tax for small business by replacing the existing 50 per cent capital gains tax goodwill exemption with a 50 per cent general capital gains tax exemption for all active assets (with an increased threshold);

- exempting venture capital investments capital gains earned through Pooled Development Funds by Australian superannuation funds, and exempting capital gains tax investments in venture capital projects in Australia by non-resident tax exempt pension funds, such as US and UK pension funds; and

- reducing the compliance burden for businesses and primary producers (that is, businesses with an annual turnover of less than A$1 million) by the introduction of a Simplified Tax System.

4.12 The first phase also proposed a broadening of the taxation base of life insurers, including the taxation of trusts like companies (which is under consideration by Parliament), and the implementation of improved anti-avoidance measures.[8]

4.13 On 11 November 1999 the Treasurer announced the second phase of reform for implementation. The first group of measures in the second phase aimed to contribute to the integrity of the system by limiting the ways individuals could marginalise taxes by allocating them to an entity. Other measures aimed to assist with the introduction of entity taxation and to reform capital allowance provisions.[9]

4.14 A number of the measures proposed to meet the opportunities and challenges of globalisation within the marketplace. These measures aimed to ensure that Australia received a fair share of tax from multinationals, that Australian companies could expand overseas and that Australia could become an attractive investment location. They involved:

- strengthening the thin capitalisation rules to prevent multinationals (both foreign and Australian-based) from reducing their Australian tax by allocating a disproportionate share of debt to their Australian operations;

- reforming the taxation arrangements of foreign expatriates to prevent double taxation on foreign investments but to ensure that tax on Australian income is collected;

- improving Australia's double taxation agreements so as to improve the competitiveness of Australian businesses offshore;

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8 Information drawn from 'The New Business Tax System', *Press Release No 058*; and from 'Proposed Reforms to Business Taxation: A Critical Assessment of Some Budgetary and Sectoral Impacts', *Current Issues Brief 9, 1999–2000*, Economics Commerce and Industrial Relations Group, Parliamentary Library, 10 November 1999.

9 'The New Business Tax System: Stage 2 Response', *Treasurer Press Release No 074*, 11 November 1999, the *Treasurer* internet site: http://www.treasurer/pressreleases/199/074.asp (accessed 20 October 2000)

- providing imputation credits for foreign dividend withholding tax so as to assist Australian firms that are expanding overseas;
- strengthening the rules for foreign trusts in order to counter tax avoidance; and
- removing the ability of non-residents to avoid Australian capital gains tax by disposing of interposed entities.[10]

4.15 The Government also announced that, consistent with Ralph report recommendations, a number of important international tax issues would be subject to further review; including the foreign source income rules, and the redrafting and redesign of the international tax legislation.[11] Phase two measures also reflected the Government's acceptance of the report's recommendation for fundamental change in the method of determining taxable income for business, in that the existing law based on legal definitions of income would be replaced with a more structured framework for the treatment of expenditure and assets.[12]

4.16 Finally, the Government made a commitment to carry on with further reviews and to maintain the more integrated and consultative arrangements which have been central to the Review of Business Taxation. In particular, it agreed to establish an on-going non-statutory Advisory Board which would ensure access to private sector expertise, not only on business tax but on all aspects of tax law, on a regular basis.[13]

4.17 The first package of legislation implementing the recommendations of the report for a new tax system (ANTS) was introduced into Parliament on 2 December 1998. It included the goods and services tax, Australian business number and fringe benefits tax. The fringe benefits tax legislation received Royal Assent on 19 April 1999 and applied from that month. The rest of the package received Royal Assent on 8 July 1999. The goods and services tax applied from 1 July 2000.[14]

Ongoing review— the Corporate Law Economic Reform Program (CLERP)

4.18 The implementation of the proposals outlined above required substantial change to the legislative framework within which Australia's financial sector operates, initiating an ongoing program of inquiry and review by Government departments and by Parliament.

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10 ibid.

11 Three aspects having an important bearing on tax minimisation schemes were: rules for taxing foreign sourced income; tax havens—claims for deduction of payments; and, record keeping by multinational enterprises.

12 See 'Proposed Reforms to Business Taxation: A Critical Assessment of Some Budgetary and Sectoral Impacts', *Current Issues Brief No 9, 1999–2000*.

13 'The New Business Tax System: Stage 2 Response', *Treasurer Press Release No 074*, 11 November 1999, the *Treasurer* internet site.

14 *Commissioner of Taxation Annual Report 1998–1999*, p. 8.

4.19 The Financial Services Reform Bill (CLERP 6), which proposed amendments to aspects of Corporations Law, was a significant reform initiative for the financial services sector under consideration in 2000. It is the sixth stage of the Corporate Law Economic Reform Program, a fundamental review of key areas of regulation affecting business and investment activity, and arose out of the recommendations of the Financial System Inquiry. An exposure draft of the Bill was released for public comment on 11 February 2000.[15]

4.20 In introducing the draft Bill, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, announced that it would drive the 'internationalisation of Australia's financial services sector' through engineering a 'complete reform' of the delivery of financial services.[16] The draft Bill proposes to replace existing chapters 7 and 8 of Corporations Law with a new chapter 7. The new chapter aims to put in place a competitively neutral regulatory framework, making regulation uniform by removing compliance costs and unnecessary distinctions between products.[17] It also aims to introduce a more consistent system of consumer protection with an emphasis on self-regulation.[18]

4.21 This draft legislation has been the subject of scrutiny by industry and by the Parliamentary Joint Statutory Committee on Corporations and Securities, which produced a report on the draft Bill in August 2000. While the draft Bill received broad industry support there have been a number of concerns expressed by the States about the Commonwealth's regulatory powers which delayed the Bill. By December 2000, however, there was some progress with New South Wales and Victoria (key states disputing the Bill) reaching an in-principle agreement, but a new date is yet to be set for the legislation.[19]

4.22 Meanwhile, the next phase of reform, CLERP 7, for which ASIC received Budget allocation in 1999–2000, is in progress. CLERP 7 aims to change obligations, processes and fees payable for every Australian company. In doing so, it will initiate a review of the range of paper-based documents companies are required to lodge by law.[20]

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15 *Report on the Draft Financial Services Reform Bill*, August 2000, Parliamentary Joint Statutory Committee on Corporations and Securities, pp. 3 and 4.

16 Quoted in Tony Walker, 'Hockey Sticks Up for Us as a World Player', Professional Services, *Australian Financial Review*, 3 November 2000, p. 73.

17 *Report on the Draft Financial Services Reform Bill*, August 2000, Parliamentary Joint Statutory Committee on Corporations and Securities, pp. 3, 4.

18 See Walker, 'Hockey Sticks Up for Us as a World Player', Professional Services, *Australian Financial Review*, 3 November 2000, p. 73.

19 *Super Funds,* SAF: the Voice of Super, February 2001, p. 11.

20 The Hon. Joe Hockey, MP, Minister for Financial Services and Regulation, Address to the Financial Planning Association Luncheon, 25 May 1999, Melbourne, p. 5. *Department of the Treasury* internet site: http://www.minsfr.treasury.gov.au?speeches/1999/014.asp

The new taxation and regulatory systems: implications for business and consumers

4.23 The challenge for modern governments is to develop consistent regulatory and taxation regimes that set the right balance between promoting innovation and the internationalisation of business, while at the same time ensuring consumer protection and market integrity.[21]

4.24 The Department of the Treasury judged that the Wallis reforms have provided a more consistent regulatory framework for financial institutions.[22] It asserts that complementary developments in reform of national competition policy occurring throughout the 1990s have improved productivity and performance, which have also been enhanced by privatisation of infrastructure services, such as in telecommunications, and various industrial reforms which have made workplace arrangements more flexible.[23]

4.25 The Government believes that taxation reforms are a key component in engineering the success of the global financial centre initiative. The Department of the Treasury advised that implementation of the New Tax System and of ongoing reforms to business tax has already supported growth, and will continue to enhance the competitiveness and efficiency of the Australian economy. It explained that the new business tax arrangements aim to provide Australia with a company tax lower than most OECD countries, including the US, and to bring it into line with those in the Asia–Pacific region. Meanwhile, capital gains reductions are designed to remove impediments to efficient asset management, improve capital mobility and make Australia's capital gains tax internationally competitive.[24]

4.26 In addition to these new business tax arrangements, the Government reports that the implementation of the GST from 1 July 2000 has brought about a number of important advantages for business, including the unification of state taxation regimes. The Department of the Treasury advised that under the Intergovernmental Agreement on the Reform of Commonwealth–State Financial Relations, State Governments will receive GST revenues allowing them to abolish taxes on debit tax by July 2005, and on quoted market securities from July 2001. This, it is predicted, will significantly reduce costs to the financial sector and the export of financial services will be GST free.[25]

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21 ibid.

22 The Committee will examine the regulatory framework in a separate report arising out of term of reference (a) prudential supervision and consumer protection for superannuation, banking and financial services.

23 Submission No 12, p. 11.

24 Submission No 12, p. 11.

25 Submission No 12, p. 10.

4.27 The RBA too has observed that the Australian financial services sector now operates in a more competitive, market-based system which allows diverse products to be offered through a range of vehicles. The RBA concludes that deregulation in particular has produced four significant changes:

- the strong growth in the size of financial markets and in their sophistication;
- an increase in the overall size of the financial sector relative to the rest of the economy;
- a tendency towards 'disintermediation'—for borrowers and lenders to bypass financial intermediaries and deal directly with each other; and
- increased efficiency in the financial system, with competitive pressure predicted to reduce interest margins and put a downward pressure on costs.[26]

4.28 As a complement to the above restructuring and reform, the Government has also implemented significant change under the *Taxation Laws Amendments Act (No. 2) 1999*, which sought to apply initiatives announced in the Government's *Investment for Growth* statement. The Government judges these changes to be important to the promotion of Australia as a global financial centre, being designed to remove obstacles to Australia's international competitiveness. In particular, the changes aim to: extend the eligibility for institutions wishing to become an Offshore Banking Unit (OBU); widen exemptions on withholding tax to include debenture issues; and, to apply new exemptions to Foreign Investment Fund interests in specified areas.[27] A discussion of these measures is at Chapter 6.

Conclusion

4.29 The Committee notes that Australia's financial regulatory regime has undergone a period of deregulation, reform and review over the last two decades. Most recently, the Wallis Report on Australian financial systems has resulted in major restructuring and rationalisation in the regulation of the Australian financial sector. In addition a new tax system has been introduced. It was designed to simplify the existing scheme for business and included the introduction of a GST. The Ralph Review of the taxation of business has also led to further changes, while the ongoing review of Corporations Law is in process.

4.30 The Committee notes that the Australian Government maintains that this comprehensive and ongoing program of restructuring and reform is making the Australian financial sector more competitive in the international marketplace. The

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26 As identified by RA Battellino Assistant Governor (Financial Markets) of the Reserve Bank of Australia, 'Australian Financial Markets: Looking Back and Looking Ahead', March 2000, p.16.

27 Submission No 12, pp. 11–12

Committee also notes that the Government believes that taxation reforms are a key component in engineering the success of the global financial services centre initiative.

4.31 However, as will be discussed in Chapter 6, evidence to the inquiry suggests that aspects of Australia's taxation regime, regulatory regime and some corporations law issues are actually constraining Australia’s efforts to become a centre for the provision of global financial services. The Committee has made a number of recommendations to address these constraints in that Chapter.

CHAPTER 5

AUSTRALIA AS A GLOBAL FINANCIAL SERVICES CENTRE —THE OPPORTUNITIES

Australia already has a range of competitive advantages providing windows of opportunity for growth in the financial services sector. This chapter identifies these opportunities, considers ways we can build Australia's profile internationally, and what approaches may attract most benefits for Australia.

Niche opportunities for Australia

5.1 During the inquiry, the Committee heard that Australia can trade on its already established identity as a centre of world financial activity. Representatives from the Reserve Bank of Australia (RBA) reminded the Committee:

> Last year we saw the establishment of the Financial Stability Forum, which was set up by the G7 countries, the seven biggest countries, to look at financial regulatory issues. The G7 invited four non-G7 countries to participate in that forum, and they chose four on the basis of these four being significant financial markets in a global sense. One of those four was Australia. The others were Singapore, Hong Kong and the Netherlands. So the G7 recognised that Australia is already a significant centre.[1]

5.2 The RBA further elaborated:

> The Australian markets are an integral part of the world financial markets. We do have quite a good advantage in terms of our time zone, in the sense that we are a couple of hours ahead of Asia and therefore link in better with the North American markets. If you look at the comparisons in market activity, Australian markets are very well represented across a whole cross-section of financial products. So to some extent we are already there. What we are talking about here is actually building on that. It is not a question of starting up. It is a question of building. If you travel around the world, most people recognise the significance of Australian markets already.[2]

5.3 Witnesses generally agreed that the Government's initiative to promote Australia as global financial centre is timely and, if it remained responsive to global and regional developments in the financial services industry, Australia's financial services sector should succeed in building a robust international profile.

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1 Committee Hansard, p. 255.

2 Committee Hansard, p. 255.

5.4 'Responsive' in this context meant focussing on what was realistically achievable for a market of Australia's size and characteristics. Melbourne financial advisers Osborne Associates commented:

> Australia's financial services sector is small in comparison to the Asia–Pacific region and globally, and to strive to become a global financial services centre, such as New York or London, when even those centres are being broken down in their elements for various factors, is just a waste of time in the short- to medium-term. The focus should be on looking at Australia's niche opportunities and building a focus there. I could give classic examples—for example, Edinburgh and Boston are two global funds management centres, but they are not in the same league as London or New York. Nonetheless, they are very substantial, very major centres of financial services.[3]

5.5 It was thought that, to develop niches in the market, Australia must consolidate domestic strengths and work to identify those markets providing maximum opportunities. It should also establish the identity and location of its substantial client base. These two factors drive the debate about whether Australia should best focus its ambitions on being a global, as against a regional, centre for financial services.

Global versus regional opportunities

5.6 Witnesses supporting the global objective argued that to take a regional focus would be to misunderstand the global nature of developments in the financial services sector. The Securities Institute of Australia told the Committee:

> I think we have to think globally. There are specific reasons why we think Asia which are more about time zone and cultural understanding than anything else. If we only think Asia, we have lost the main game. It is not about regionalisation; it is about globalisation.[4]

5.7 Dr George Gilligan, Monash University, favouring the global approach, explained that Australia's relationship with Asia, as alluded to here, is not substantial enough for Australia to take a strong place in the markets of the region:

> …although Australia may want to perceive itself as integrally involved in the Asia–Pacific region—the other member states in the Asia–Pacific region rarely perceive Australia as that integrated. Certainly, for instance, comments by Dr Mahathir—about the utility of APEC and perceiving APEC as not being terribly useful by and large to the interests of those nations within ASEAN—are instructive on that particular point.[5]

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3 Committee Hansard, p. 203.

4 Committee Hansard, p. 604.

5 Committee Hansard, pp. 146–47.

5.8 To a number of witnesses supporting the regional focus, market size was the determining issue. The RBA judged that Australia could not hope to compete within the huge well-established northern hemisphere markets and should look to opportunities arising in Asia's developing markets. The RBA saw that:

> …the reality is that the North American financial markets are so competitive and so advanced it would be very hard for an Australian firm to break into those markets. It is similar in the case of the London markets. There are obviously niche products that Australian firms can sell there, but I think the prospects are probably much greater in the Asian region where markets are less developed. I think as a matter of being realistic it is the Asian area where the prospects are the best.[6]

5.9 Osborne Associates agreed:

> I would say that, from an Australian perspective, a geopolitical and financial services sector perspective, the primary focus should be on the Asia–Pacific region as a first and primary priority, rather than striving to be 'global', 'huge', 'New York', 'London'. We have neither the size or scale nor the abilities to be able to establish ourselves as a global centre for finance.[7]

5.10 Others argued that it is not the size but the quality of Australia's financial markets and products that make us competitive. The Investment and Financial Services Association (IFSA), for example, saw that Australia's funds management industry was well placed to offer its services globally and to develop Australia's reputation as a centre of excellence.[8] This was also supported by Professor Drysdale of the Australian National University (ANU) who commented:

> Even though we are small, we can mix it with the biggest and best of them internationally in terms of the development of financial products and in terms of the supply to the marketplace in Australia and internationally. We are potentially globally competitive.[9]

5.11 Professor Drysdale, as an expert in Australia–Asia economic relations, further clarified the global versus regional debate. He observed that, while Australia has already developed strong links to markets in the northern hemisphere, 'many of the older and larger institutions in Australia have not developed successful plays on such a scale or to such a depth in the region'.[10]

5.12 Professor Drysdale argued that by building on Australia's skills base—'especially that component which makes us able to relate more readily to this part of

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6 Committee Hansard, p. 254.

7 Committee Hansard, p. 236.

8 Submission No 11, p. 13.

9 Committee Hansard, p. 555.

10 Committee Hansard, pp. 555–56.

the world’s financial market than people from other parts of the world’—Australia can act as a vehicle for the international community to connect with the markets of the region, thereby enhancing Australia's global competitiveness.[11]

5.13 If this view is accepted, the debate about whether we should have a global or Asian focus loses significance. Witnesses overall agreed that the long term objective for Australia was to gain a greater share of global finance business—opinions only varied about the degree of emphasis placed on servicing Asian markets as the first step to achieving that objective. The issue becomes one of maximising opportunities through timely action, rather than choosing between one distinct path or another.

Global ‘gateway’—services to the Asia–Pacific region

5.14 Axiss Australia, the Government’s vehicle to promote Australia as a global financial centre, is at present positioning Australia as the financial ‘gateway’ to the Asia–Pacific region. At a public hearing, Axiss Australia told the Committee that, given world markets operate in three regions—North America, Asia and Europe, there are competitive advantages for Australia if it takes this course.[12] Axiss’s representative explained to the Committee:

> The objective of the financial centre is to ensure that Australian financial services become a gateway to the Asia–Pacific region and that we create an environment whereby the decision makers in North America and Europe use Australia as a gateway to those three billion people and the economy behind those three billion people.[13]

5.15 Axiss Australia concluded that the key to success was in having the flexibility to meet opportunities as they arise.[14] Industry representatives agreed, and identified a range of evolving opportunities for financial service providers within the region.

5.16 Osborne Associates asserted that to be successful Australia has to focus on identified sectors with genuine potential—funds management, venture capital, and research and education.[15] It reported:

> In the funds management sector, there are 60 or 70 funds management organisations in this town and a similar number in Sydney. The opportunities for those organisations to grow and develop not only here but also in a regional context are quite substantial.[16]

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11 Committee Hansard pp. 557–58.

12 Committee Hansard, p. 123.

13 Committee Hansard, p. 123.

14 ibid.

15 As identified in research conducted by the by the Melbourne Financial Services Taskforce, see Committee Hansard, p. 230.

16 Committee Hansard, p. 230.

5.17 The Australian Financial Markets Association (AFMA) confirmed there is potential to develop debt markets and to export debt skills:

> We have probably one of the most skilled securitisation debt markets in the world. We have been building and trading debt products from the early1970s, some of our natural skills and strengths. The Government, having given us large levels of debt over the last 20 years, has helped to encourage the building of debt markets and debt skills. As Asia starts to need to build its debt markets, we could take that skill and deliver it into those forums and make Sydney the hub of the Asian region.[17]

5.18 Finally, the RBA defined high value financial products and advised promoting their development to generate spin-off industries:

> …funds management is a very high value added product. There is also the debt origination things, corporate advisory work. On top of that, it is not just the straight financial products. It is all the supporting services that go with it—legal, accounting, even education. There is a whole range of services where Australia is more advanced compared with other countries in the region. I think we should look to key off those. So rather than concentrating on services where you can provide quite unskilled staff, we should look to capitalise on the very high levels of education and skills we already have here.[18]

Education—the benefits and the opportunities

5.19 Experts from a number of disciplines and industry representatives reported a range of opportunities arising from Australia’s strong credentials in education and professional training. They described how Australia's domestic strengths in training innovative professionals and educators have earned Australia an education export industry valued at over $30 billion in 1999.[19]

5.20 The Committee heard that there is potential for Australia to further trade on this, not only through attracting investment to add vitality to domestic industries, but also through building on export opportunities. While many witnesses focussed on the export of education services in finance-related disciplines and in telecommunications technology, it was also argued that cultural and language studies had great potential as a complement to these.

5.21 Another strand in the evidence drew out the importance of building understanding of financial matters and competence in financial management among the wider population. This was seen as the first step in skilling up the labour force to

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17 Committee Hansard, p. 136.

18 Committee Hansard, p. 259.

19 See ‘What is Making Australia a Global Financial Centre’, *Minister for Finance Services and Regulation Press Release no. FSR/054,* Minister the Hon Joe Hockey, *Department of the Treasury* internet site (accessed 20 October 2000)

seize the opportunities opening in the global marketplace: as investor, trader, service provider, educator and so on.

Finance and industry education for Australians—the first step

5.22 Axiss Australia told the Committee that the organisation's central business plan has a 'a very strong focus on education and skills training', based on the conviction that to realise opportunities we need to 'retain an innovative, skilled workforce within Australia'.[20]

5.23 In this context, one of Axiss's first initiatives was the establishment the Axiss Scholarship program. In 2001, forty scholarships combining work experience in leading public and private organisations in the finance and regulatory sector are being offered to top graduates in appropriate disciplines.[21] To further develop the quality of Australia's domestic industry, Axiss Australia also has in place an integrated program aimed at building IT development along with industry training and research initiatives. These are described in the section on financial training below.[22]

5.24 Witnesses agreed that the development of a level of financial literacy within the Australian community is important. Changes in the global trading and regulatory environment mean that the general population must have a better understanding of consumer protection issues, of investment and taxation matters. Without a more sophisticated understanding of financial matters, Australian can not generate the necessary level of sophistication and depth in its financial market sector to become globally competitive.

5.25 Consequently, Dr Gilligan recommended that financial management training should be part of a broader education platform, beginning with children and proceeding through to workplace based education programs, and through those run by ASIC and other agencies.[23] This view was supported by the Australian Principals Centre. The Centre warned, however, that there will be problems in sustaining a standard of teaching to support this training because of the evolving shortages of teachers generally, and maths and science teachers in particular.[24]

5.26 The Centre saw the solution in the provision of innovative teaching packages, using the internet and funded by venture capital. In its view, there were also significant opportunities for Australia through developing internet education packages and training, and for a more innovative and flexible approach to IT training than is

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20 Committee Hansard, p. 125.

21 See 'Axiss Scholar Programme', *Axiss Australia* internet site: http://www.axiss.com.au/scholar/studentsum.htm (accessed 1 November 2000)

22 'Research and Training Programmes', *Axiss Australia* internet site: http://www.axiss.com.au/training/default.htm (accessed 1 November 2000)

23 Committee Hansard , p. 148.

24 Committee Hansard , p. 584–85; and passim.

presently offered through TAFE's and universities. Australia could then develop a niche market for training and export of education in the IT area to the region.[25]

Building market opportunities in the finance sector

5.27 The Government advised the Committee that Australia has already laid very good foundations for building niche markets for educators in the financial services industry through out the Asia–Pacific region. In his submission to the Committee, the Minister for Trade the Hon. Mark Vaile MP referred to the activities undertaken by Government in establishing bilateral relationships and building ties through regional bodies, such as the Asia Pacific Economic Cooperation (APEC).[26]

5.28 In particular, the Minister cited the steps taken by APEC Finance Ministers to strengthen regional financial architecture, noting that, in response to the Asia currency crisis in 1998, the Australian Government had committed A$50 million under the Economic and Financial Management Initiative to strengthen financial infrastructure in affected countries. Among other things, this involved provision of training for banking supervisors and industry regulators throughout the region.[27]

5.29 This initiative drew on the expertise of Australian industry educators, regulators and Government departments, providing an opportunity, not only to showcase Australian expertise in the region, but also to establish ties and consolidate relationships between institutions, industries and governments.

5.30 To further bolster Australia's regional and international reputation in this area, Axiss Australia works with other public sector, corporate interests and educators to build opportunities and establish strategic alliances through which Australia can network the globe. A number of collaborative arrangements have evolved, including:

- STARlab which provides practical training in financial markets and aims to be the Asia Pacific's leading business school;
- the Securities Institute of Australia which works with securities regulators and exchanges, industry professional associations and government-linked funds managers in the Asia–Pacific region to provide tailored practical education and training to local markets; and
- the Securities Industry Research Centre of the Asia Pacific (SIRCA) which conducts applied research into the design of equity, futures, over the counter markets and market impacts of financial information, with the aim of improving efficiency of national and regional market.[28]

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25 Committee Hansard, pp. 584 and 585.

26 Submission No 35, pp. [1–2].

27 ibid. p. 3.

28 'Research and Training Programmes', *Axiss Australia* internet site.

5.31 In June 2000, Minister Hockey announced a major new Axiss initiative in this area—the Australian Financial Services Training Alliance (AFSTA), which is to provide training on a global scale to financial services organisations. It aims to deliver, online, an entire range of products for all aspects of financial services training. Members of the Alliance, comprising some 14 industry and training bodies, may also offer joint programs as well as undertaking joint marketing and promotional activity in Asia.[29]

5.32 Axiss Australia's focus on opportunities arising out of provision of quality education and training in the finance and related areas was endorsed by industry organisations and educators who also argued that building Australia's professionalism and expertise will open doors of opportunity and strengthen the global potential of the industry.

5.33 A member of the International General Insurance Committee of the Insurance Council of Australia stated:

> We see potential for the promotion and development of Australia as a centre of excellence. By this we mean that Australia is extremely well serviced with its skill base in the area of general insurance, including risk management, actuarial, financial, catastrophe modelling, statistical and, of course, basic underwriting and claim skills as well as a range of other general management skills.[30]

5.34 In its submission, CPA Australia observed that Australia's regional standing is already well established, with training in Australian institutions in accountancy, business and finance sector being highly sought after throughout out the East Asian region.[31] Osborne Associates reported that Australian institutions are also locating overseas to provide training:

> There are very fine universities here that are reaching out into the Asia-Pacific region. Monash has operations in Malaysia; others have them in other parts of the region. Some are going into India. So there are opportunities there. [32]

5.35 The Committee also heard that industry bodies are bolstering the status of the industry by developing professional standards of accreditation for the finance sector. The Securities Institute of Australia (which plays a major role in industry education), for example, told the Committee of Australia's active involvement in the launch of a new global qualification called the Certified International Investment Analyst.[33]

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29 'Research and Training Programmes', *Axiss Australia* internet site.

30 Committee Hansard, p. 242.

31 Australian Society of CPAs (CPA Australia), Submission No. 5, p. 2.

32 Committee Hansard, p. 230.

33 Committee Hansard, p. 602.

5.36 The Australian Financial Markets Association (AFMA) told the Committee of the 'huge opportunity' opened by this process. The Association convenes accreditation programs for the industry and is developing a professional program for stockbrokers at present. It observed:

> We need to build a program of equalisation of our professionals so that the professional status, training and educational qualifications of our operatives here are equal to those of any other country in the world. That creates a high level of regard, of respect, for what we are doing in this country. It also creates a transferability of people both from other jurisdictions coming here and of Australian professionals moving into international markets.[34]

5.37 The Committee also heard that another area of significant potential is in providing actuarial training, arising from the restructuring of Asian and Japanese financial markets. Osborne Associates observed that there is therefore 'tremendous opportunity in a regional context' for the actuary profession to grow and develop.[35] The firm also reported on the emergent export of privatisation skills, with the skills base established in Victoria enabling the export of legal services on privatisation to South Korea by Melbourne solicitors.[36]

Asian language and cultural studies

5.38 The Committee heard that Australia's cultural diversity and language skills have proven to be a drawcard to overseas investors and industries, particularly in the provision of backroom services, as discussed below. In terms of developing Australia's credentials overseas, the Committee was told that Australia can also boast a high international standing in provision of Asian studies programs, feeding Asia literate experts into the financial markets of the region.

5.39 Professor Milner, Dean of the Faculty of Asian Studies at the ANU, told the Committee that the university has the largest concentration of Asian specialists in any single university in the world. He also reported that Australia has the most extensive network of universities in the region—in Griffith, Sydney, Monash and Melbourne—offering Asian studies with broad Asian interests. Professor Milner emphasised that these centres were exceptional in offering a wide range of Asian languages, something that is not available anywhere in Asia, other than in Japan.[37]

5.40 Professor Drydale said that a number of elite students coming out of these centres are currently working in financial markets in Japan, Singapore, Hong Kong. He believed that a role could be played by these experts in forging links between Asian and Australian institutions by working for and with them in the region.[38]

34 Committee Hansard, p. 135.

35 See Committee Hansard, p. 239.

36 Committee Hansard, p. 239.

37 Committee Hansard, p. 552.

38 Committee Hansard, p. 556.

Professor Drysdale also saw 'strong potential' for this new generation of Asia literate experts—combining language training and more general training in the professions with in the region—to breakdown institutional and legal barriers which have so far operated against Australian penetration of the markets.[39]

5.41 However, both Professors Drysdale and Milner warned that low morale and funding limits in the university sector would not promote these developments.[40] The need to ensure an adequate supply of an appropriately educated workforce in Australia is addressed in Chapter 8.

Backroom services

5.42 Providing administration or back room services—in funds administration, investment management and information processing—to major financial centres has provided opportunities for new centres to claim a share of global wealth. Ireland's International Financial Services Centre (IFSC) is a case in point. The IFSC has quickly established itself as the second largest funds administration and custody centre in the world. It functions primarily as a service centre for investment management, with investment decisions being made in the traditional locations of London and New York.[41]

5.43 Australia's cost competitiveness in providing all capital market functions, from front to back office activities, was established by a recent study conducted by the Gemini Consulting Group—the *Asia Pacific Capital Markets Survey 1999: Benchmarking Study of Operating Costs.*[42] The study identified Sydney and Singapore as the main contenders to become the region's primary processing centre.[43]

5.44 Australia is therefore in a position to capitalise on predicted trends which estimate that 80 per cent of the top American and European companies will seek to have a presence in the Asia Pacific, within the next five years.[44]

5.45 The Committee heard that this cost effectiveness is complemented by Australia's diverse language and cultural skills which, with the generally high skills-base of its workforce, makes Australia attractive to major industry players seeking to establish call centres for financial services.

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39 Committee Hansard, pp. 556–57.

40 Committee Hansard, pp. 561–62.

41 See **Appendix 4** for more detail.

42 'Gemini Confirms Australia as Key Global Financial Centre', Minister for Financial Services and Regulation*, Press Release no. FSR/056*, *Department of the Treasury* internet site.

43 This was based on an assessment of the comparative costs of processing, foreign exchange, money market, debt securities and derivative transactions in all major financial centres in the Asia Pacific region—Sydney, Hong Kong, Singapore and Tokyo. See 'Gemini Confirms Australia as Key Global Financial Centre', ibid.

44 Kate Marshall, 'Attractions of an Asian Time Zone', Special Report: Call Centres, *Australian Financial Review*, 6 December 2000, p. 14.

5.46 Professor Drysdale saw the establishing of backroom services as integral to the development of Australia as a financial services centre, with linguistic skills enhancing opportunities:

> One of the interests, of course, in the provision of financial market services from an Australian base is to develop our capacity from this base to provide more back-room services to major institutions in the region—including Japanese institutions, I might say. We have a particular advantage, not only because of our educational focus in Australia on the Asian area but also because of our multicultural society, particularly in Sydney, I think, covering all the language streams, to develop the provision of those services to the East Asian market on a scale and from a competitive base that should see significant enhancement of our share in those markets.[45]

5.47 Osborne Associates concurred with this view, pointing out the attraction to major industry players is already proven:

> Australia might like to look at call centres for the Asia–Pacific region where there is a need for a wide range of linguistic abilities to be able to service the region. A classic example would be American Express which had its regional call centre placed in Sydney. One of the reasons that it did so was because of the range of linguistic abilities in Australia.[46]

5.48 The Department of Communications, Information Technology and the Arts (DCITA) told the Committee that these attractions were underpinned by Australia's level of technological expertise:

> Australia is well placed and has had significant growth in that activity, including call centres that are providing services, if you like, on a global basis, not just to customers within Australia…Australia has been considered to have particular strengths in some of these areas, because of the combination of our technical skills and also the language abilities of our population, which has helped in being able to set up facilities that do service global markets.[47]

5.49 At hearings Vanguard Investments Australia confirmed this, reporting its interest in building IT development centres in Australia and citing Australia's 'massive call centre capabilities'.[48] Vanguard reported:

> We are a huge e-commerce provider. We have a million registered users on our web site in the US and we probably have 400 people working on our web site in the US. So it is a very big part of our business going forward,

45 Committee Hansard, p. 558.

46 Committee Hansard, p. 238.

47 Committee Hansard, p. 571.

48 Committee Hansard, pp. 173–74.

> and that is actually one of the areas we would like to develop potentially in Australia.[49]

E-commerce and telecommunications

5.50 The Committee heard that developments in e-commerce and telecommunications technologies will be a key to Australia's future as a financial services centre. As Axiss Australia explained:

> …it is no longer, as the old model was, the case that London and New York were the end of a trading route where there was a port and people were there to transact in the old commodities and goods: it is now a World Wide Web with a portal and the ability for people to transact on a global basis with the fundamental things: human beings and equipment that allows that global transaction.50

5.51 Taking this into account, the International Banks and Securities Association of Australia (IBSA) advised in its submission: 'Australia should focus on our strengths when marketing, especially our world leadership in information technology and telecommunications'.[51] To do so it suggested:

> Australia should not try to confront Singapore and Hong Kong head-on with tax concessions, but outflank them with our better information technology and telecommunications capability, superior workforce and capacity to respond to quickly changing markets.[52]

5.52 As Chapter 3 of this report has recorded, Australia is extremely competitive, both globally and regionally, in terms of its usage of information technologies. **Table 4: Australia's information economy** gives an indication of this.

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49 Committee Hansard, p. 174.

50 Committee Hansard, p. 128.

51 Submission No 2, p. 18

52 Submission No 2, p. 6.

Table 4: Australia's information economy[53]

	World ranking	Asia–Pacific ranking
Computers per capita (1999)	6	1
Computer power per capita (1999)	6	1
E—commerce environment (survey)	6	2
Internet connections per capita (1999)	9	2
IT environment for business (survey)	8	2

5.53 Axiss Australia has sought to promote Australia's computer literacy as a competitive advantage to investors looking for locations with developed information infrastructure:

> The solution we have looked at as a centre surrounds the ability to provide a skilled workforce, an innovative environment—so that capital is attracted to Australia because of innovation and creativity of financial products and markets—and an IT and T structure which allows people to operate in this age of communication with the right equipment, being the computers and the communications lines at the right price.[54]

5.54 In October 2000, Axiss launched its Australian Financial Services Training Alliance (AFSTA) website. Promoted as the world's first E2B hub (education to business portal) and 'the only global one stop shop for financial services training', it is a vehicle to showcase Australia's expertise internationally as complete package—integrating industry expertise with cyberspace technology.[55] At the launch of the initiative the Minister hailed the initiative as 'a significant step forward in establishing Australia as a centre for financial services'.[56]

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53 Source: The World Competitiveness Yearbook 2000, cited in Axiss Australia, Executive Briefing, *Information Technology and Communications Infrastructure in Australia*; prepared in association with the Department of Communications, Information Technology and the Arts, *Axiss Australia* internet site: (accessed 1 November 2000).

54 Committee Hansard, p. 128.

55 'World's First Online E2B hub for Finance Sector Training Launched', October 2000, Media Centre, Media Releases, *Axiss Australia* internet site (accessed 20 October 2000)

56 'Research and Training Programmes', *Axiss Australia* internet site.

5.55 Axiss Australia's website articulates the Government's overall plan in promoting: e-commerce developments across businesses and government; the liberalisation of the telecommunications market; the development of self-regulatory consumer protection mechanisms; and in providing support for investment through the 'Building on IT Strengths' program and the Innovation Investments Fund.[57]

5.56 In support of this, the Minister for Education, Training and Youth Affairs the Hon. Dr David Kemp MP, alerted the Committee to the Government's commitment to increase skill supply in the IT area from both domestic and overseas sources. He reported the establishment of the IT&T Skills Taskforce as an industry initiative and of the IT&T Skills Exchange, which aims to improve information about skills in demand, arrange for development of appropriate courses and promote their uptake with employers, employees, students and other job seekers.[58] The Committee notes that Australia is suffering from a severe skills shortage in the IT industry, estimated to be around 30 000 jobs. The Morgan & Banks Job Index recently found that 47.8 per cent of companies reported that they were experiencing a major shortage of IT workers.

5.57 These initiatives were advanced against a background of others, involving the Department of the Treasury, the Department of Communications, Information Technology and the Arts, the Australian Taxation Office and the regulatory body, the Australian Securities and Investments Commission.

5.58 To consolidate its commitment, on 29 January 2001, the Government launched its 'Backing Australia's Ability—Innovation Action Plan' which allocates some $2.9 billion to generating Australia's research and technology base.[59] The Plan was welcomed by Australia's venture capital industry, which saw that it would encourage investor confidence in early startup and high risk investing in biotechnology, telecommunications and information technology.[60]

5.59 At hearings the Committee had also heard that the Government's wave of taxation reforms had been very effective in encouraging investment in IT. The National Office for the Information Economy, for example, told the Committee that these reforms had overseen an expansion in the availability of venture capital to fund both start-ups and long-term investment in the IT industry, with some international venture companies now showing interest.[61]

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57 Drawn from Axiss Australia, Executive Briefing, *Information Technology and Communications Infrastructure in Australia*; prepared in association with the Department of Communications, Information Technology and the Arts, *Axiss Australia* internet site.

58 Submission No 37, p. 2.

59 See 'Backing Australia's Ability—an Innovation Action Plan for the Future', Ministers Minchin, Alston, and Kemp, *Press Release*, 29 January 2001, *Minister of Industry and Resources* Internet site: http.www. minister.industry.gov.au

60 'VCs Welcome Innovation', *Investor*, 5–11 February 2001, p. 6.

61 Committee Hansard, p. 572.

Emissions and electricity trading

5.60 Other evolving areas of opportunity arising for Australia were in the greenhouse emissions (carbon) trading and in electricity trading. Both of these areas are 'leading edge' developments, the foundations of which are still being established in world decision-making fora. Witnesses saw, however, that if sound opportunities were to arise for Australia, then we must prepare now.

5.61 With regard to carbon emissions trading, the Finance and Treasury Association advocated awareness but caution:

> It is a fairly leading-edge kind of area with potentially a great impact on Australia's economy and of course also potentially an area in which we can be quite active. We have a number of Australian industries, and our forestry sector, for instance, has a lot of opportunities to create carbon credits so we can become quite involved in that area. I think we have taken a realistic position and, until a little bit more is known about whether there is going to be full agreement to the Kyoto Protocol, we are concentrating our efforts on other areas. I am merely flagging it as a potentially significant arena for activity.[62]

5.62 While the Australian Greenhouse Office, recognising the significant opportunities, saw merit in early preparations:

> Most other industrial countries would not have the forest sequestration potential that Australia would have. So we do have potential supply. If a market is established, it would attract capital into the development of our forests, which would increase our carbon sequestration ability or performance and, in effect, would cause the creation of a greater number of credits which could be used for trading purposes. So in that context, the Sydney Futures Exchange and others have seen that potential and are working to develop a market. You might comment that they are, in effect, positioning themselves in a market the rules for which as yet are unknown. But in all probability, if players do not position themselves in that market now, it will be too late when the rules are eventually known. So it is a useful activity to start positioning now.[63]

5.63 Indications are that this thinking is timely—even though the Kyoto Protocol Agreement may not be ratified before 2003, opportunities for Australia are already manifesting. A recent agreement between NSW State Forests and the Tokyo Electric Power Company will see 40 000 hectares of new forest planted, allowing Japanese power stations to write—off tons of carbon emissions. In exchange, it is reported that

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62 Committee Hansard, pp. 272–73.

63 Committee Hansard, p. 593.

NSW will receive $130 million to invest in new forests and create 200 jobs in the regions.[64]

5.64 According to the Finance and Treasury Association, the potential of electricity trading is equivalently great:

> It is a very rapidly growing market. There are some very big dollar amounts involved. There are some international players there, so it is not simply a question of one Australian wins and one Australian loses. If we do not build our expertise in this area, money will flow out of Australia. We are quite leading edge in electricity in terms of putting it on the market, having the national electricity grid, and our professionals are in demand overseas. Something like that Pacific Power case highlighted that there is still a long way to go there. Electricity trading has been happening in Australia for five years or so now and it is still at that stage.[65]

5.65 These developments show that carbon and electricity trading opportunities are not just a dim possibility. Australia has, apparently, some potential in both these areas. Vigilance kept on international developments should yield competitive advantages to Australia that few other countries could match.

Conclusion

5.66 Although Australia has already achieved some recognition as a centre of world financial activity, the Committee considers that there are significant opportunities for Australia to strengthen its position as a global financial services centre. In particular, the Committee considers that positioning Australia as the financial gateway to the Asia–Pacific region can assist in the realisation of Australia's global financial services ambitions. The challenge is to ensure that in pursuing the 'gateway' objective Australia does not become just a branch office for multinational companies to channel their more productive investment into Asia.

5.67 To avoid this, the Committee considers that the Government should exploit opportunities existing in a number of other areas, especially by:

- building on the range of opportunities arising from Australia's strong credentials in education and professional training to build expertise and innovation among professionals and educators as well as to export skills and financial expertise;
- building on Australia's cultural diversity and linguistic skills, especially in Asian languages;
- sharing in the opportunities to provide backroom services in funds administration, investment management and information processing;

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64 Julie Macken, 'Clean Capitalism', *Australian Financial Review*, 28–29 October 2000, p. 28.

65 Committee Hansard, p. 273.

- promoting and making effective use of developments in e-commerce and telecommunications technologies; and
- taking advantage of Australia's competitive edge in the emerging areas of carbon and electricity trading.

5.68 The Committee notes that a theme underpinning the evidence to the inquiry was that, to ensure benefits arise, the Australian Government and the finance industry needs to be responsive to evolving opportunities in the market place, particularly to developments in the Asia–Pacific region.

Recommendation 2

5.69 The Committee recommends that Government and industry continue to monitor Australia's potential to develop niche markets in the Asia–Pacific region and work together to identify educational, IT and other initiatives which will generate opportunities for Australia and enhance Australia's reputation in the global financial services industry.

5.70 The Committee also sees merit in suggestions from witnesses that Australian policy makers should adopt as a guiding principle the aim of generating *genuine* market opportunities for Australia: through promoting development at the value-added end of the financial services market—in funds management, venture capital, and research and education.

Recommendation 3

5.71 The Committee recommends that to support the global financial centre initiative a 'whole of government' approach should be adopted to promote development at the value-added end of the financial services market to maximise opportunities and build wealth for all Australians.

5.72 Additional recommendations building on the opportunities outlined in this chapter are in Chapter 8—'Improving Australia's Potential as a Global Financial Services Centre'.

CHAPTER 6

AUSTRALIA AS A GLOBAL FINANCIAL SERVICES CENTRE —THE CONSTRAINTS

While Australia has many advantages and opportunities to achieve its goal as a centre for the provision of global financial services, a number of constraints were identified in evidence to the inquiry. The most significant of these related to Australia's taxation and regulatory regimes, including those aspects affecting foreign investment and expatriate staff, and to developments in Corporations Law. This chapter examines these issues.

Nature of the constraints—an overview

6.1 The constraints identified to the Committee appear to be both attitudinal and real, and go to the heart of comparisons made by the major investors between the other major centres and any perceived advantages in locating in Australia. As the AMP advised the Committee:

> Simply put, Australia will only become a centre for global financial services if, on balance, the relative advantages of purchasing financial services in Australia outweigh the relative costs.[1]

6.2 While acknowledging that constraints exist, and that it is not going to be easy, a number of witnesses pointed out that there are no particular 'show stoppers', and that the goal is realisable with minimal costs. Nevertheless, it was agreed that there is a need to overcome some uncertainties about the level playing field concept as it relates to Australia and overseas market operators.[2] For example, Vanguard Investments Australia Ltd noted:

> I do not believe the changes required are too great or too costly to implement. They mainly require some willingness to understand a fairly complex area and a will to make progress.[3]

6.3 Many of the issues which have been raised in evidence to the Committee have been discussed with the responsible policy departments, including the Department of the Treasury and the Australian Taxation Office (ATO). Their responses are included in the report. The Committee is pleased to note that some of the issues raised are matters which are already receiving attention by the Government. Nevertheless, the

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1 Submission No 10, p. 7.

2 For example, RBA Committee Hansard, p. 253 and ASX Committee Hansard, p. 111.

3 Submission No 15, p. 2.

Committee has considered the constraints put in evidence to it and, where appropriate, has made recommendations for further action.

Taxation issues

6.4 Based on industry evidence received by the Committee, Australia's taxation regime would appear to be the most active constraint on Australia's competitiveness in the international market place. According to some, Australia has a reputation as a 'high tax' country and this impedes its development as a finance centre.[4] While there was no suggestion that Australia should seek to replicate the tax concessions offered by some competitors, nor to compete with tax havens such as the Republic of Vanuatu, evidence to the inquiry emphasised that Australia's success depends on having an internationally competitive tax system.[5] Others submitted that, where possible, we should 'outflank' competitors with superior information technology and telecommunications capability, superior workforce and capacity to respond more quickly to changing markets.[6]

6.5 Whilst they are all interrelated, the issues raised primarily concerned Australia's Offshore Banking Unit regime, the treatment of Collective Investment Vehicles, withholding taxes, instances of double taxation, and other corporate tax issues. In the view of some, these issues, which are discussed in turn below, 'threaten the competitiveness of the funds management industry in Australia'[7] and 'are detrimental or not favourable to international activity in financial markets here'.[8]

6.6 The issues raised provide the Government with a dilemma. On the one hand, the Government has the objective of the establishment of a global financial services centre and attempts to attract foreign investment and capital finance 'traffic' through the provision of a globally competitive taxation regime; on the other hand, there are issues of prudential supervision and the need to 'ring fence' certain concessional measures; issues of international taxation neutrality and the Government's commitment to its membership of the OECD; the OECD's commitment to eliminating 'unfairly competitive' tax regimes; and the Government commitment to maintain a revenue base to support national infrastructure.

Offshore Banking Units

6.7 An Offshore Banking Unit (OBU) is an entity that institutions may set up to operate financial transactions between non-resident borrowers and lenders. These are concessionally taxed at 10 per cent in Australia. Two separate issues were raised in

4 Submission No 14, p. 4.

5 For example, Submission No 12, p. 19.

6 For example, Submission No 2, p. 6.

7 Submission No 15, p. 3.

8 Committee Hansard, p. 161.

relation the OBUs. Firstly the issue of whether, by OECD standards, Australia had a harmful taxation regime for OBUs; secondly, whether the current arrangements for OBUs should be extended and/or simplified.

6.8 In relation to the first issue: during the course of the inquiry, the OECD released a report titled *Toward Global Tax Co-operation* which listed a number of countries including Australia, as having 'harmful' taxation regimes or practices. [9] The report followed a 1998 study of harmful tax competition and a decision at that time by the OECD Ministerial Council to pursue a project whereby OECD member countries would identify, report and eliminate the harmful features of their preferential schemes. This report was essentially an update on the progress of that project.

6.9 Australia's OBU regime was also listed along with Ireland's Financial Services Centre, Canada's International Banking Centres, Belgium's Co-ordination Centres (to name a few) as a potentially harmful, preferential taxation regime.[10] The OECD report defined a preferential tax regime as being potentially harmful, as follows:

> …a preferential tax regime is identified as potentially harmful if it has features that suggest that the regime has the potential to constitute a harmful tax practice, even though there has not yet been an overall assessment of all the relevant factors to determine whether regimes are actually harmful.[11]

6.10 In seeking clarification from representatives of the Department of the Treasury and the Australian Taxation Office (ATO), the Committee was informed that the Australian scheme had essentially been caught up in the formal analysis of taxation regimes by the OECD report. The ATO was confident, however, that when the final analysis is prepared during the next 12 months, Australia's OBU regime would be vindicated. The Department of the Treasury indicated that the scheme was no more favourable than many others:

> I think that it is quite misleading to paint Australia as a tax haven. The process to date has been that, since about 1997, the OECD was looking at potentially harmful tax regimes within member countries. It was drawing a distinction between them and tax havens as classically understood.
>
> …there was quite a substantial list of regimes in member countries that were listed as potentially harmful. So Australia in no way has been singled out in that sense, or is the only one.

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9 *Towards Global Tax Co-operation, Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs, Progress in Identifying and Eliminating Harmful Tax Practices,* OECD 2000, p. 12.

10 ibid, pp. 12–13.

11 ibid, p. 12.

> I think that it is fair to say that Australia has really been caught up in the formalities of this. No one, or very few, actually see our OBU regime as harmful in the sense that it was really targeted.
>
> In terms of the countries that are on this list of potentially harmful, it also includes—apart from Australia-the United States, Canada and France.[12]

6.11 The second concern about the OBU scheme was the obverse. Witnesses and submissions to the inquiry sought to have the OBU scheme extended and/or simplified and to have its features 'marketed' as an advantage for a global financial services centre. In its original submission to the Committee, the International Banks and Securities Association (IBSA) stated: 'The offshore banking (OBU) regime is neither easy to administer or understand'.[13]

6.12 Australia requires that businesses keep separate accounting records for their domestic and Offshore Banking Unit activities, to ensure that the OBU regime is 'ring fenced' and the concessional 10 per cent tax rate is not abused. Following a request by the Committee to further clarify its concerns, IBSA provided a supplementary submission commenting that:

> …member banks have frequently commented on the complexity of the OBU legislation and difficulty in interpreting it. The OBU regime needs to be better presented and marketed.[14]

6.13 IBSA suggested a number of enhancements to improve the attractiveness of the regime including changes to the rules for apportioning expenses; removal of GST from OBU transactions; clarification of certain rules including access to the regime; removal of dividend withholding tax from OBU profit repatriations; widening the eligibility criteria for OBU status to include corporate treasuries; widening the range of activities to include back office processing; and improving the flexibility of authorities to update the OBU regime to maintain its competitiveness.[15]

6.14 Professor Gordon de Brouwer also expressed the view that the operation of the OBU regime was actually undermining the integrity of the regime. In his view, there are concerns associated with the definition of an OBU—as an OBU earning more than 10 per cent of its income through non-OBU sources, then ceases to be an OBU. Professor de Brouwer explained that it was 'necessary to reduce the complexity or difficulty involved in operating the system if international business is to be done here.'[16]

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12 Committee Hansard, pp. 607–08.

13 Submission No 2, p. 4 and Committee Hansard, p. 201.

14 Submission No 18, Attachment 2, p. 1.

15 ibid.

16 Committee Hansard, p. 163.

6.15 The Australian Taxation Office responded in detail to the various issues raised above. It acknowledged IBSA's concerns relating to the complexity of OBU rules for apportioning expenses and about the application of the new thin capitalisation rules to OBUs. The ATO reported that it is holding ongoing consultations with IBSA, and a number of other bodies, in order to solve any problems related to expense allocation.[17]

6.16 The ATO discerned that IBSA's main objection to the present OBU regime is to the guidelines, which allow the Treasurer to determine whether a company is an OBU. The ATO also noted IBSA's complaint that the guidelines do not make it clear what capital, employment and other requirements the Tax Office might expect of an overseas applicant.[18]

6.17 The ATO responded by enunciating the terms for classification of OBUs, and noting that APRA and the ATO also assess each application in detail according to these guidelines. The ATO explained that there are no specific capital or employment requirements in the guidelines because these are not the principal areas of concern. It advised that the value adding propensity of firms is assessed by other criteria, and emphasised:

> It should be noted that, apart from allowing only appropriate companies to be eligible for declaration as an OBU, the whole of the OBU regime is designed to ensure that the offshore banking activity occurs in Australia, the activity adds genuine economic value and the concession is not abused, for example by being used as a mere conduit for income or for activities like money laundering. Whether the enterprise will add value will depend on the functions to be performed, the assets to be used and the risks that will be assumed.[19]

6.18 Further, the ATO stated that the OBU regime is overall 'concessional' when the entire package is considered. It concluded 'it is up to individual companies to determine whether the benefit of a concessional income tax rate of 10 per cent outweighs the costs they perceive are involved in obtaining that benefit.'[20]

6.19 In response to the Committee's request for information on the subject of OBUs, the Department of the Treasury endorsed the ATO's view advising that: 'The Government is committed to developing Australia as a global financial centre and the OBU regime is a component of that strategy.'[21]

6.20 The Department of the Treasury justified the Government's position *vis a vis* Australia's international standing on tax concessions by submitting that Australia is

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17 Submission No 38, pp. 7 and 9.

18 ibid, p.7.

19 ibid, p. 8.

20 ibid, p. 9.

21 Submission No 36, p. 3.

not alone in having a regime listed as 'potentially' harmful and there are no immediate implications. It advised that the Australian OBU regime is comparable to similar off-shore financial regimes; and that consistent with the OECD timetable, Australia will work with the OECD over the next three years to develop guidelines to determine 'actual' harm and further evaluate regimes that have been listed as 'potentially' harmful.[22]

6.21 The Department of the Treasury also advised that, in agreeing to the OECD work on harmful tax practices in 1998, Australia made it clear to the OECD that taxation should not inhibit Australia from being attractive to financial centre activities; and that further evaluation of Australia's OBU regime by the OECD will need to take that policy position into account.[23]

Collective Investment Vehicles

6.22 Collective Investment Vehicles (CIVs) are mechanisms such as unit trusts which enable less wealthy investors to band together to invest in particular assets. Whereas a wealthy individual could invest directly, these vehicles allow others to combine their capital to invest. To retain some equity of taxation treatment these vehicles are allowed a flow-through taxation system whereby they are not taxed as an entity but the tax becomes a liability of the individual investor.

6.23 CIVs and the treatment of taxable income and capital gains derived from them was one of the major issues raised by witnesses and in submissions as an impediment to the establishment of the global finance centre. Under proposed new arrangements recommended by the Ralph Review of Business Taxation, flow-through taxation treatment for income derived from CIVs will only be permitted in certain circumstances.[24]

6.24 In its submission, Vanguard Investments Australia noted that 'the proposed definition of a CIV is too restrictive' and that it 'will hinder new starters in the funds management business'.[25] Vanguard went on to explain that:

> Vanguard would not have been able to launch its retail fund range under the proposed rules because flow through taxation would not have been available due to the number of investors required in its funds in the early stages of launch (the first 12 months).
>
> Further, the definition of a CIV introduces a rigidity of structure for managed fund offerings by restricting the ability of the fund manager to

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22 Submission No 36, pp. 3–4.

23 Submission No 36, pp. 3–4.

24 See Review of Business Taxation, *A Tax System Redesigned, More Certain, Equitable and Durable,* Report, July 1999.

25 Submission No 15, p. 3.

> divide its investors into classes based upon criteria which have nothing to do with taxation (for instance, institutional and retail classes of units in a fund as is the norm for US mutual funds)…
>
> The Government's proposed changes to the tax system in relation to CGT and CIVs put US funds at a disadvantage to local funds because Australian investors in US funds will not get flow through taxation treatment.[26]

6.25 Similarly, Skandia Assurance and Financial Services submitted that the definition of CIVs was 'restrictive'; in particular, that the 300-member test for CIVs was regarded as being too high, and that this should be reduced to a lower threshold.[27]

6.26 The Investment and Financial Services Association (IFSA) also drew the Committee's attention to problems which it perceived with the CIVs. Fundamental to IFSA's concerns are that 'indirect investors in managed funds should be treated identically to other investors…who choose to invest directly in property and shares'.[28] At the public hearing, IFSA elaborated by stating that, while it was originally supportive of the CIV category, the actual definition of what a CIV will be will exclude large sections of the industry, such as Listed Investment Companies (LICs), which currently operate as CIVs.[29]

6.27 IBSA, too, expressed further concerns in its submission, advising the Committee that:

> Follow through on financial tax policy must be more decisive and consistent to enhance credibility amongst other things. For example, the foreign investment fund (FIF) initiative, enacted in 1999, to increase competition in the funds management market, by improving access by US funds, is under threat from Review of Business Tax reforms. Should this threat materialise, the effective reversal of policy…could do significant harm to Australia's reputation as a location from which to conduct financial business.[30]

6.28 IBSA also submitted that: 'There is a strong case for [the Government] to remove the potential blockage to competition from foreign funds, for example, by determining that FIF-exempt offshore funds be included in the definition of CIV'.[31]

6.29 As part of its evidence about the CIV issue, Skandia also expressed concern about the FIF tax rule, suggesting that, while the exemption from foreign investment funds tax provided to US mutual funds was an important step in the development of Australia as a centre for global finance, the non-inclusion of US mutual funds in the

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26 Submission No 15, pp. 3–4.

27 Submission No 13, p. 2 and Committee Hansard, pp. 183 and 186.

28 Submission No 11, p. 15.

29 Committee Hansard, p. 97.

30 Submission No 2, p. 4.

31 Submission No 18, Attachment, p. 8.

CIV definition appears to have diminished this important development and, in its view, is ‘somewhat contradictory in relation to the Government’s earlier stance of open competition’.[32] In Skandia’s view, with all foreign funds, other than US funds, subject to this onerous FIF tax, and local registered Australian funds not being required to bring to account unrealised capital gains, this has created an ‘unfair playing field’.[33]

6.30 The AMP submitted that the current FIF rules are ‘inefficient, distorting and require Australia to incur significant transaction costs for no identifiable efficiency to Australia’s taxation system’. Further the AMP described the rules to be a ‘classic case of utilising a sledge hammer to solve a perceived evasion problem’.[34]

6.31 When asked by the Committee to respond to the issues raised about the problems being experienced with the restrictive definition of CIVs, the Department of the Treasury initially advised that ‘the Treasurer has that issue under active consideration’.[35]

6.32 In a subsequent submission, the Department of the Treasury elaborated its response by stating that CIVs were excluded from the Ralph Review of Business Taxation recommendation to tax trusts like companies (‘entity tax regime’), and that to prevent parties circumventing the entity tax regime, Ralph recommended that CIV status be restricted. Restrictions included a CIV being an Australian resident unit trust.[36]

6.33 In relation to the issue of the flow-through treatment of foreign funds, the Department of the Treasury also submitted that, in its view, ‘industry argues that denying flow-through tax treatment to foreign funds renders the Foreign Investment Fund exemption ineffective.’ Further, the Department of the Treasury submitted that issues raised in consultations on business tax reforms are under active consideration, including those on entity taxation and CIVs and that further consultations are expected.[37]

6.34 In November 2000, the ATO alerted the Committee to the Government’s October announcement that, after consideration of a number of representations it had received about the flow through taxation treatment of CIVs, the proposed CIV regime foreshadowed in the Ralph Review would not proceed. The ATO advised that, as a result: ‘In the interests of minimising compliance and restructuring costs, companies,

32 Submission No 13, p. 2.

33 Committee Hansard, p. 193.

34 Submission No 10, p. 8.

35 Committee Hansard, p. 635.

36 Submission No 36, p. 3.

37 Submission No 36, p. 3.

fixed trusts, limited partnerships and cooperatives will broadly retain their current tax treatment.’[38]

Interest withholding taxes

6.35 Concerns about interest withholding taxes were brought to the Committee’s attention by groups such as the Australian Financial Markets Association (AFMA), which advised that: ‘interest withholding tax is probably the biggest burden we have upon our markets at the moment’.[39] AFMA explained that the cost is believed to be somewhere between A$150 million and A$250 million per year. The Association believes that the tax should be repealed and that this would create a greater flow of transactions in and out of this country and put the overseas investor and the Australian investor economically on the same footing.[40]

6.36 Vanguard Investments Australia shared the concern about the existence of a withholding tax, pointing out that there is no dividend withholding from Ireland, and that, in its view, Australia would not be disadvantaged by moving to an environment where it allows funds to be offered to overseas investors without withholding tax, because ‘we are not getting any foreign investors today,’ and in a sense, we would have ‘nothing to lose’.[41]

6.37 Packer and Co Ltd also shared this view, submitting that the withholding tax on capital gains applied to foreign investors in Australian-based unit trusts should be removed as, with it in place, the company ‘cannot attract any rational overseas investor’. Further, Packer and Co Ltd, like AFMA, emphasised the need for a level playing field.[42]

6.38 Finally, IBSA observed that the present interest withholding tax regime provides a great disincentive to foreign banks, through disadvantaging them relative to banks incorporated in Australia.[43] To remove such perceived constraints, the Broken Hill Proprietary Co Ltd (BHP) urged the Government to act promptly and revisit the issue of dividend withholding taxes, in order to secure Australia's competitiveness.[44]

6.39 Responding to these suggestions, the ATO reminded the Committee that any consideration of withholding taxes should take into account the level of capital flows into and out of Australia, and the role of taxes in capital exporting countries: the ATO

38 Submission No 38, p. 7.

39 Committee Hansard, p. 136.

40 Committee Hansard, pp. 136 and 142.

41 Committee Hansard, p. 172.

42 Submission No 16, pp. 1–2.

43 Submission No. 2, p.4.

44 Committee Hansard, pp. 57879.

advised that capital exporting countries like Australia tend to emphasise resident-based taxing rights, as have the owners of foreign investment.[45]

6.40 The ATO perceived IBSA's main concern to be that, under current legislation, an Australian branch of a foreign bank is not seen to be a resident company, and so interest paid to the non resident bank is subject to 10 per cent interest withholding tax. However, the ATO pointed out that a range of exemptions are available for Australian subsidiaries of a foreign bank, as the bank can borrow section 128F exempt funds and on lend those funds to an Australian branch of a foreign bank.[46]

6.41 In conclusion, the ATO advised that under the various concessions allowed the full exemption can in effect be obtained (in terms of borrowings raised by means of widely distributed commercial paper). The ATO also explained that these arrangements are quite acceptable under current legislation and that, in relation to interest withholding tax, 'foreign banks are arguably advantaged rather than disadvantaged relative to banks incorporated in Australia'.[47]

Double taxation

6.42 BHP representatives also raised a concern relating to double taxation of joint venture projects offshore. Under the Ralph recommendations relating to taxing entity groups on a consolidated basis, joint venture projects are discriminated against in terms of tax payable by the various entities. The Ralph Review's consolidated income tax treatment was an attempt to eliminate complexities and costs with respect to compliance and to imbed anti-avoidance measures in those complex corporate tax structures.

6.43 However, as the BHP representative pointed out in a public hearing, many mining and exploration projects are necessarily joint ventures, either to share the risk and the rewards, or sometimes necessary for exploration in developing countries, where approvals require that the host country share in the profits of the venture. BHP advised the Committee that:

> …this is an instance that BHP is currently involved with—under the Ralph committee, if you have an offshore subsidiary—and let us take a mining project in, for example, Indonesia—that project would be subject to tax in Indonesia, but the profits could be remitted back to Australia exempt from any Australia tax in the company's hands, provided that it is a wholly owned project of BHP. However, if it were a joint venture project—and I must say that this is really the norm, not the exception, when we talk about mining and petroleum projects offshore in the commodity businesses—to share risk and rewards it is very common for incorporated companies to joint venture.

45 Submission No 38, p. 5.

46 Section 128F of the *Income Taxation Assessment Act 1936* exempts interest from withholding tax interest paid or credited on publicly offered debentures. See Submission No 38, pp. 5–6.

47 ibid, p. 6.

> Under that scenario, the profits would be taxed in the first instance in Indonesia and then there would be a second level of tax upon receipt in Australia. That, of course, creates a very big disincentive for undertaking foreign projects owned through Australia with joint venture partners.[48]

6.44 In order to address this concern, BHP recommended that Australian multinationals should be able to invest offshore via joint venture companies without double tax on profits, and that Australia should push for renegotiation of double tax agreements in order to reduce the level of dividend withholding tax on profit repatriation to Australia.[49]

6.45 Responding to the Committee's request for the ATO's reply to these suggestions, the ATO contacted BHP seeking clarification of its views on the matter. BHP explained that, in particular, it sought that the intercorporate dividend rebate for unfranked distributions (other than distributions within a wholly owned company group) between resident companies should be removed. The ATO advised that the Government had accepted this recommendation, finding that the 'current law treats different resident companies in an inconsistent manner', and that this 'has resulted in loopholes because most unfranked dividends between companies are freed from tax'.[50] Accordingly, the issue was addressed in the New Business Tax System (Miscellaneous) Bill (No 1) 2000. The Bill received Royal Assent on 30 June 2000.[51]

Other corporate tax issues

Dividend streaming

6.46 In addressing the Committee during one of its public hearings, BHP also raised the matter of 'dividend streaming' and the fact that the Australian Government had chosen not to implement this even though the US and the UK have such concessions. Ralph defined 'streaming' as 'ensuring that certain investors receive particular types of income (such as dividends or interest) which have beneficial tax characteristics to them (such as franking credits), whereas other owners receive alternative income types with benefits for them.'[52]

6.47 The BHP representative noted that he accepted the reasons for not implementing such a scheme related to the large cost to government revenue. However, with respect to the global financial centre objective he noted:

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48 Committee Hansard, p. 578.

49 Submission No 26, pp. 1–2.

50 As noted in the Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill (No 1) 2000.

51 Submission No 38, p. 2.

52 Review of Business Taxation, *A Tax System Redesigned, More Certain, Equitable and Durable,* Report, July 1999, p. 796.

> …the US and the UK have comparable systems in place which make them more attractive for having international headquarters.[53]

Mark-up on in-house non-core services

6.48 BHP also drew the Committee's attention to the current transfer pricing arrangements, whereby, under an ATO ruling, a 7.5 per cent mark up must be charged on inter-company non-core services. In the view of BHP, this has implications because in other countries that mark-up may not be allowed as a tax deduction and that Australia 'has to be careful not to be out of step with the developments that are happening around the world'.[54] According to BHP, the OECD and the US accept cost recovery as an acceptable level of charging in relation to non-core services.

Goods and Services Tax

6.49 A number of other issues were also raised with the Committee including some uncertainties surrounding the application of the Goods and Services Tax (GST) in certain situations. For example, IBSA raised the GST treatment of OBUs, while AMP raised the uncertainties associated with what would happen when an Australian based manager buys shares on the US market.[55]

6.50 In regard to the suggestions by IBSA and Vanguard about the GST and financial services in the global context, the ATO reported that it had forwarded suggestions to the relevant sections, and advised that three issues identified by IBSA will be addressed by proposed changes to the Taxation Laws Amendment Bill (No 8) 2000.[56] The ATO reported that these changes will:

- allow input tax credits in relation to supplies of precious metals by an Australian entity to an overseas branch or where an Australian branch of an overseas entity supplies its parent overseas. The credits are available where the overseas entity uses the precious metals for making input taxed supplies overseas;
- exempt employee share schemes from a GST liability (reverse charge) where the scheme is supplied by an offshore entity to an *Australian 100 per cent subsidiary or* branch of the supplier; and
- ensure an overseas entity will not be required to register for GST in Australia where the overseas entity supplies employees in Australia to a 100 per cent subsidiary of the supplier (if the overseas entity supplied employees to a branch this is exempt from GST).

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53 Committee Hansard, p. 578.

54 Submission No 26, p. 2; and Committee Hansard, p. 579.

55 IBSA: Committee Hansard, p. 201, Submission No 18, pp. 3–4; and AMP: Committee Hansard, p. 14.

56 Submission No. 38, p. 3.

6.51 The ATO explained that, in relation to the last point, the exclusion only extends to those payments made by the Australian recipient that would, if made directly to the employee, be subject to PAYG. This will mean that the supply of employees is effectively tax free. However, the ATO also advised that if the overseas entity is making other supplies to Australia, and must register because of those supplies, or if it chooses to register, then the supply of employee services will remain a taxable supply.[57]

Conclusion—taxation issues

6.52 The Committee notes the concerns expressed about a number of features of Australia's taxation regime which appear to reduce its competitiveness in the global market place by not providing for, at the very least, a level playing field. However, the Committee also notes that a number of taxation issues raised during the inquiry are now being addressed by the Government. In particular, the Government did not proceed with the CIV regime proposed by the Ralph Review, and continues to consult over the implementation of the entity taxation regime.

6.53 The Committee has sympathy with the Government's dilemma in instituting measures which will, on the one hand, attract foreign financial services business to Australia (but may be criticised as being a potentially harmful taxation regimes by fellow competitor nations) while, on the other hand, balancing this with measures which are necessary to provide a fair an equitable tax revenue base.

6.54 In this regard, the Committee notes the ATO's cautionary remarks, made in its final submission to the inquiry, about the tendency of the evidence received by the Committee:

> …many of the submissions in relation to tax seem to suggest that Australia should (at least in particular circumstances) relinquish its right to tax income and gains at source. This would have major ramifications for Australia's revenue and economy. While the abandonment of such taxing rights may benefit particular groups, industries or sectors of the economy, the effect of such a move would need to be weighed against the wider implications for the economy, including efficiency and equity. Apart from this, all of our income tax law is built on the twin interconnected concepts of residence and source and it would be a fundamental shift to remove one of those basic building blocks. It would also facilitate tax avoidance.[58]

6.55 At the same time, the Committee is anxious that the Government is fully cognisant of the importance of designing and implementing a taxation system that consolidates Australia's attraction as a growth base for international and local businesses, and works against any tendency for Australian businesses to move offshore in search of more relaxed taxation treatment.

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57 ibid, pp. 3–4.

58 Submission No 38, p. 1.

6.56 The Committee acknowledges the challenges entailed in this. It also recognises the complexity of the issues and of the tax law implications of change in these areas. For that reason, the Committee considers it would be inappropriate to make specific recommendations to address each issue.

6.57 Nevertheless, the Committee reiterates its view that the Government should take urgent action to ensure that Australia's taxation system is *at least competitive* with other existing national regimes, compatible with the objective of promoting Australia as a global financial centre, and consistent with the necessity to provide a fair and equitable tax revenue base.

6.58 The Committee notes the current debate to permit dividend streaming, which would allow overseas banks to pay dividends directly to shareholders resident in that country. The measures would also increase the franking credit benefits for Australian resident shareholders. However, the Committee also recognises that there would need to be appropriate safeguards or controls to prevent exploitation and that there could be possible revenue consequences for Government.

6.59 The Committee also notes that on 7 August 2000, the Treasurer announced the implementation of a Ralph Inquiry recommendation to establish a Board of Taxation to advise on the development and implementation of business tax legislation. The Board is a non-statutory body which will advise the Government on the design and operation of Australia's tax laws, including on issues relating to the integrity and functioning of the tax system. The Committee considers that this body would be the most appropriate body to give close consideration to the above issues; in particular, to give consideration to any anomalies in Australia’s taxation regime which might detract from Australia’s goal to become a global financial services centre.

Recommendation 4

6.60 The Committee recommends that, in order to ensure that Australia has a competitive taxation regime, the Treasurer refer the taxation issues raised during the inquiry to the Board of Taxation for review and advice, and to take action as appropriate.

Regulatory issues

6.61 Aspects of Australia’s regulatory regime were also identified in evidence to the inquiry as being constraints which need to be addressed if Australia is to succeed in its goal of becoming a centre for the provision of global financial services. As pointed out in Chapter 2, there is widespread recognition that the strength of its prudential supervision and regulatory regime is an advantage for Australia. However, there are a number of issues which need to be addressed to ensure that an appropriate regulatory environment exists which is conducive to the competitive provision of global financial services.

6.62 Like the taxation issues, many of the concerns raised by witnesses and in submissions are somewhat interrelated. However, the majority related to the pace of regulatory change and the uncertainties which arise in areas of policy, the need for increased consideration of prudential supervision and consumer protection for e-commerce and internet trading, the impact of Australia's telecommunications policy, and the overall need for a ‘can do’ approach to regulatory change. These issues are discussed in turn below.

The pace of regulatory change

6.63 As outlined in Chapter 3, the taxation and regulatory environments have been the subject of major reforms in recent years. In addition, the Government is working to bring the regulatory framework in line with international trends. It is recognised that this will necessitate change over time. However, some industry representatives were concerned about the actual pace of regulatory and tax changes in Australia and the uncertainties associated with those changes. For example, Vanguard Investments Australia observed that, although Australia is a good place to do business, and it does not object to the highly regulated nature of the funds management industry, in its view: ‘the pace and uncertainty of regulatory change and in particular taxation changes are often a concern’.[59]

6.64 In giving evidence to the Committee the representative from Vanguard went on to note:

> I must say that I feel sometimes that the Government is running my business, in the sense that just trying to keep up with the government's changes in the tax code or the regulatory reform, from the managed investment act to superannuation reforms to GST is a treadmill. I salute the energy of the Government, but it would be nice to actually direct it into something that is directly productive for the client.
>
> I would say that regulatory change is a bit of a barrier…
>
> The industry seems to need to fight a continual rearguard action with regulators in the Treasury to ensure the industry’s future is not jeopardised by unintended consequences of reform.[60]

6.65 J B Were and Son also submitted that the pace of regulatory change and the cost of complying with new requirements in the marketplace could have adverse consequences for small investors.[61]

6.66 Although not specifically related to the pace of change, J B Were also drew the Committee’s attention to another aspect of the regulatory environment, namely the

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59 Submission No 15, p. 3.

60 Committee Hansard, pp. 173 and 169.

61 Submission No 27, p. 1.

specific difficulties it faced because of the application of the Foreign Acquisitions and Takeovers Act. According to the company, its clients are concerned that under this Act its holding of an interest in shares, which are acquired on behalf of its institutional and mutual funds clients, are subject to the notification and reporting requirements imposed by Australian Foreign Investment Policy. As the clients are investors with no interest in control, they believe that there should be legislative recognition that permits people in these categories to be exempted from the control related reporting requirements.[62]

6.67 Associated with the pace of regulatory change, came some calls for the regulators to at least issue authoritative policy statements, where the legislative framework does not provide sufficient guidance. For example, when referring to the impact of the prospectus provisions contained in the Corporations Law, and the lack of guidance about what should be included in prospectuses, the Australian Stock Exchange (ASX) submitted that a 'sufficiently authoritative policy statement' from the regulatory policy makers 'would provide considerable comfort to issuers and their legal advisers who currently interpret the legislation in a very conservative manner.'[63]

6.68 Similarly, the ASX advised that where legislation was exceedingly slow to be developed, this can also cause frustrations and could potentially hamper the development of Australia as a global financial services centre. The ASX gave the example of the *Commonwealth Inscribed Stock Act 1911*, where industry has sought changes for at least the last eight years, to enable legal title and Commonwealth securities to be settled electronically. However, the ASX advised the Committee that it was reassured by comments made to it by the Minister for Financial Services and Regulation that the necessary changes to the Act will be effected early 2001.[64]

6.69 Another aspect of Australia's regulatory regime which was of concern were the uncertainties associated with the regulatory powers of the Commonwealth arising from certain High Court decisions.[65] These uncertainties have had implications for the progression of the Corporate Law Economic Reform Program (CLERP) referred to in Chapter 4. Evidence received on this is discussed below under 'Corporations law issues.'

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62 Committee Hansard, p. 293.

63 Committee Hansard, p. 109.

64 Committee Hansard, p. 109.

65 In *Re Wakim* the issue of the cross-vesting of State corporate regulatory power to the Commonwealth was resolved with the High Court invalidating the arrangements; in *The Queen v Hughes*, the issue of the powers of ASIC to regulate the many corporations and businesses in Australia was resolved in the Commonwealth's favour. However, the air of uncertainty which was created about the validity of the incorporation of thousands of companies doing business in Australia led to feelings that the goal of becoming a centre for global finance was also under threat.

Prudential supervision for e-commerce and internet banking

6.70 One of the major drivers of change in the regulatory regime is the need to keep pace with the changing technology. Axiss Australia submitted that:

> While major steps have been taken to establish a world class prudential and regulatory policy framework, continued efforts will be needed to maintain and improve that framework—particularly in the context of a rapidly changing financial sector, driven by technological development and increased internationalisation.[66]

6.71 The National Office for the Information Economy (NOIE) advised the Committee that Australia was well positioned in terms of electronic business and the emerging information economy. NOIE stated in evidence to the inquiry that:

> We are among the leaders in terms of internet infrastructure, the penetration of the internet and internet activity throughout not only the finance sector but all areas of the economy…
>
> Internet banking in Australia is one of…the fastest growing electronic applications in Australia…(and) Australia…is well up with the leaders.[67]

6.72 NOIE also advised the Committee that ensuring that the regulatory framework is such that there is the certainty of legal backing necessary for electronic transfers has been a large priority of the Government. NOIE referred to the Electronic Transactions Acts, movements on security standards to ensure security of transactions, and the work done by the National Electronic Authentication Council, which is looking at the fundamental things that allow people to feel secure about involving themselves in electronic transactions.[68]

6.73 However, the Committee notes comments by APRA that there are a number of potential prudential risks from internet banking including operational and security risks, reputational risks and outsourcing risks. APRA is particularly concerned that there is a potential systemic risk where banks rely on a few third party providers which APRA has no jurisdiction over. APRA is considering whether there is a case for specific legislation to enable it to make a more thorough assessment of third party providers. APRA is also concerned that internet banking has the potential to lead to 'virtual runs' on banks which needs to be addressed by banks in their liquidity policies.

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66 Submission No 12, p. 19.

67 Committee Hansard, pp. 563–64.

68 Committee Hansard, p. 569.

Telecommunications policy

6.74 Axiss Australia has judged that having a world class information technology and telecommunications (IT&T) infrastructure available at competitive cost is crucial to Australia's development as a global financial centre.[69]

6.75 In the view of NOIE, Australia has a very open and competitive telecommunications environment, and is a world leader in this area. The Office also submitted that, in its view, there were no barriers in the IT&T area which militated against Australia being a global financial services centre. However, NOIE also submitted that Australian companies have faced constraints in operating overseas, as inefficient pricing structures limit opportunities for investment in some countries.[70]

6.76 Professor Peter Drysdale drew the Committee's attention to what he saw as aspects of Australia's telecommunications policy that affect its competitiveness in the financial services area, in particular the policies which artificially separate datacasting from TV broadcasting.[71]

6.77 When asked by the Committee to respond to concerns that Australia's telecommunications policy may well hamper the development of Australia as a global financial centre, NOIE advised that it had not heard from industry about the telecommunications regime being 'any sort of constraint to the operation of something like an international global centre'. In fact, NOIE, continued:

> …in many cases, we have heard the opposite—that it is a strength. Our capacity is going up dramatically and our prices are going down. Our regime, because it is so open and competitive, is very encouraging to a lot of organisations.[72]

A 'can-do' approach to regulatory change

6.78 Australia has been criticised by some organisations such as IBSA for not having a 'can do' image as manager of a competitive tax climate for international financial operations.[73] As mentioned above, the length of time taken to address the changes required to the Inscribed Stock Act is an example of the lack of a 'can do' approach to regulatory change. Such an example highlights the need for a greater willingness on the part of regulatory policy makers to work with industry to solve both the real and perceived constraints to the development of the global financial services centre.

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69 Committee Hansard, p. 131.

70 Submission No 32, p. 1 and Committee Hansard, p. 570.

71 Submission No 29, p. 1 and Committee Hansard, p. 559.

72 Committee Hansard, p. 568.

73 Submission No 2, p. 4.

6.79 In addressing the Committee at the public hearing in Sydney, Vanguard Investments Australia's representative was very positive about Australia's goal to become a global financial services centre, but he also urged a change in attitude to fixing certain impediments to that goal:

> If there is a willingness to address some of the issues that I have raised today and that some other people have addressed and to really think through some of the implications of tax changes, I think we can really make Australia a terrific place to do business as a global financial service centre. I am very optimistic about that: It is a great place to do business, the regulatory structure is good and the educated work force is good. It is a very low cost place to do business today, and a attractive place to live. What more can you ask for? We just have to do the kind of hard work associated with looking at the details.[74]

Conclusion—regulatory issues

6.80 The Committee acknowledges that the pace of regulatory and tax changes in Australia has not only made it difficult for industry, but has also introduced some uncertainties which have had the potential to hamper the development of a global financial services centre. However, the Committee sees it as imperative to ensure that there is a balance between maintaining high standards in Australia's prudential supervision and regulatory regime, while being prepared to respond quickly to changing circumstances without imposing additional and unnecessary burdens on stakeholders, some of which may have unintended consequences.

6.81 The Committee also notes that the solution to the problem is regarded as being relatively simple, that is, arms of government and industry must work more closely together with a united will—or willingness—to respond more effectively and efficiently to the need for change. With such a will, uncertainties could be addressed more quickly by regulatory policy makers issuing authoritative policy statements until such time as the legislation can be developed or amended, if required, to reflect a desirable change.

6.82 The Committee urges Government agencies including the Department of the Treasury, APRA, ASIC, the ACCC and the ATO to adopt a 'whole of government' approach to facilitate a harmonious and internationally competitive tax and regulatory regime. Coupled with this, the Committee also supports any initiatives by government agencies and industry to work more closely together.

6.83 In relation to those regulatory issues concerning the emerging technologies, the Committee regards this as being an area requiring close attention by government, notwithstanding the work that is already being done in this area.

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74 Committee Hansard, p. 177.

Corporations law issues

6.84 As recorded in Chapter 4 of this report, the Government is committed to an ongoing review of Corporate Law through the Corporate Law Economic Reform Program (CLERP). Currently the sixth stage of the CLERP is under consideration with the development and consideration of the Financial Services Reform Bill (CLERP 6), while CLERP 7 is already underway.

6.85 The Financial Services Reform Bill (FSR) has important ramifications for Australia's goal as a global financial centre as it aims to address criticisms that regulation is currently piecemeal and varied and, if enacted, will put in place a single licensing regime for all financial products, changes to product disclosure requirements and a single authorisation procedure for financial exchanges and clearing and settlement facilities.[75] Because the legislation aims at developing a unified national approach to these matters, it has some constitutional implications which have delayed its progress.

6.86 As mentioned in Chapter 4, on 21 December 2000 there was a breakthrough when the New South Wales and Victoria Governments came to an in-principle agreement with the Federal Government over the legislation. This resulted from a compromise designed to overcome the problems arising from the High Court’s decision on the *Hughes* case.[76]

6.87 Meanwhile, the provisions of the Corporate Law Economic Reform Program are the subject of an ongoing review by the Parliamentary Joint Statutory Committee on Corporations and Securities. That Committee released its *Report on the Draft Financial Services Reform Bill* in August 2000.

6.88 The Joint Committee found that there was general support for the principles and objectives of the draft Bill. In commenting on Australia as an international financial centre, the Joint Committee highlighted the importance of the evidence given to it by the ASX that the Australian market needs to be able to respond quickly to change, domestic and international, in order to continue to grow and to remain relevant. It also highlighted the ASX’s concerns about the adverse impacts of increased regulation, and the need to have a level of regulation which ‘best facilitates the choice of Australia as a centre for financial markets operations.’ In its conclusion,

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75 Financial Services Reform Bill, Commentary on the Draft Provisions, Corporate Law Economic Reform Program, Financial Markets Division, Department of the Treasury, February 2000, pp. 1–2.

76 In particular, it was agreed that the Corporations Agreement will specifically exclude the use of the referred power for the purpose of regulating industrial relations, and that no one State will be able to unilaterally terminate the reference of the power to amend the Corporations Law and remain in the new scheme. See ‘Corporations Law Agreement’, Joint News Release, Attorney General the Hon Daryl Williams AM QC MP, and the Minister for Financial Services and Regulation the Hon Joe Hockey MP, *Press Release No. FSR/ 087*, 21 December 2000, *Minister for Financial Services and Regulation* Internet site.

the Joint Committee recommended that the final Bill or the regulations address the concerns of the ASX.[77]

6.89 With respect to consideration of these issues under the inquiry which is the subject of this report, the Committee sought not to duplicate the work of the Joint Committee. However, a considerable number of issues were raised during the course of the Committee's inquiry concerning the Bill requirements under Corporations Law. These related primarily to such matters as uncertainties in the Bill which require clarification; the perceived lack of industry experience on the part of those drawing up the Bill which has resulted in certain aspects of the proposed changes being not practical in reality; certain other aspects of the Bill—including the licensing arrangements and 14-day cooling off period; and the reporting requirements and prospectus provisions proposed under the draft Bill. These are discussed in turn below.

Uncertainties requiring clarification

6.90 Organisations providing evidence to the Committee tended to support the general thrust of the Bill and its reforms but had concerns about certain details. For example, the ASX explained that while it did not see any of the issues arising as 'show stoppers' in the way people think about global financial centre issues, it considered that the CLERP reforms required certain clarifications about such things as the meaning of derivatives, the extent to which licences are needed, and the definition of a clearing house facility. In particular, the ASX drew the Committee's attention to the uncertainties surrounding the level playing field concept.[78]

Lack of industry experience

6.91 Other evidence to the inquiry commented on a perceived lack of industry experience on the part of those drawing up the legislative changes which has resulted in a number of issues which do not appear to take into account commercial reality. For example, J B Were and Son noted that:

> In broad terms, J B Were endorses the philosophy embodied in the Bill of putting in place a new integrated regulatory framework for Australia's financial product markets, clearing and settlements facilities and financial services providers. Whilst we recognise the desirability of implementing an integrated framework, we think that there is further work to be done having regard to the diversity of the sectors comprising the financial services industry.
>
> …we are concerned that those drafting these new regulatory regimes may not have had relevant, first hand experience of the industries that they seek

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77 Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Draft Financial Services Reform Bill,* August 2000, pp. 10, 20 and 29.

78 Committee Hansard, pp. 111–12.

> to regulate, or a substantial appreciation of the key differences between the diverse sectors within the financial services industry. This is particularly apparent in the context of several new requirements imposed by the Bill, which present enormous practical difficulties when applied to certain sectors of the financial services industry.[79]

6.92 The representatives from J B Were and Son used as examples the proposed requirement to provide to clients a financial services guide and written statements of advice. The representatives drew the Committee's attention to the differences between the ways in which the stock broking industry works and the financial management industry saying that the financial planning industry is in comparison a prolonged and measured process whereas the broking industry is by nature a quick execution by telephone industry in the main. In particular, the issue of distinguishing between personal and general advice was regarded by the company as being 'vague, subjective and hard to apply in practice.'[80]

Licensing arrangements

6.93 A number of other specific aspects of the Bill were also drawn to the Committee's attention, including the proposed arrangements for licensing. J B Were expressed its concern that there were no apparent measures adopted to facilitate the grandfathering of existing licensees to the new regime, and that it was concerned that the process involved in getting a licence is getting more onerous.[81]

6.94 In response to this issue, ASIC agreed that CLERP 6 did not provide for grandfathering, and advised that it had suggested to the Government that it think about installing grandfathering in some form.[82]

6.95 With respect to the 'relicensing' provisions of CLERP 6, the Committee canvassed the views of ASIC which expressed sympathy with the administrative load both to themselves as the regulator and to organisations seeking to be relicensed under the proposed new scheme. ASIC reported that it had put a proposal to the Government regarding licences:

> We would think that perhaps the regulatory dollar might be better spent in giving us greater surveillance powers and authority, greater ability to bring forward to ask them to show cause why their license should not be subject to special conditions or even why they should be licensed at all in the case of people who are not doing the right thing or are perceived not to have staff with the right competence. That might be a more efficient and effective approach. We have put to the government that they might wish to think

79 Committee Hansard, pp. 288–89.

80 Committee Hansard, pp. 289–90, and p. 292.

81 Committee Hansard, pp. 292 and 304.

82 Committee Hansard, p. 314.

> about that because it would also meant that the fact that we do not have as many resources as we might have had might be assuaged to some extent.[83]

6.96 The Committee sought the advice of the Department of the Treasury in the matter of the proposed licensing arrangements. In response this request, the Department of the Treasury advised that it was aware of concerns about the necessity for industry participants who were currently operating under the various service provider licensing and registration schemes to obtain a new licence under the FSR regime, and concerns about the ability of the regulator to licence the anticipated number of applicants within the proposed two-year transitional period.[84]

6.97 The Department of the Treasury also advised that, given that the FSR regime imposes new or differing licensing criteria as compared with existing regimes, the Government has been concerned that to merely grandfather existing licensees/registrants across 'would be to undermine the integrity of the FSR regime and to hinder the regulator's ability to ensure that all Australian Financial Service Licensees had met, and were meeting, comparable standards.'[85]

6.98 However, the Department of the Treasury also pointed out that the Government has been keen at the same time 'to ensure that the transitional provisions result in minimum disruption to industry and that the regulator will be able to effectively and efficiently administer the transition to the new regime.' With this in mind, the Department of the Treasury advised that:

> The Government now proposes to provide for a streamlined or fast-track mechanism for registrants or licensees under existing financial service business on the basis of self-declarations about compliance with the relevant licensing criteria. This approach will minimise disruption to business while preserving the integrity of the licensing regime.[86]

14-day cooling off period

6.99 J B Were also drew attention to the impact of the proposed 14-day cooling-off period for investments in managed funds, claiming that it does not take into account commercial reality:

> Another proposal in the FSR which doesn't appear to take into account commercial reality is that the FSR also proposes that there be a 14 day 'cooling off' period for investment in managed funds. Given that most managed equities funds are valued daily, it seems that the fundamental issue of market risk during the 14 days has been overlooked. If the price goes up, the client keeps the investment. If it goes down, the client would be silly

83 Committee Hansard, p. 314.

84 Submission No 36, p. 2.

85 Submission No 36, p. 3

86 Submission No 36, p. 3.

> not to say 'Thanks, but no thanks'—it is unworkable in our opinion. It is patently unfair to existing investors—they give away the upside for fourteen days, but they have all of the downside.[87]

6.100 ASIC responded to this issue by informing the Committee that it did not consider 'cooling-off' as a philosophy as being the best way to go. Instead, ASIC suggested that putting protections in place to prevent 'cold-calling'—to prevent or put constraints on people suddenly being accosted on the telephone, being rung up or sent an e-mail out of the blue—was the more appropriate strategy.[88]

6.101 The Committee sought clarification from the Department of the Treasury about the 14-day cooling off period at a public hearing in Canberra, and upon not being completely satisfied that the anomalies had been fully recognised, asked the Department of the Treasury to consider the matter further.[89]

6.102 In its subsequent reply, the Department of the Treasury advised that the inclusion of a cooling off period in the FSR Bill was to ensure that consumers could participate with greater confidence in the financial services sector by having a period to reflect on decisions made 'in the heat of the sales pitch' and to reverse those decisions if the consumer reconsiders their initial decision. According to the Department of the Treasury, it was never the intention that consumers would use the cooling off period as a way to protect themselves against market movement. The Commentary to the draft FSR Bill provides that 'where the market moves against the consumer in the cooling off period, the amount returned to the consumer will be reduced by the amount of the market movement.' Further the Department of the Treasury submitted that 'the removal of cooling off periods in relation to a particular financial product would trigger a more prescriptive and inflexible obligation on industry as to the timing of giving of disclosure documents.[90]

Reporting requirements

6.103 One of the important Corporations Law issues raised by the ASX related to the frequency of reporting by Australian listed companies, with the ASX submitting that there should be more frequent reporting as a protection measure. In its submission to the House of Representatives Standing Committee on Economics, Finance and Public Administration inquiry into the international financial market

87 Committee Hansard, p. 291.

88 Committee Hansard, p. 315.

89 Committee Hansard, p. 632.

90 Submission No 36, p. 1.

effects on government policy, the ASX suggested that 'more detailed and frequent reporting creates a significantly better informed marketplace.'[91]

6.104 When questioned about its views on the frequency of reporting, the ASX explained that under the continuous disclosure requirement, a listed entity needs to report any price sensitive matter to the market promptly and that may be every day if the circumstances require it. Beyond that, the ASX advised:

> …we have a requirement in Australia for half-yearly reporting. Of course, in the US they go to quarterly reporting.[92]

6.105 The ASX further explained that, in the case of those companies that listed on its markets after 1 July 1999, 'we introduced quarterly cash flow reporting for companies that are best described as cash rich companies,' typically described as the dot coms.[93]

Prospectus requirements

6.106 In giving evidence to the Committee at a public hearing in Sydney the ASX listed as one of its main concerns the prospectus requirements under the Corporations Law:

> One of the main impediments to the development of an active retail interest rate market in Australia has been the impact of the prospectus provisions contained in the Corporations Law. There has been a concern on the part of most issuers that the requirements for a prospectus relating to debt securities are too onerous with the effect that there are substantial costs involved in raising retail debt capital. ASX has actively pursued the need for shortened prospectuses for debt issuers for the past 12 months. Federal authorities have indicated that they believe the CLERP 4 changes which took effect on 13 March 2000 provide sufficient flexibility to accommodate the special needs of debt security issuers. There is still, however, major concern on the part of many issuers and advisers that while the new legislation is flexible it does not provide sufficient guidance as to what should be included in their prospectuse…ASX acknowledges that the new legislation creates flexibility for borrowers regarding what type of prospectus they should produce. However, some in the industry argue it is this very flexibility that creates uncertainty. They point out that other markets, where there are deep and flourishing retail markets, have clear, prescriptive prospectus provisions. The Minister for Financial Services has ruled out further legislative change for the time being. However, ASX believes that a similar result could be achieved if regulatory policy makers issued a sufficiently authoritative

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91 ASX Submission to House of Representatives Standing Committee on Economics, Finance and Public Administration inquiry into the international financial market effects on government policy, May 1999, p. 2.

92 Committee Hansard, pp. 112–13.

93 Committee Hansard, p. 113.

> policy statement. This would provide considerable comfort to issuers and their legal advisers who currently interpret the legislation in a very conservative manner.[94]

6.107 The Institute of Chartered Accountants in Australia indicated that it was not aware of any significant on-going concerns as to the onerous nature of the prospectus provisions in the Corporations Law. However, like the ASX, the Institute expressed its support for any further explanation via policy statements, if this would help to alleviate some of the ASX's concerns.[95]

Conclusion—corporations law issues

6.108 The Committee acknowledges that, as described above, there are a number of issues associated with proposed changes to Corporations Law in Australia which have the potential to adversely impact on the development of a global financial services centre because of their potential impact on investors. Mindful that the responsibility for oversight of Corporations Law issues properly resides with the Joint Statutory Committee on Corporations and Securities, the Committee has not made any particular recommendations in this area.

6.109 However, in relation to the issues before it, the Committee considers that the matters raised should be examined by the relevant regulatory policy makers in order to ensure that the concerns identified are addressed.

6.110 In particular, the Committee draws to the attention of the Department of the Treasury the need for certain issues to be clarified and the need for certain proposals contained in the draft legislation and/or its associated regulations to be practical.

6.111 The Committee is pleased to note that concerns about the proposed licensing arrangements appear to have been addressed, but it considers that the issue of the 14-day cooling off period requires further examination.

6.112 The Committee supports calls for more frequent reporting by Australian listed companies, as moving to a requirement for companies listed on the stock exchange to report quarterly (rather than half-yearly, and coming into line with the USA system) to complement the system of continuous disclosure of price sensitive matters in existence would also enhance transparency.

6.113 In relation to the issue of the prospectus requirements, the Committee considers that there would be merit in the Government reviewing the prospectus provisions of the Corporations Law with a view to streamlining them. In the meantime, the Committee also sees merit in the proposal that the regulatory policy

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94 Committee Hansard, p. 109.

95 Submission No 33, p. 2.

makers issue a sufficiently authoritative policy statement containing guidance on what should be included in prospectuses.

Treatment of expatriate staff

6.114 The treatment of expatriate staff was raised as an issue in evidence to the Committee by a number of organisations including the International Banks and Securities Association of Australia (IBSA) and the Broken Hill Proprietary Co Ltd (BHP). For example, BHP submitted that the tax regime for both arriving and departing international executives must be competitive to both attract and retain the best international executives, but that the existing rules (and some of the proposed amendments to the tax system) are/would be a disincentive for attracting international executives.[96]

6.115 The evidence suggested that expatriate staff who come to work in Australia for short periods of time are at a distinct disadvantage in terms of their superannuation, health insurance and other remuneration. Witnesses argued that, at present, employers of expatriate staff are required to contribute to the superannuation guarantee system for those staff but that those monies are then not portable back to their home countries nor are they available until retirement. Without an express exemption, similar contributions may have to be made by expatriate employees to the Medicare scheme without the contributors becoming eligible to claim.

6.116 BHP advised the Committee in a public hearing:

> One of the major issues that BHP has is dealing with retirement plans when employees come to Australia…Due to the operation of Australian income tax, fringe benefits tax and the superannuation guarantee charge laws, Australian companies are compelled to contribute to Australian complying superannuation funds and no foreign superannuation funds in respect of expatriates working in Australia. That, of course, enables the company to get a tax deduction for superannuation contributions in Australia. This is the case even where the foreign funds are genuine retirement plans that are approved by foreign tax and pensioner authorities in comparably taxed jurisdictions.
>
> Foreign executives with benefits in Australian complying funds are subject to preservation rules. So if you have an executive coming out here at age 35, working in Australia for eight years and then going back to, say, the US, this is obviously a real problem, because they cannot take their benefits until a minimum age of 55 years…So this is a disincentive for expatriates working in Australia and it complicates the administration of benefits for foreigners who leave Australia.[97]

96 Submission No 26, p. 2.

97 Committee Hansard, pp. 579–80.

6.117 The BHP representative went on to comment about the requirements under Medicare:

> Health insurance has been of some concern, because under the rules, Medicare access is not automatic. It is automatic where there are reciprocal agreements in place, and there are seven agreements, mainly with Commonwealth and some European countries but notably not the US. As a result, the only means by which the Medicare levy is not payable, given that people coming in to Australia are unable to take advantage of Medicare, is by making an annual application to the minister not to pay the levy. I might say that that has not proved to be a problem but, from an administrative sense, it does become a bind. I wonder about the worth of that procedure and whether that could be simplified in some way by elections on tax returns or lodged through taxation, et cetera, as a means to simplify that process.[98]

6.118 BHP also raised some concerns regarding employee share plans:

> One of the difficulties with employee share plans—and this is consistent with some of the rules that also apply when an expatriate completes and assignment in Australia—is that there is generally a deemed taxable point at the time of departure. There have been some moves in Ralph to try to ameliorate those by putting in place security deposits as a mechanism to defer the taxing point that Australia would have over those assets or superannuation arrangements until a later point where the gains are actually realised. In other words, when the expatriate has the cash in their hands and the realisation of the gains, it is a more reasonable taxing point for them to pay at that time. In relation to the way the rules are working with employee share plans, there is not that deferral opportunity until realisation. Under the Ralph report recommendations, the trigger point is at the time the expatriate leaves the country. That does not really create the right environment for expatriates. They see that as a significant disincentive.[99]

6.119 Another representative of BHP added to these comments agreeing that the proposed changes will not be an incentive to expatriate staff to locate in Australia and noted also that the regime was being modelled on the Canadian scheme:

> …under the Ralph measures for expatriates departing Australia, there is a recommendation that the security deposits measures be modelled on the position that is currently contemplated in Canada. Upon review, those rules seem to have some difficulties in terms of the interaction with double tax agreements and also the potential to generate double taxation or the lack of a foreign tax credit for Australian tax paid. Hence, we think that the rules as recommended create difficulties whereas the rules as they currently stand in electing to defer tax to the ultimate realisation of the asset are a more realistic outcome. That would obviously mirror the true economics,

98 Committee Hansard, p. 580.

99 Committee Hansard, p. 580.

> whereas to deem again at a particular point is taxing an unrealised gain that may in fact never be realised.[100]

6.120 The representatives from BHP went on to say that there were similar concerns with the proposed changes in relation to expatriate owned assets:

> Again, Ralph has gone down a path of a security deposit. There is a big issue relating to double tax agreements and the taxing point in Australia, which occurs at one time, and a taxing point overseas, which can occur at a different time. There may not be the ability to offset foreign tax credits. Therefore, that can create a double taxation situation.[101]

6.121 In offering solutions to the problems perceived to be associated with the treatment of expatriate staff, BHP submitted that:

- the superannuation rules should allow for the withdrawal of benefits or the transfer of accumulated benefits in Australian funds to foreign superannuation funds with appropriate safeguards;
- Australian employers should be allowed to contribute to genuine foreign retirement plans without penalty;
- the Federal Government should pursue the negotiation of reciprocal retirement agreement to allow for the rollover of benefits between jurisdictions;
- the proposal to impose Australian taxation upon the cessation (of) residency by a participant in an Australian employee share plan is not appropriate and employees should have the option of deferring the taxing point until the relevant cessation time; and
- the proposal to deem a disposal of assets held at the time of cessation of residency should be modified to allow for deferral until ultimate realisation of the assets.[102]

6.122 IBSA too drew the Committee's attention to the need to address expatriate tax issues 'efficiently and sympathetically', especially with regard to the 'poor management of the Superannuation Guarantee in respect of expatriates' and the Medicare surcharge.[103]

6.123 Although the company had no specific data on the extent of the problem—that is the number of people and the quantum of dollars involved—William M Mercer Pty Ltd was also of the view that the difficulties that superannuation requirements cause

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100 Committee Hansard, pp. 580–81.

101 Committee Hansard, p. 581.

102 Submission No 26, p. 2.

103 Submission No 2, p. 4 and Committee Hansard, p. 206.

employers, particularly when they are transferring employees into and out of Australia, was a major constraint for Australia becoming a financial centre.[104] In its submission, William M Mercer advised that the main superannuation barriers related to:

- the requirement to contribute to an Australian fund;
- difficulties in contributing to an overseas fund;
- the requirement to retain benefits in Australia;
- difficulties in transferring overseas benefits to Australia; and
- difficulties in contributing to an Australian fund for Australian employees working overseas.[105]

6.124 William M Mercer also recommended to the Committee the following:

- extend the exemption from Superannuation Guarantee to employers participating in their employer's superannuation fund overseas;
- improve the tax treatment of contributions made to overseas funds;
- allow greater access to preserved benefits for those leaving Australia permanently;
- allow a longer period in which to transfer an overseas benefits into Australia on a free basis;
- vary the tax treatment on benefits transferred to Australia so that the tax can be met from the benefit itself; and
- allow greater flexibility to employers to provide superannuation for their overseas employees through an Australian superannuation fund without potentially significant tax penalties on the fund.[106]

6.125 The Committee raised concerns about the treatment of expatriate staff with the ATO and the Department of the Treasury to seek information about the state-of-play and whether there any moves to alleviate some of them.

6.126 The ATO advised the Committee that the matter was a policy one and referred the Committee to the Department of the Treasury.[107] Treasury subsequently advised the Committee that, with respect to Superannuation Guarantee (SG) payments:

104 Committee Hansard, p. 405.

105 Submission No 4, pp. 5–8.

106 Submission No 4, p. 8.

107 Submission No 38, p. 2.

> …employers are, in principle required to make SG contributions on behalf of non -residents performing work in Australia. However, the Government currently provides an SG exemption to:
>
> . Employers of certain non-resident senior executives who meet the eligibility criteria for the former class 413 (executive (overseas)) visa, which in 1996 was incorporated into a new single Class 457—Business (Long Stay) visa; and
>
> . Non-residents employed for the Sydney 2000 Olympic and Paralympic Games.[108]

6.127 The Department of the Treasury further informed the Committee that:

> The Government has also entered into bilateral negotiations with several countries to include provisions within social security agreements to exempt employers from making SG contributions on behalf of non-resident employees seconded to Australia (generally for a period of up to four years) where those employees are covered by an equivalent scheme in the other country. While some of these negotiations are quite advanced, at this stage it is not possible to determine when the first agreements may be concluded.
>
> In addition, on 25 June 1997, the Assistant Treasurer announced that the Australian Government would be prepared to enter into bilateral negotiations with other countries to facilitate reciprocal agreements for the transfer of superannuation benefits by non-residents on permanent departure from Australia.[109]

6.128 The Committee's inquiry into the Taxation Laws Amendment (Superannuation Contributions) Bill 2000 also received evidence about some of the issues raised above, in particular, about portability of superannuation funds. In that evidence, there was general agreement that the establishment of bilateral and reciprocal agreements for the transfer of superannuation benefits by non-residents on permanent departure from Australia was an appropriate response by Government. However, it was universally acknowledged, including by the ATO, that the process of obtaining these agreements was slow, and that other, or interim, measures might be needed to address these issues in a timely manner.[110]

6.129 In regard to the issue of double taxation and, in particular, the taxation treatment of foreign employees participating in Australian-based employee share plans, the Committee notes that the House of Representatives Standing Committee on Employment, Education and Workplace Relations examined this issue in Chapter 4 of

108 Submission No 31, p. 1.

109 Submission No 31, p. 1.

110 See *Report on the Taxation Laws Amendment (Superannuation Contributions) Bill 2000*, Senate Select Committee on Superannuation and Financial Services Committee, December 2000.

its report *Shared Endeavours—Inquiry into Employee Share Ownership in Australian Enterprises*, published in September 2000.

6.130 In that report, the House of Representatives Standing Committee stated that it had 'received conflicting advice concerning whether aspects of Australian law helped or hindered the operation of employee share plans across international boundaries'.[111] It recommended, however, that to ensure that Australia is globally competitive, the Australian Taxation Office should work to ensure that foreign employees' contributions to Australian employee share plans should not be doubly taxed when those employees leave Australia.[112]

Conclusion—expatriate issues

6.131 The Committee concludes that there are some serious anomalies in the treatment of expatriate staff with regard to superannuation, taxation and health insurance matters, and that these anomalies may constitute real disincentives to international executives contemplating Australia as a business or employment base, so diminishing Australia's potential to become a global financial services centre.

6.132 In the view of the Committee, the current policy, as enunciated by the Department of the Treasury, only partially address the issues raised during the course of this inquiry concerning remuneration for expatriate staff. The Committee therefore considers that further action is needed.

6.133 The Committee notes the many apparently practical suggestions for reform which have been made by some groups.

6.134 To safeguard Australia's global competitiveness, the Committee regards it as essential that the Government conduct a review of the arrangements surrounding the superannuation entitlements of expatriate staff employed to work for varying periods of time in Australia. In particular, it should seek to ascertain whether Superannuation Guarantee arrangements can be streamlined, and portability of funds effected more expeditiously than by the present process of establishing bilateral agreements.

6.135 With respect to the other issues raised in evidence to the Committee by BHP, IBSA and William M Mercer Pty Ltd, the Committee does have sympathy, particularly in regard to the administratively cumbersome Medicare exemption system.

6.136 With respect to other remuneration measures, the Committee recognises the need for the ATO to be able to trace and capture fair taxation payments from individuals who come to work in this country, particularly with respect to employee share plans and the accumulation of other assets. Quite often the amounts of shares

111 *Shared Endeavours*, p. 170.

112 ibid, see Recommendation 39, p. 175 for specific recommendations.

and assets that are offered to senior executives involve considerable value and there needs to be some mechanism of capturing a fair and reasonable percentage of any gains made.

6.137 That being said, the Committee emphasises that Australia cannot afford to lose opportunities to be gained by welcoming foreign expertise to Australia, and by showcasing Australian expertise overseas. The Committee therefore recommends that urgent action be taken to review and fine tune current arrangements in these areas.

Recommendation 5

6.138 The Committee recommends that the Treasurer review the superannuation arrangements for expatriate staff, in order to ascertain whether:

- **a) Superannuation Guarantee arrangements can be streamlined;and**
- **b) portability of funds for expatriate employees leaving the country could be effected more expeditiously through the present process of establishing bilateral agreements or through other, or interim measures.**

Recommendation 6

6.139 The Committee recommends that the Board of Taxation review the arrangements for the taxation of salaries and remuneration for expatriate staff employed to work for varying periods of time in Australia, and, within the limits and guides of the various international treaties, advise the Treasurer on whether or not:

- **a) the systems or regimes are onerous or complicated making compliance by companies difficult;**
- **b) the systems or regimes are fair with respect to the levels of taxation required;**
- **c) the systems or regimes are sufficiently attractive so as to not unduly deter prospective employees from coming to Australia; and**
- **d) the current system of electing to defer tax to the time of ultimate realisation of assets is fair and equitable.**

Recommendation 7

6.140 The Committee recommends that the Treasurer review the entitlements of expatriate staff to Medicare and consider ways to streamline the exemptions requirements.

Conclusion

6.141 A number of constraints hampering Australia's goal to become a global financial services centre were drawn to the Committee's attention during the course of the inquiry. These constraints primarily related to taxation matters, the regulatory regime, some Corporations Law issues and the treatment of expatriate staff.

6.142 The Committee acknowledges that, for many in the industry, the constraints have been real and have hindered opportunities for investment and growth. Nevertheless, the Committee also notes that a number of the reported constraints appear to be more perceived than real, as many evolved out of a need to clarify uncertainties in the various regimes.

6.143 The Committee considers that Australia's success depends on having an internationally competitive tax system and that there is an urgent need for Government to work towards this goal. Equally urgent is the need to ensure that Australia's regulatory framework is not overly burdensome and is responsive to developments underpinning the internationalisation of the market place, such as those in the telecommunications area. Uncertainties associated with Corporations Law must also be resolved if Australia's attraction as a growth base for international and local businesses is to be consolidated.

6.144 In this regard, Government must also ensure that problems arising from present arrangements for expatriate staff are addressed. Australia cannot afford to lose opportunities to be gained by welcoming foreign expertise to Australia, and by showcasing Australian expertise overseas.

6.145 The Committee accepts that there is a dilemma to be faced, in terms of balancing domestic policy with international ambitions, but with determination on the part of regulatory policy makers, working in conjunction with industry, the Committee considers that the constraints identified can be minimised, so that Australia can enhance its performance as a provider of global financial services.

CHAPTER 7

OTHER ISSUES

A number of other issues were raised in evidence to the Committee which, while not constituting constraints as such, were important factors—or challenges—to be considered for the development of Australia as a global financial services centre. These issues primarily relate to the physical location of Australia; the size and scale of the Australian market; the need to maintain financial system integrity and national sovereignty; and, the possible need to rationalise the number of clearing houses and industry representative bodies. This chapter examines these issues.

Location

Proximity of Australia to other markets

7.1 The Committee heard that, whatever the emerging opportunities in the Asia Pacific, these were no substitute for being close to the large, established markets of the northern hemisphere. Even with the advent of greater communications through technology, witnesses and submissions to the inquiry held the view that it was a distinct advantage to be 'at the coalface' having person-to-person dealings with the major market operators. This being so, Australia, at such a great distance from those markets, can only hope to increase its share of the market by degrees.

7.2 The advantages of being physically close to the major markets in New York or London were highlighted in recent press reports. For example, in an article in the *Australian Financial Review,* the following comments were reported:

> There is a real benefit in being based overseas…You get a much better feel for the markets and the opportunities. You get a smell for what is happening. The world securities industry is run out of New York…You have to live in the US or you miss out on deals…Some of the deals we are doing in the United States now could not have been done if I had remained in Australia.[1]

7.3 Whilst acknowledging that, in the view of some, the world operates under three regions: North America, Asia and Europe (as discussed in Chapter 5), in the view of Axiss Australia, 'Australia is perfectly positioned between the two other time zones to be the gateway', especially for the Asia–Pacific region.[2]

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1 *Australian Financial Review,* 29–30 April 2000, p. 21.

2 Committee Hansard, p. 123.

7.4 Axiss further advised that, even with the advent of technology, 'on the ground knowledge' will be vital for global financial markets of the future, and that Australia has to be ready when there is a shift from America holding the balance of power.[3]

Impact of technology

7.5 Different views were expressed about the effects technology could have on overcoming the problems of distance in order to realise Australia's potential to become a centre for the provision of global financial services.

7.6 Axiss Australia expressed the view that technology 'will eliminate borders'; that 'the domestic size and liquidity of our market will be less relevant as technology facilitates size and liquidity across borders'; and, that 'the geographical distance will be less of an issue for Australia'.[4] In evidence to the Committee, Axiss advised that, in addition to a supply of skilled labour and regulatory and tax structures conducive to the operation of financial services and financial instruments, technology will play a key role in future financial services centres:

> Our analysis has shown that, in the future financial services centres, the environment which will be conducive to growth of the activity in that area will revolve around the physical infrastructure that is associated with telecommunications, the availability of telecommunications and information technology… [5]

7.7 However, the Reserve Bank of Australia (RBA) expressed the view that 'Australia is a long way from the major population centres of the world and therefore from the customers that ultimately drive financial activity', and that while 'the development of technology these days is reducing to some extent the problems of distance, … this is a two-edged sword for Australia'. The RBA advised the Committee that:

> While it is making it easier for Australian firms to sell products into Asia, for example, it is also making it easier for financial firms out of North America and Europe to sell products into Asia so the development of technology is a two-edged sword for Australia.[6]

7.8 CPA Australia also considered that Australia's distance from Europe and North America, where many of the world's major financial institutions are based, 'still represents a difficulty'. CPA Australia submitted that:

> While electronic mediums are overcoming the 'tyranny of distance' the financial services industry still relies on personal contact of facilitate

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3 ibid.

4 Committee Hansard, p. 119.

5 ibid.

6 Committee Hansard, p. 253.

> business decisions (and that) e-mail, video-conferencing and the other electronic communication mediums will continue to supplement rather than replace face-to-face business contact.[7]

7.9 The National Office for the Information Economy (NOIE) also assured the Committee that there was still 'some significance associated with the actual physical position of a centre'.[8] Responding to further questioning from the Committee about Australia's physical distance from other centres and whether the need to be in Silicone Valley, London or New York was still a hurdle, NOIE advised that:

> … it is nowhere near the hurdle it was. As you get more familiarity with people working with electronically connected systems, the actual location issue disappears. However, you cannot get away from the fact that it is important for Australia to make its presence felt where the major decision makers are, whether it is Silicon Valley or some other place.[9]

7.10 Professor Drysdale of the Australian National University explained why location is important, especially in the East Asian markets, even with the advent of new technologies:

> Let me explain a bit why location is still important. Operation in particular time zones is still important in these markets. Ultimately, services are provided, as the Japanese say, 'belly to belly'—person to person—at the end of an e-commerce trade. Even many financial services have to be provided 'belly to belly'. So location is important in that context too, across a range of services.

And:

> There will be an opportunity to operate in markets because of these new technologies which are not significantly influenced by location, but…location remains important in the delivery of financial services, especially to markets within the same time zone—markets you have to relate to closely.[10]

7.11 In view of the importance being placed on technology as a means of enhancing Australia's potential to become a centre for the provision of global financial services, resourcing of technology was another issue drawn to the Committee's attention. The Finance and Treasury Association stated that, in its view: 'there was not any real focus on technology in (the) most recent budget and (that as technology)

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7 Submission No 5, p. 4.

8 Committee Hansard, p. 568.

9 Committee Hansard, pp. 571–72.

10 Committee Hansard, pp. 558–59.

is such a fast-moving area…it needs to be kept constantly under focus and needs to be an area where the Government is constantly guiding things.'[11]

7.12 The Committee notes that, as recorded in Chapter 5 of this report, the Government has since made substantial commitments in the area with the announcement of its technology innovation statement: 'Backing Australia's Ability—an Innovation Action Plan for the Future'.[12]

Size and scale of the Australian market

7.13 The size and scale of the Australian market has been raised in evidence to the Committee as a challenge for Australia, and one which can really only be addressed by forming more strategic alliances.

7.14 In evidence to the Committee, and commenting on the announcements of mergers between stock exchanges in Europe and the USA, the Australian Stock Exchange (ASX) noted:

> We certainly see the environment developing in Europe as a challenge. ASX has always regarded itself as being pretty well up to the mark in the way we apply technology, our business development skills and our supervisory qualities, but we certainly are very mindful of our lack of scale. When the Australian equities market is only one to 1½ per cent of world global capital, as measured by the Morgan Stanley Capital Index, then one of the other driving forces for ASX going forward is the success of Australia's financial centre ambitions. It really needs to garner more scale, and one way of doing that is to look at a link-up with other markets.[13]

7.15 The ASX went on to advise the Committee that it is considering link-ups with the Singapore Exchange and exploring the possibility of linkages with the NASDAQ market in North America.[14]

7.16 In the view of Dr George Gilligan, of Monash University, the ASX plans to build up strategic alliances 'is a very sensible strategy'.[15] Dr Gilligan further submitted that:

> The relatively small size (in global terms) of Australia's population and financial markets, allied with its relative isolation geographically, renders it somewhat isolated in terms of global political and economic strategic partnerships in comparison to EU Member States for example.

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11 Committee Hansard, p. 270.

12 Ministers Minchin, Alston, and Kemp, *Press Release*, 29 January 2001, *Minister of Industry and Resources* Internet site: http.www. minister.industry.gov.au

13 Committee Hansard, p. 113.

14 Committee Hansard, pp. 113–14.

15 Committee Hansard, p. 145.

> Consequently it is eminently sensible in a globalised financial sector for Australian exchanges and financial institutions to seek strategic alliances around the world.[16]

7.17 A number of other participants in the inquiry expressed their view that the relative size of the local financial services market is a limiting factor in the further development of Australia as a global centre. Among these were CPA Australia and the representative from the Namoi Cotton Cooperative who stated respectively that:

> The relative size of [the] local market does limit the scope for domestically generated growth.[17]
>
> And:
>
> From your perspective, you are perhaps looking at Sydney being a larger financial centre in terms of volume, using the products that already exist on the Sydney Futures Exchange and perhaps introducing other products such as cotton. One hindrance, I believe, is the volume that you need to make a liquid market in those various contracts. Wheat is fairly lightly traded on the SFE. We do not have the volume in this market to make it a competitive market[18]

7.18 The representatives of J B Were and Son also expressed the view that, amongst other things, 'the relative size of the Australian equities market makes it difficult for fund managers to operate inconspicuously or efficiently'.[19]

Maintenance of financial system integrity and national sovereignty

7.19 Related to the challenge of addressing the size and scale of the Australian markets by the formation of strategic alliances is how to maintain financial system integrity and national sovereignty when such alliances, and therefore interdependence, may be formed and the domestic economy may be vulnerable to international market fluctuations.

7.20 The matter of whether globalisation is undermining national sovereignty has been the subject of comment by the OECD.[20] The OECD has identified the issues to be faced by governments seeking to reap the benefits of globalisation without undermining national sovereignty, as firstly, the need for adjustment in the structures or the machinery of government to enable government to function effectively in an interdependent world; and secondly, the need for governments to examine the impact

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16 Submission No 14, p. 5.

17 Submission No 5, p. 4.

18 Committee Hansard, p. 574.

19 Committee Hansard, p. 293.

20 OECD, Strategic Management and Policy-making: *Globalisation: What Challenges and Opportunities for Governments?*

of globalisation on national and international policy-making processes, so as to protect and strengthen the basic democratic underpinnings sought for national and global governance.

7.21 The ASX advised the Committee that it does not seek exclusive relationships with the entities with which it seeks to form alliances, and that it is always mindful of the need to preserve Australia's market integrity, as this is seen to give Australia a competitive edge. The ASX advised that, during the Asian financial crisis of the last few years, 'Australia was seen as something of a safe haven because of the integrity of markets that we were able to offer'. [21] The ASX assured the Committee that it had no intention of lowering its standards to meet the requirements of an alliance partner.[22]

7.22 Dr George Gilligan also commented on the issue of preserving standards of probity when engaged in pursuing strategic alliances. Dr Gilligan advised the Committee that:

> There is a sense that one should not sell 'the entire family silver' for the sake of being engaged in cooperative international arrangements. An alliance may be an alliance or a commercial agreement. If the conditions relative to that agreement change or worsen in the future, informed decisions are made—whether it be the Australian Parliament or exchanges such as the ASX—that the renegotiation or withdrawal from those alliances may or may not occur.[23]

7.23 Axiss Australia advised the Committee on how to deal with the question of sovereignty:

> …it is important in the globalisation of the financial markets that our domestic economy does become integrated into the global economy so that the liquidity of our domestic market becomes part of the liquidity of the global market by that integration. In doing so, the practices within our domestic financial markets become standardised with the global markets that are generated out of the United States and Europe. In that way there is a protection mechanism against hedge funds and other operators isolating our economy and our marketplace and putting pressure on our currency or on our interest rates. The best defence against undesirable activity such as that is deep liquid markets which are arbitrageable and integrated with the global economy so that you do have the maximum number of counterparty participants able to take an offsetting position with the pressure from the hedge funds.
>
> And:

21 Committee Hansard, p. 114.

22 Committee Hansard, p. 115.

23 Committee Hansard, p. 150.

> …as long as there is some synergy between the domestic economy and the international economy, there is less ability for weights of money to isolate our economy and to move it in a counter direction to the general global economy.[24]

7.24 Further, Axiss pointed out that sovereign risk was becoming an issue, and that where there was an unpalatable level of risk, such as in Hong Kong where the established regulatory environment could be changed overnight by a decision of the Chinese mainland, activity would not locate there; rather there would be a preference to locate to a place like Australia, where even if there is a change of government, the result would not be abnormal or outrageous.[25]

Rationalisation of clearing houses

7.25 Australia currently has multiple clearing and settlement houses and questions have been raised whether the size of Australia's market is large enough to support multiple clearing houses.[26] There are five clearing houses in Australia at the moment, the Australian Stock Exchange (ASX), the Sydney Futures Exchange (SFE), Austraclear, Options Clearing House and the Reserve Bank Information and Transfer System (RITS). According to recent media reports, SFE and Austraclear have already announced their intention to merge, citing global competitiveness as a factor.[27]

7.26 In a warning delivered at the 2000 Financial Markets Conference in Atlanta recently, the US Federal Reserve Chairman, Mr Alan Greenspan, was reported as saying that the inability of clearing rooms to cope with the volume of equity transactions threatens the integrity of financial markets. Mr Greenspan said that, although electronic finance had increased the efficiency of front offices, if settlement times were not reduced operational risks for investors would increase.[28]

7.27 In evidence to the inquiry, the Australian Financial Markets Association (AFMA) advised the Committee that, in its view, five clearing houses in this country are 'too many and too confusing'. Further AFMA submitted that:

> …we believe that the number of clearing houses should be rationalised. If they cannot be brought down to a single or one or two clearing centres, we at least should be building a bridge between them. Then, if you have your securities or your instruments in one clearing house, you can actually transfer or trade through another and the bridge will honour that transaction. Euroclear and Cedel have done this for years in Europe.[29]

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24 Committee Hansard, p. 121.

25 Committee Hansard, p. 129.

26 *Investor Weekly*, 25 September–1 October, 2000, p. 7.

27 ibid.

28 *Investor Weekly,* 23–29 October, 2000, p. 11.

29 Committee Hansard, p. 138.

7.28 The RBA submitted that it had some responsibilities in the area of clearing and settlement services and that 'it was very keen to try and see some improvement in these areas'.[30] Further the RBA submitted that rationalising the number of clearing houses would facilitate Australia becoming a global financial services centre. The RBA told the Committee:

> At the moment we have five clearing houses in Australia. We have one for equities, one for private sector fixed interest securities, one for government securities and then there are two clearing houses for derivatives—one on the ASX and one for the Futures Exchange. The reality is that, if we want to maintain control over these services in Australia, we are going to have to rationalise here and become more efficient.[31]

7.29 The Committee notes J B Were and Son's observation that global standards will emerge over time, and this will dictate the level of rationalisation.[32]

7.30 The Committee is also aware that the Australian Securities Market User Group (ASMUG) has commissioned the Securities Industry Research Centre of Asia Pacific (SIRCA) to assess whether the rationalisation and restructuring of the clearing and settlement industry in Australia would be beneficial. The study aimed to take into account potential industry savings, operational efficiencies, savings to end investors, reduced clearing and settlement risk, and economic efficiency from improved market liquidity.[33]

7.31 The results of the research were released in late November 2000. The study estimated that a cost saving of about $40 million a year could be made if current players consolidated. ASMUG announced that it supported further rationalisation of the industry, and agreed with the SIRCA's findings that the restructuring could best be achieved by adopting a 'transitional' model. Under this model clearing houses would rationalise along instrument lines, with debt and debt derivatives forming one axis and equities and equity derivatives another. The fact that the process had already begun, with SFE and Austclear announcing intention to consolidate, led the study to predict that the changes would be in place within 12 to 18 months.[34]

Rationalisation of consultative and representative organisations

7.32 Related to the issue of rationalising clearing houses is the need perceived by some to rationalise the number of industry representative bodies. AFMA was one

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30 Committee Hansard, p. 254.

31 Committee Hansard, p. 266.

32 Submission No 27, p. 2.

33 *Investor Weekly,* 23–29 October, 2000, p. 11.

34 Kate Perry, 'Support for Clearing House Rationalisation', *Investor Weekly News*, 20–26 November, 2000, p. 7.

group which submitted to the Committee that: ‘We believe that there are too many industry associations in this country covering this industry.’[35]

7.33 In further evidence to the Committee, AFMA expanded on its views, emphasising that it meant 'restructuring' rather than 'downsizing'. The advantages of restructuring were seen by AFMA to relate to: gaining economies of operations; the development of business services for the industry (primarily education and training with a 'whole of industry' approach); and, closer ties between associations which would allow greater policy coordination within the financial services industry.[36]

7.34 AFMA also submitted that the first structural casualty of deregulation was the ‘silo’ approach to financial services businesses, whereas now many organisations are ‘allfinanz’ or spanning all aspects of the financial services sector under a single organisation or holding company. In its view, 'all that remains is for the associations to adapt to structural changes and pull together to serve the financial services industry and its stakeholders more efficiently'.[37]

7.35 In expressing his support for the concept of improving or increasing levels of liaison between the industry and government so that there are practical initiatives at both policy development and operational levels, Dr Gilligan was of the view that such improvements would raise Australia's competitiveness through coordinated financial services industry.[38]

Other matters

Futures trading

7.36 The Namoi Cotton Cooperative, a cotton merchant in Australia, drew the Committee's attention to the impact on agricultural industries engaged in forward marketing. Namoi Cotton advised the Committee that:

> We buy cotton from a number of farmers and we on-sell that cotton to various centres throughout the world. Asia is our primary market. The price of that cotton is based on the New York Futures Exchange and the New York Board of Trade cotton contract. Basically buyers and sellers within that exchange set the price, and it is priced in US cents per pound. Specifically being in Australia, whenever we sell cotton throughout the world it is priced in US dollars. So on top of having a futures price risk, we also have a foreign exchange currency risk. My position here is as manager of those two risks when we purchase cotton from an individual grower. We go out each day an offer an Australian dollar price to a grower. We also

35 Committee Hansard, p. 138.

36 Submission No 34, p. 1.

37 Submission No 34, p. 2.

38 Committee Hansard, p. 145, and Submission No 14, p. 5.

> offer a US dollar price, if the grower has his own currency. We have to hedge those exposures accordingly when we purchase that cotton.[39]

7.37 Namoi Cotton explained that both the wool and wheat industries, for example, also have contracts with the Sydney Futures Exchange, and that they too would be looking at forward pricing as it offers an opportunity for a farmer or an end user to lock in a price they are happy with at a future date.[40]

Money laundering

7.38 Although there was not a great deal of evidence taken on this issue, the reputation of Australia in international terms was discussed with representatives of the Reserve Bank of Australia.

7.39 In response to questions about the OECD drawing up black, white and grey lists of jurisdictions in relation to money laundering, and Australia's rating on those lists, the RBA advised the Committee that the Financial Stability Forum had recently published a three-part list of offshore financial centres, in order to encourage those with relatively poor records or systems to improve:

> We see the process of publication of these lists in a positive light, as an attempt to encourage those that are at the bottom parts to bring themselves up to the top. We have no doubt that if Australia were included on these lists we would be in the top category. I do not think that has any strong implications for our role as a global centre.[41]

Conclusion

7.40 There are a number of important factors or challenges which must be addressed if Australia is to achieve its goal of becoming a centre for the provision of global financial services. While Australia’s physical location is seen by some to be a disadvantage, the Committee considers that there is scope for technology, and opportunities for person-to-person contact, especially in the Asia–Pacific region, to assist in overcoming this perceived disadvantage.

7.41 Similarly, while it is acknowledged that the size and scale of Australia’s market has some limitations, the Committee considers that this can be overcome to some degree by the formation of strategic alliances, so long as those alliances enable Australia to maintain its financial system integrity and national sovereignty.

7.42 The Committee notes the calls for the rationalisation of clearing houses in Australia, in order to overcome the confusion surrounding the current arrangements.

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39 Committee Hansard, p. 573.

40 Committee Hansard, pp. 573–74.

41 Committee Hansard, p. 267.

The Committee considers that there is scope to improve the efficiency with which services are delivered by consolidating and rationalising current players.

7.43 The Committee also notes calls for the rationalisation of industry representative bodies. In the Committee's experience, having too many points of contact between industry and government has not been conducive to efficient and effective policy development and implementation. While it is beyond the scope of the Committee's authority to require industry to consider these calls, the Committee would look favourably on any effort made by industry to rationalise industry representative bodies.

7.44 The Committee notes that, in October 2000, the views of a coalition of 15 major financial, employer and employee groups—representing superannuation, financial services, professional groups, trade unions and business—presented a statement of principles for Australia's retirement income system to the Prime Minister and other key political figures. This demonstrates that presenting a single point of contact between industry and government is possible.

Recommendation 8

7.45 The Committee recommends that the Government support and encourage industry groups to look at ways in which the Australian financial services industry can become more competitive and cost effective, including through consolidation and rationalisation of processes and activities within industry.

CHAPTER 8

IMPROVING AUSTRALIA'S POTENTIAL AS A GLOBAL FINANCIAL SERVICES CENTRE

Chapter 6 of this report identified a number of constraints, or perceived constraints, that policy makers need to address to clear the path for Australia's development as a global financial services centre. Notwithstanding these constraints, Australia also needs to consolidate its competitive advantages, and to seize the opportunities arising from these, to achieve the goal. This chapter suggests a range of strategies which might assist in that process, including: streamlining access to Australia and its services; reaffirming Australia's commitment to Asia; establishing strategic alliances, ensuring that we have an adequate supply of an appropriately educated workforce; and, conducting further research to obtain data on industry development and company movements that will assist Government decision-making.

Streamlining access to Australia and its services

Need for a one-stop shop

8.1 One of the most useful suggestions made to the Committee was that streamlining access to Australia and its services is one of the keys to more effective promotion of Australia and its advantages to the rest of the world.

8.2 While expressing satisfaction with the assistance it received from a variety of different Australian authorities when it was seeking to access the Australian market, Skandia Assurance and Financial Services advised the Committee that, when it was negotiating in Ireland, it was able to meet with all relevant bodies—the regulator, the service providers and the different government bodies—in one three day visit, because they work cohesively together.

8.3 By contrast, when negotiating to access the Australian market, Skandia had to talk with Austrade, Australia's ambassador in Stockholm, and with both the NSW and Victorian Governments on the ground in Australia. This suggested that the 'one-stop shop' coordination, such as exists in Dublin, may be more efficient than the current Australian arrangements, but that this was a role for the global financial centre.[1]

Need for branding of Australia's global financial services centre

8.4 Associated with having a 'one-stop shop' approach was the issue of branding of the Australian centre for global financial services. In evidence to the Committee witnesses and submitters referred to the need to 'brand' a city rather than the country and, in so doing, to overcome the current Sydney–Melbourne impasse.

1 Committee Hansard, pp. 186–87.

8.5 For example, the Australian Financial Markets Association (AFMA) pointed out that, in its view, 'it is difficult for a country to be a financial centre.' In evidence to the Committee AFMA explained:

> The US has New York as its financial centre, England has London…Japan has Tokyo…and even China is developing Shanghai as its financial centre. So, in those cases, it is actually a city that is a financial centre.[2]

8.6 AFMA further submitted that, in its view, Australia should 'focus on the strengths of each of [its] cities and to promote a city's strength separately as opposed to trying to pool it and call Australia the financial centre.'[3] For example, in the US Chicago is the futures centre, Boston is the financial service centre and other cities can have specialities. However, while Sydney is the hub of financial markets in Australia now, if the hub moves over time to a different location, then that will become the new hub.[4]

8.7 These views were shared by others giving evidence to the inquiry, with Professor de Brouwer, for example, emphasising the need to brand a city—Sydney—as the financial centre.[5] The Reserve Bank of Australia, however, while acknowledging that Sydney is the centre most readily recognised by international market participants (especially for foreign exchange and bond trading) saw that 'the question of where financial activity should be located is a matter best left to market participants.'[6]

Need to brand and promote Axiss Australia

8.8 Related to the issue of branding a city is the naming of the Australian centre for global finance, wherever it may be located. The Committee notes that the centre for global finances has undergone a change of name since its inception and that this may have caused some confusion in the marketplace, especially as there does not appear to have been a great deal of public articulation of the meaning of the new name. Witnesses who commented on this issue indicated that they had never heard of Axiss Australia, or the centre as it was previously named, the Australian Centre for Global Finance, and had never met the Chief Executive Officer.[7] The need for branding and promoting Australia's global financial services centre is discussed below in the section dealing with the need for data on the performance of Axiss Australia.

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2 Committee Hansard, p. 136.

3 Committee Hansard, p. 136.

4 Committee Hansard, p. 140.

5 Committee Hansard, p. 160.

6 Submission No 23, p. 2.

7 For example, Skandia Assurance and Financial Services, Committee Hansard, p. 187 and Namoi Cotton Cooperative, Committee Hansard p. 573.

Reaffirmation of Australia's commitment to Asia

8.9 In Chapter 5 the Committee canvassed the views expressed on whether Australia should be focusing its efforts globally or in the Asia–Pacific region. The majority of evidence suggested that there was more value to Australia in focusing its efforts in the region, and indeed, it is the stated objective of Axiss Australia to make Australia a leading financial services centre in the Asia–Pacific region.

8.10 In evidence to the inquiry, the Committee was informed that reaffirming its commitment to Asia would be a major step in enhancing Australia's potential to become the provider of financial services in the region. Witnesses, such as Professor Peter Drysdale and Professor Anthony Milner of the Australian National University (ANU), emphasised that Government has a role in reminding Australians of the importance of acquiring a sophisticated knowledge of the region; in promoting and funding the teaching of Asian languages and Asian studies in schools and universities; and, in assisting Australians study in Asian universities.[8]

8.11 The Committee forwarded these suggestions to the Minister for Education, Training and Youth Affairs, the Hon Dr David Kemp, MP. In his response, the Minister agreed with Professor Drysdale that Australia's active engagement in regional groupings like APEC are important in developing regional financial markets, and reported that the Department of Education, Training and Youth Affairs (DETYA) is at present conducting a project through APEC which aims to identify barriers to trade and investment in education services in the region.[9]

8.12 In regard to linking and training initiatives, the Minister advised that DETYA has for some years provided funding to assist Australian universities to establish links with their counterparts in the Asia–Pacific region, under such schemes as University Mobility in Asia and the Pacific. DETYA also funds the National Asian Languages and Studies in Australian Schools Strategy within the secondary and primary schools sector, and has agreed to contribute A$30 million annually to boost the study of Asia in Australian schools through to 2002.[10]

8.13 Responding to the problems outlined by Professors Drysdale and Milner—relating to lost morale and scarce funding for Asian studies in universities—Dr Kemp explained that, while the Commonwealth provides block funding to universities to carry out teaching and research, decisions about the funding of specific programs is a matter for the individual institution.[11]

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8 Committee Hansard, p. 553.

9 Submission No 37, pp.1–2.

10 ibid.

11 Submission No 37, p. 1.

Establishing strategic alliances with other financial markets

8.14 As noted in Chapter 7, the Australian Stock Exchange (ASX) saw that the relative uncompetitiveness of Australian markets is because of the lack of market size.[12] To counter this, the ASX, among other witnesses, recommended that Australia should work to form strategic alliances with other stockmarkets, to give much needed mass to the Australian financial sector.

8.15 Dr George Gilligan observed that the formation of such strategic alliances was a reality of the present international system, and judged that the gaining critical mass in Australian markets in this way would provide more opportunities than would feasibly arise from perceived advantages in other areas.[13]

8.16 Therefore, Dr Gilligan proposed that an appropriate regime for foreign ownership, including cross-equity ownership, in Australia should be established.[14] He suggested that:

> The Committee ought to seriously consider whether it should recommend changes in cross-vesting arrangements that may exist in terms of ownership of Australian exchanges or Australian organisations, because obviously people from outside are not going to come and invest capital and resources, whether they be physical, human or whatever, if they do not perceive themselves as deriving benefits from it. Increasingly, although those transactions occur across national borders, the organisational infrastructures of both businesses and exchanges have got to be international.[15]

Ensuring an adequate supply of an appropriately educated workforce

8.17 One of the most significant issues drawn to the attention of the Committee during the inquiry was the importance of having an appropriately educated workforce. Axiss Australia was one of many groups which submitted that an education, training and research framework delivering a highly skilled, innovative, cost competitive and responsive workforce was one of the keys to enhancing Australia's future prospects as a global financial centre.[16]

8.18 As established in Chapters 3 and 5 of this report, Australia's current workforce is well educated and this is one of the advantages which Australia has in terms of attracting business to Australia and so promoting Australia as a centre for the provision of global financial services. With this highly educated workforce Australia also has opportunities to export skills to the region.

8.19 Chapters 5 and 7 of the report record the Government's efforts to bolster Australia's research and technology development with its 'Backing Australia's

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12 Committee Hansard, p. 113.

13 Submission 14, p. 5 and Committee Hansard, p. 147.

14 Submission no. 14, p. 6.

15 Committee Hansard, p. 152.

16 Committee Hansard, p. 131.

Ability—an Innovation Action Plan for the Future'.[17] This may go some way to address the concerns expressed by witnesses to the inquiry who pointed out that, especially in the IT area, Australian experts are 'leaving Australia in droves' to seek better pay and conditions elsewhere. Given this, it would appear that there is a great deal of work to be done to ensure that Australia can attract and retain a workforce which can meet Australia's current and future needs as a centre for the provision of global financial services. For example, given the severe down turn in the NASDAQ and the impact on the job market in Silicon Valley, there could be opportunities for progressive Australian companies to begin a selective recruitment campaign to alleviate the IT shortage in Australia.

Need to identify the skills required

8.20 To build that workforce, the Securities Institute of Australia asserted that a more strategic focus on future education and training needs would be achieved by first identifying what the skills needed for domestic and global competitiveness are.[18] The Committee notes that some work has already been done in this area, with AFMA, for example, commending the research of the Securities Industry Research Centre of the Asia Pacific (SIRCA), as described in Chapter 5, to the Committee.[19]

8.21 During the inquiry, different views were expressed about the best areas for development. Evidence suggested a range of possibilities: such as improving language skills; improving IT skills; improving knowledge and understanding of the Asia–Pacific region; and, improving financial literacy generally.

8.22 The issue of improving language skills attracted a mixed response. Some, like the Reserve Bank of Australia argued that, as English is the accepted language of the financial markets, 'other linguistic skills very rarely come into play.'[20] Others, like Osborne Associates, pointed out that, in its view, having a wide range of linguistic abilities is a great advantage, and referred to the establishment of the American Express regional call centre located in Sydney on this basis.[21]

8.23 In the field of telecommunication and e-commerce the opportunities for Australia were judged to be open ended—as the ATO told the Committee, e-commerce has the 'potential to redefine pretty much every single component of the market right through to function'.[22] Australia's present standing is based on the sophistication of its telecommunications infrastructure and use of computer technologies in both the public and private sector. The Committee also heard from

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17 Ministers Minchin, Alston, and Kemp, *Press Release*, 29 January 2001, *Minister of Industry and Resources* Internet site: http.www. minister.industry.gov.au

18 Committee Hansard, p. 601.

19 Committee Hansard, pp. 135–36.

20 Committee Hansard, p. 259.

21 Committee Hansard, p. 238.

22 Committee Hansard, p. 630.

DCITA that venture capital is moving into IT development, but other reports indicate that Australia remains behind in innovation and production of technology compared with its peers.[23]

8.24 In this regard, the National Office for the Information Economy (NOIE) drew the Committee's attention to the difficulties it perceived in maintaining a supply of people skilled in the IT&T area. NOIE advised that 'those who are really good…are leaving Australia in droves' because there are better opportunities overseas and they are remunerated at a higher rate. NOIE explained that, in the longer term, 'we will have and continue to have a significant shortage of information technology teachers.'[24]

8.25 Improving Australia's knowledge and awareness of the Asia–Pacific region was also highlighted by many in evidence to the inquiry. For example, when the Committee asked the Insurance Council of Australia for its views on the adequacy of educational preparedness for dealing within the Pacific, the Council advised that it was a 'gap that we should address.' The Council submitted that:

> …there appear to us to be very strong opportunities for us to revise our position in terms of things like languages, the written text, how we present ourselves, and certainly in developing better Asia Pacific focused education products here in Australia.[25]

Developing an education and training strategy

8.26 The issue of improving the financial literacy of Australians overall dovetails with the need to develop a more comprehensive education and training strategy, in support of Australia's global financial centre initiative in the long term. In its submission to the inquiry, the AMP stated that:

> Australia's education and training facilities must be able to deliver sufficient quantities of highly educated and capable people to service a centre for financial services.[26]

8.27 Axiss Australia told the Committee that it had a 'very strong focus on education and skill training' and, further, it believed that the necessary skills development must occur at 'high school level through to universities'.[27] Axiss Australia also reported that, in order to ensure that Australia has the right mix and level of skills to meet market demands, it had engaged a consultant to research, develop and articulate an appropriate education and training strategy.[28]

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23 David Crowe, 'Nothing Ventured Nothing Gained', Perspective, *Australian Financial Review*, 28–29 October 2000, pp. 22–23.

24 Committee Hansard, p. 586.

25 Committee Hansard, p. 243.

26 Submission No 10, p. 9.

27 Committee Hansard, p. 125.

28 Committee Hansard, p. 132 and Submission No 22, p. 1.

8.28 So far, Axiss Australia has been active in its focus on building skills post university, through its scholarship schemes, and within the finance industry through its Australian Financial Services Training Alliance (AFSTA) (see Chapter 5 for detail). In its view, the development of joint programs and joint marketing activity between the 14 industry bodies and Axiss should result in increased global exporting of training services and products.[29]

8.29 However, Axiss's as yet unrealised commitment to build literacy in financial matters in secondary schools, in order to foster strengths at tertiary level, received strong support from education experts. The Australian Principals Centre advised the Committee, for example, that in order to lift the levels of knowledge about things like superannuation and investments, financial literacy 'ought to be the diet of all children in schools.' The Centre concluded that 'it is time to rethink a whole range of those issues.'[30]

8.30 Chapter 5 of this report provides some detail on what initiatives and commitments Government has made to build opportunities for Australia as an education provider, to consolidate domestic IT and finance related skills and to attract overseas expertise to Australian industries. As Minister Kemp's response above indicates, the Government's approach also involves education initiatives which work to promote Asian literacy within schools and to establish links between tertiary institutions regionally.

8.31 However, the Committee heard little evidence of any initiatives that might work to promote financial literacy earlier in life, or to consolidate language and cultural training with financial skills in later years. The Committee's recommendations are outlined below.

Research and data needs

8.32 One of the difficulties encountered by the Committee in conducting this inquiry was the lack of readily available data on matters which are necessary to understand if Australia is to develop its potential as a global financial services centre, such as the reasons companies come to and leave Australia.

8.33 In response to a request for information of this nature, Axiss Australia advised the Committee that it was trying to track financial services operations.[31] In general, the reasons for movements in the financial services industry advanced by Axiss were as follows:

> certain sectors of the financial services industry are contracting and concentrating into one or two operations such as foreign exchange dealing and certain levels of principal trading and equity markets. If anything, outflows of activity from Australia are centred on treasury dealing desks,

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29 Submission No 22, p. 1.

30 Committee Hansard, pp. 590-591.

31 Committee Hansard, p. 125.

> foreign exchange desks and those areas that can perhaps be operated from one location. Because there is much more currency activity in other currencies at another location, they include the Aussie dollar in that location.
>
> On the reverse, where a financial services provider is seeking a skilled work force, a better environment and a low cost and efficient location, then there is an inflow from the more expensive places such as Singapore and Hong Kong to Australia.[32]

8.34 Axiss Australia subsequently provided the Committee with a listing of companies within the financial sector moving operations to and from Australia.[33] This list is included at **Appendix 7** of the report. Axiss Australia advised that the list provided was based on media reports, and did not pretend to be a full and comprehensive list of all company movements. The information provided did not include any reasons for such company movement.

8.35 The Committee notes, that according to an article in the *Australian Financial Review,* one of the main reasons advanced by companies leaving Australia is to be closer to the action. Lend Lease's Finance Director, Robert Tsenin, was reported as saying:

> There is real benefit in being based overseas…you get a much better feel for the markets and the opportunities. You get a smell for what is happening. You get to form relationships and get a handle on the market dynamics.[34]

8.36 The Committee considers it an imperative to quantify the real reasons for Australian companies going overseas; and to discover the degree to which Australia's taxation and regulatory regimes encourage that movement. A systematic survey of what attracts firms to other countries would complement such a study.

8.37 Another aspect which came to the Committee's attention during the inquiry was the absence of specific data on the numbers of expatriate staff who were affected or likely to be affected by the superannuation, taxation and health insurance arrangements in Australia.[35] The Finance and Treasury Association advised that a survey of expatriates based in Australia would reveal useful data in this context.[36]

8.38 The Committee was keen to establish from Axiss Australia what performance information it uses in order to measure its success in promoting Australia as a global financial services centre. In response to a request for such information, Axiss

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32 Committee Hansard, p. 126.

33 Submission No 22, p. 1.

34 *Australian Financial Review,* 29–30 April 2000, p. 21.

35 This issue also came up during the Committee's hearings on the Taxation Laws Amendment (Superannuation Contributions) Bill 2000, where it was clear that industry groups did not have any verifiable estimates of the numbers of expats affected by legislation, or by particular legislative change, in these areas—see ATO evidence quoted in the Committee's Report on the Taxation Laws Amendment (Superannuation Contributions) Bill 2000, December 2000, p. 19.

36 Committee Hansard, p. 269.

Australia advised that 'a number of factors make finding "useful" measures of Axiss' success in achieving its objective difficult.' Further, it advised the Committee that the impact of global trends are beyond the control of Axiss, and that it intends to measure its success around its activities with the private sector in increasing awareness of Australia as a global financial centre.[37]

Conclusion

8.39 As discussed elsewhere in this report, Australia has many advantages which enhance its potential to become a global financial services centre. These advantages include those which secure Australia's business environment, the demographic and knowledge-based advantages, and Australia's advantages in relation to its location and infrastructure. Gaining leverage from its advantages, Australia also has many opportunities to become a provider of global financial services.

8.40 The Committee has noted that there are a number of constraints to be addressed, in particular ensuring that Australia has an internationally competitive, efficient, equitable and certain tax and regulatory system. However, the Committee considers that there are a number of other areas in which Australia could further improve its potential to become a global financial services centre.

Streamlining access to Australia and its services

8.41 The Committee notes the calls for a streamlined access point for companies and others seeking to enter the Australian financial services market. In the view of the Committee, streamlining the access point can only enhance Australia's reputation as a country where a cohesive effort by governments, regulators, and service providers facilitates entry to Australian markets. The Committee supports any moves by Commonwealth and State Governments, regulators and service providers to achieve this 'one-stop shop' approach.

Recommendation 9

8.42 The Committee recommends that the Commonwealth Government work with State Governments, regulators and service providers to provide a one-stop shop to streamline access to Australia for companies and others seeking to enter the Australian financial services market.

8.43 The Committee recognises the need to brand Australia's financial services centre, clarify its role and promote its identity. The Committee suggests that this is an area in which Axiss Australia must work more closely and vigorously with industry, so that the branding of the centre is achieved prior to the centre's activities being passed on to industry. The Committee is also aware that the branding issue will have to be kept under review by industry if niche opportunities for more than one city emerge.

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37 Submission No 22, p. 2.

Reaffirming Australia's commitment to Asia

8.44 The Committee notes that there are a number of Government initiatives in the area of Asian education and training. Nevertheless the Committee sees considerable merit in the Government reaffirming Australia's commitment to Asia as overall success will require the ongoing commitment of Government to generate policy approaches, to fund and promote initiatives that will consolidate regional ties and promote confidence in Australia's markets and motives.

Recommendation 10

8.45 The Committee recommends that the Government make a statement which reaffirms Australia's commitment to Asia.

Establishing strategic alliances

8.46 The Committee notes the calls for Australia to form strategic alliances with other stockmarkets to give much needed mass to the Australian financial sector. However, as discussed in Chapter 7, the Committee urges caution with this approach in order to ensure that any strategic alliances are not achieved at the expense of Australia's financial system integrity and national sovereignty.

8.47 The Committee notes that the issues raised by Dr George Gilligan, in relation to changes in cross-vesting arrangements to give mass to the Australian market and build international ties, are matters to be considered as part of the Government's comprehensive review of foreign source income rules and international taxation, as agreed in its response to the Ralph Review.

Ensuring an educated workforce

8.48 The Committee acknowledges that Australia already has a highly skilled workforce, but the challenge is to ensure that the supply continues to meet current as well as future needs. The Committee regards it as imperative to identify the skills required, develop a comprehensive education and training strategy and develop programs accordingly. Recognising that this requires programs to meet both global and local needs, the Committee considers that this is an area requiring extensive consultation with a range of educational bodies.

8.49 The Committee notes that Australia is suffering from a severe skills shortage in the IT industry, estimated to be around 30 000 jobs. The Morgan & Banks Job Index recently found that 47.8 per cent of companies reported that they were experiencing a major shortage of IT workers. The Committee is aware that, with the slow-down of the US economy, as evidenced by the severe downturn in the NASDAQ, there has been an impact on the IT industry, especially in Silicon Valley. The Committee considers that there may be opportunities for progressive Australian companies to begin selective recruitment campaigns in Silicon Valley to alleviate the IT shortage in Australia.

8.50 The Committee recognises the importance of promoting Australian expertise and industries throughout the region and globally through the AFSTA initiative. However, the Committee believes that Axiss Australia should work more closely with DETYA and other educational bodies to adopt a broader education and training strategy—with an emphasis on innovation in provision and export of language, finance and technology studies—and should look at the potential for education of secondary school students.

Recommendation 11

8.51 The Committee recommends that Axiss Australia work with the Department of Education, Training and Youth Affairs and other educational bodies to:

a) consider the development of mechanisms for educating primary and secondary students about financial matters, including through IT initiatives;

b) develop a coordinated strategy to build and promote study of financial services skills along with Asian language and cultural studies in the tertiary sector, and within the Australian financial services industry; and

c) consider ways in which to foster and promote existing developments in financial services accreditation, education and training overseas.

Recommendation 12

8.52 The Committee also recommends that, to enhance international recognition of Australia's status as a 'gateway' to the Asia–Pacific region, the Government should continue to consolidate Australia's reputation by forging productive engagement between Australian institutions and organisations and those in the region, through regional organisations such as APEC and bilaterally.

Research and data needs

8.53 The Committee has already identified the difficulties it faced in obtaining appropriate performance information in relation to certain aspects which are essential to understand if we are to develop as a global financial services centre.

8.54 The Committee regards it as imperative to conduct appropriate research in order to ascertain such critically important information as the reasons companies and other financial service providers come into and leave Australia and the reasons expatriates come into and leave Australia. The Committee recognises that there may be some elements of commercial or personal confidentiality involved, but considers that it should still be possible to obtain data which is more useful than the current generalisations.

8.55 The Committee notes that Axiss Australia is already doing some work in this area, but it does not appear to be sufficiently robust to advise Government. The Committee is particularly concerned that Axiss should adopt a rigorous and systematic approach to investigate how Australia's taxation and regulatory regimes affect international competitiveness. This should complement the Government's commitment to conduct a comprehensive review of foreign source income rules and international taxation, but need not concentrate solely on those matters.

Recommendation 13

8.56 The Committee recommends that Axiss Australia develop and conduct an on-going research project so as to provide advice to Government on:

> **a) the reasons companies and other financial service providers come into and leave Australia; and,**
>
> **b) the reasons expatriate staff come to and leave Australia.**

8.57 The Committee is also concerned to discover that Axiss Australia does not have indicators in place by which it can measure its performance in promoting the objective of Australia as a global financial services centre. The Government has allocated some $7 million to the project, and has the right to be assured that the outputs of the centre and its contribution to outcomes can be demonstrated. The Committee recognises the difficulties associated with this task, and that some aspects of performance are likely to be beyond the control of Axiss. However, the Committee regards it as imperative for such performance measures to be in place to provide a guide to the success or otherwise of the centre.

Recommendation 14

8.58 The Committee recommends that Axiss Australia, as a matter of priority, develop some meaningful indicators by which it can measure its performance in delivering the outcome of promoting Australia as a global financial services centre.

Senator John Watson

Committee Chair

APPENDIX 1

LIST OF SUBMISSIONS

1. Osborne Associates
2. International Banks and Securities Association of Australia (IBSA)
3. NRMA
4. William M. Mercer Pty Ltd
5. Australian Society of CPAs (now CPA Australia)
6. The Finance and Treasury Association
7. Council of Small Business Organisations of Australia
8. Australian Prudential Regulation Authority
9. Institutional Analysis Pty Ltd
10. AMP
11. Investment & Financial Services Association
12. Department of the Treasury
13. Skandia Assurance & Financial Services
14. Dr George Gilligan, Monash University
15. Vanguard Investments Australia Ltd
16. Packer & Co. Ltd
17. Puzzle Financial Advice P/L
18. IBSA (Supplementary Submission)
19. Puzzle Financial Advice P/L (Supplementary Submission)
20. Australian Accounting Standards Board
21. Australian Principals Centre Ltd

22. Axiss Australia (Supplementary Submission to Submission No. 12 from the Department of the Treasury)

23. Reserve Bank of Australia

24. Puzzle Financial Advice P/L (Supplementary Submission))

25. Australian Securities & Investments Commission

26. The Broken Hill Proprietary Company Ltd (BHP)

27. J B Were & Son

28. BHP (Supplementary Submission)

29. Professor Peter Drysdale, Australian National University

30. Department of the Treasury (Supplementary Submission)

31. Department of the Treasury (Supplementary Submission)

32. Department of Communications, Information Technology and the Arts

33. The Institute of Chartered Accountants in Australia

34. Australian Financial Markets Association

35. The Hon Mark Vaile MP, Minister for Trade

36. Department of the Treasury (Supplementary Submission)

37. The Hon. Dr David Kemp MP, Minister for Education, Training and Youth Affairs

38. Australian Taxation Office

APPENDIX 2

WITNESSES WHO APPEARED BEFORE THE COMMITTEE AT PUBLIC HEARINGS

Monday, 15 May 2000, Sydney

Australian Mutual Provident Society Ltd
Mr Kevin Casey, Senior Strategy and Technical Adviser
Mr Gerald Naughton, Senior Investment Manager

Association of Superannuation Funds of Australia
Dr Michaela Anderson, Director, Policy and Research
Ms Philippa Smith, Chief Executive Director

Financial Services Consumer Policy Centre
Mr John Berrill, Partner Superannuation, Martin Blackburn Cashman
Mr Chris Connolly, Director
Mr Khaldoun Hajaj, Researcher

Australian, Food, Metals, Engineering Printing and Kindred Industries Union
Mr Barry Terzic, National Research Officer

Retail Employees Superannuation Trust
Mr Damian Hill, Administration Manager
Mr Elliott Sabbah, Operations Manager

Phillips Fox Actuaries and Consultants
Mr Michael Rice, Managing Director

Investment and Financial Services Association
Miss Lynn Ralph, Chief Executive Officer
Ms Annabelle Kline, Senior Policy Manager

Tuesday, 16 May 2000, Sydney

Australian Stock Exchange
Ms Rosemary Kennedy, National Manager, Interest Rates Markets
Mr Michael Roche, Executive General Manager, Strategic Planning and Corporate Relations

Australian Centre for Global Finance, Treasury
Mr Leslie Hosking, Chief Executive Officer
Miss Maryanne Mrakovcic, General Manager

Australian Financial Markets Association
Mr Kenton Farrow, Chief Executive
Mr John Rappell, Director Research and Policy

Dr George Gilligan

Prof Gordon de Brouwer

Vanguard Investments Australia Ltd
Mr Jeremy Duffield, Managing Director

Skandia Assurance and Financial Services
Mr Johan Hofvander, Regional Manager, Asia-Pacific
Mr Ross Laidlaw, Country Manager

International Banks and Securities Association of Australia
Mr Robert Webster, Executive Director

Friday, 9 June 2000, Melbourne

Superannuation Complaints Tribunal
Mr Graham McDonald, Chair
Ms Nicole Cullen, Deputy Chairperson
Mrs Margaret McDonald, Director

Osborne Associates
Mr Bradley Treadwell, Managing Director

Insurance Council of Australia Ltd
Mr Philip Maguire, Deputy Chief Executive
Ms Joan Fitzpatrick, Member International Committee for General Insurance
Mr Vincent McLenaghan, Chairman, International General Insurance Committee

Reserve Bank of Australia
Mr Ric Battellino, Assistant Governor, Financial Markets
Dr Robert Rankin, Head of International Department

Finance and Treasury Association
Mr Anthony Michell, Technical Manager, Policy, Research and Professional Development

Australian Banking Industry Ombudsman
Mr Colin Neave, Banking Ombudsman

J B Were & Son
Mr Terrence Campbell, Executive Chairman

Ms Priscilla Boreham, Corporate Counsel
Ms Lisa Gay, General Counsel

Australian Securities and Investment Commission
Mr Alan Cameron, Chairman
Ms Delia Rickard, Director, Office of Consumer Protection
Ms Jillian Segal, Commissioner
Mr Shane Tregillis, National Director Regulation

Australian Accounting Standards Board
Mr Keith Alfredson, Chairman

Thursday, 15 June 2000, Melbourne

Australian Council of Trade Unions
Ms Linda Rubinstein, Senior Industrial Officer

Industry Funds Forum
Ms Ann Byrne, Convenor
Ms Anne-Marie Darke, Executive Member

Corporate Super Association
Mr Mark Cerche, Chairman
Mr Nicholas Brookes, Secretary

Institute of Chartered Accountants of Australia
Mr David Coogan, Chairperson, Superannuation Taskforce
Mr Richard Rassi, Partner Deloitte Touche Tohmatsu

William M Mercer Pty Ltd
Mr Wayne Walker, Executive Director
Mr John Ward, Manager, Research and Information

Ms Fiona Ogilvy-O'Donnell

Towers Perrin
Mr Kenneth Lockery, Principal

CPA Australia
Mr Bradley Pragnell, Superannuation Policy Adviser

Association of Independent Retirees Inc
Mr Alan Beaton, President, South Australian Division and National Councillor

Friday, 16 June, 2000, Brisbane

Puzzle Finance Advice Pty Ltd
Mr Bruce Baker, Director
Mr Gary Lanham
Mr Mervyn Whimp

Hairdressers Association Superannuation Fund
Mrs Yvonne Bell, Consultant to Fund
Mr Jeffrey Osborne, Director (Trustee Company)

Mrs Carmel Reading

Law Employees Superannuation Fund
Mr Peter Short, Chairman
Mr Ray Rinaudo, Director

Voyager Resort Ltd
Mr Geoff Heaton, Company Secretary and Resort Manager

Mr Dan Scheiwe

Mr Paul Henderson

Friday, 14 July, 2000, Canberra

Australian National University
Prof Peter Drysdale, Head Australia-Japan Research Centre and Acting Director Asia Pacific School of Economics and Management
Prof Anthony Milner, Dean, Faculty of Asian Studies

The National Office for the Information Economy, Department of Communications, Information, Technology and the Arts

Dr Rodney Badger, Deputy Chief Executive Officer NOIE and Executive Director Information Technology
Mr Phillip Malone, Acting General Manager, E-Commerce
Mr Gregory Piko, Acting General Manager, Information and Communications Industry Development
Mr Brenton Thomas, Acting General Manager, Consumer and Competition Branch

Namoi Cotton Cooperative (teleconference)
Mr Andrew Lennon, Risk Manager

The Broken Hill Proprietary Co Ltd (teleconference)
Mr Ian Edney, Vice President Taxes
Mr Alistair Mytton, Manager, Corporate Tax Advisory

Australian Principals' Centre
Mr Nicholas Thornton, Chief Executive Officer

Australian Greenhouse Office
Dr David Harrison, Special Adviser, Emission Trading
Dr Gary Richards, Manager, National Carbon Accounting System
Mr Stephen Moran, Director, Climate Section, Department of Foreign Affairs and Trade

Securities Institute of Australia
Ms Penelope Le Couteur, Managing Director
Mr Darren Davis, National Policy Adviser

Department of the Treasury
Mr Blair Comley, General Manager, Indirect Tax Division
Mr Bruce Paine, General Manager, Business Entitics and International Tax Division
Mr Gary Potts, Executive Director, Markets Group
Mr Michael Willcock, General Manager, Financial Markets Division
Mr Leslie Hosking, Chief Executive Officer, Axiss Australia

Australian Taxation Office
Mr James Killaly, Deputy Commissioner, Large Business and International

Friday, 1 September 2000, Canberra

Australian National Audit Office
Mr Peter White, Executive Director, Revenue Branch
Mr Norman Grimmond, Senior Auditor Performance Audit Services Group

Financial Planning Association of Australia
Mr Con Hristodoulidis, Senior Manager, Public Policy
Mr Maurice Pinto, Chairperson, Superannuation and Retirement Incomes Committee

Australian Consumers Association
Ms Louise Petschler, Senior Policy Officer, Financial Services

Australian Taxation Office
Mr David Diment, Assistant Commissioner, Superannuation

Institute of Actuaries of Australia
Dr David Knox, President
Ms Jane Ferguson, Director Public Affairs
Ms Christa Marjoribanks, Member, General Insurance Practice Committee

Australian Institute of Criminology
Dr Adam Graycar, Director
Dr Peter Grabosky, Director of Research

WA Shearing Contractors Association (teleconference)
Mr Neville Munns, Secretary

Monday, 16 October 2000, Canberra

Care Incorporated
Mr David Tennant, Director

National Farmers Federation
Mr Richard Calver, Director, Industrial Relations

Australian Association of Permanent Building Societies
Mr Jim Freemantle, Chairman
Mr Jim Larkey, Executive Director

First Samuel Ltd
Mr Anthony Starkins, Managing Director

Association of Financial Advisers
Mr John Hibberd, President
Mr Dugald Mitchell, Consultant

Tuesday, 17 October 2000, Canberra

Australian Securities and Investments Commission
Mr Sean Hughes, Director, Deposits, Investment, Superannuation and Consumers
Mr Peter Kell, Coordinator, Office of Consumer Protection
Ms Angela Longo, Senior Lawyer
Ms Delia Rickard, Office of Consumer Protection
Mr Malcolm Rodgers, Director, Regulatory Policy

Australian Prudential Regulation Authority
Mr Roger Brown, Senior Manager, Rehabilitation and Enforcement
Mr Keith Chapman, General Manager, Specialised Institutions Division
Mr Leslie Phelps, Executive General Manager, Specialised Institutions Division
Mr Darryl Roberts, General Manager, Policy Development and Statistics

Department of the Treasury
Mr Roger Brake, General Manager, Retirement and Personal Income Division
Mr Raphael Cicchini, Manager, Superannuation Unit, Retirement and Personal Income Division

Ms Jan Harris, General Manager, Consumer Affairs Division
Mr William Keown, Acting General Manager, Financial Institutions Division
Mr David Maher, Analyst, Financial Institutions Division
Mr Michael Rosser, Manager, Investor Protection Unit, Financial Markets Division
Ms Karen Witham, Manager, Superannuation and Insurance Unit, Financial Institutions Division
Mr Michael Willcock, General Manager, Financial Markets Division

Australian Taxation Office

Mr Leo Bator, Deputy Commissioner of Taxation
Mr David Diment, Assistant Commissioner of Taxation

Australian Competition and Consumer Commission

Mr Allan Asher, Deputy Chairman
Mr Carl Buik, Director, Consumer Protection

APPENDIX 3

TABLED DOCUMENTS/EXHIBITS

1. ASFA submission on Financial Services Reform Bill. May 2000 – tabled by Ms Philippa Smith, CEO, ASFA, 15 May 2000, Sydney.

2. Correspondence from Hesta Super Fund to Barry Terzic, AMWU, dated 12 May 2000 relating to Superannuation – Process Pack – tabled by Mr Barry Terzic, National Research Officer, AMWU, 15 May 2000, Sydney.

3. Extract from Workplace Relations Act 1996 – tabled by Mr Barry Terzic, National Research Officer, AMWU, 15 May 200, Sydney.

4. Correspondence to APRA, dated 20 August 1999 and correspondence from APRA, dated 9 September 1999 relating to monitoring gainful employment for members over age 65 – tabled by Ms Lynn Ralph, CEO, IFSA, 15 May 2000, Sydney.

5. Opening statement by Mr Les Hosking, Chief Executive Officer, Australian Centre for Global Finance and fact sheets about the Centre – tabled by Mr Les Hosking, CEO, Australian Centre for Global Finance, 16 May 2000, Sydney.

6. *AFMA 1999 Australian Financial Markets Report – Overview* – tabled by Mr Kenton Farrow, Chief Executive, Australian Financial Markets Association, 16 May 2000, Sydney.

7. *IBSA 1999 Annual Report* – tabled by Mr Robert Webster, Executive Director, International Banks and Securities Association of Australia, 16 May 2000, Sydney.

8. *'Disclosure Model'* – tabled by Ms Ann Byrne, Convenor, Industry Funds Forum, 15 June 2000, Melbourne.

9. The following documents, issued by the Queensland Department of Justice and Attorney-General were tabled by Mr Baker, Puzzle Financial Advice Pty Ltd, 16 June 2000, Brisbane:

   - Enduring Power of Attorney
   - Powers of Attorney Act 1998
   - Advance Health Directive
   - Statutory Health Attorney
   - Enduring Power of Attorney – long form.

10. *Law Employees Superannuation Fund (LESF), Annual Report to Members for the year ending 30 June 1999* – tabled by Ms Carmel Reading, 16 June 2000, Brisbane.

11. A document issued by the Hotel Motel & Accommodation Association of Queensland entitled ‘ Important notice to members – EPAS superannuation 28/9/98’ – tabled by Mr Geoff Heaton, 16 June 2000, Brisbane.

12. Report prepared for ASIC by Phillips Fox Actuaries and Consultants, *Financial Products and Intermediary Remuneration,* 10 November 1999 – provided by ASIC in response to questions taken on notice at the public hearing in Melbourne on 9 June 2000.

13. A document entitled, ‘An IOSCO Technical Committee Release: International Securities Regulators Issue New Economy Bulletin, Sydney Australia 19 May 2000’, provided by ASIC in response to questions taken on notice at the public hearing on 9 June 2000.

14. Response by Ms Yvonne Bell, Hairdressers Association Superannuation Fund, to questions taken on notice at the public hearing in Brisbane on 16 June 2000, relating to names of trustees and the court involved.

15. A document entitled, ‘National Bandwidth Inquiry – Report of the Australian Information Economy Advisory Council’, provided by National Office of Information Economy in response to questions asked at the public hearing on 14 July 2000.

16. Four discussion papers, ‘Establishing the Boundaries’, ‘Issuing the Permits’, ‘Crediting the Carbon’ and ‘Designing the Market’, provided by the Australian Greenhouse Office in response to questions asked at the public hearing on 14 July 2000.

17. Final Report from the Centre for International Economics Canberra and Sydney, which was commissioned by the Australian Greenhouse Office, provided by the Australian Greenhouse Office in response to questions asked at the public hearing on 14 July 2000.

18. Australian Institute of Criminology brochure outlining the Institute's function, aims and programs, tabled by Dr Adam Graycar, Director, at the committee's public hearing on 1 September 2000.

19. Australian Institute of Criminology brochure No. 56 - *Superannuation Crime* - tabled by Dr Adam Graycar, Director, at the committee's public hearing on 1 September 2000.

20. Australian Institute of Criminology brochure No. 132 - *Fraud & Financial Abuse of Older Persons* - tabled by Dr Adam Graycar, Director, at the committee's public hearing on 1 September 2000.

21. Australian Institute of Criminology brochure No. 139 - *Substitute Decision Making and Older People* - tabled by Dr Adam Graycar, Director, at the committee's public hearing on 1 September 2000.

22. Chant Links & Associates, *1999 Superannuation Guarantee Audit Summary Report*, provided by the Australian Taxation Office and received as an exhibit to the inquiry on 3 October 2000.

23. Brochure entitled *Code of Ethics & Rules of Professional Conduct*, provided by the Financial Planning Association and received as an exhibit to the inquiry on 3 October 2000.

24 National Farmers' Federation publication *Reform,* Spring 2000, provided by Mr Richard Calver, NFF, during the public hearing on 16 October 2000.

25 Article entitled *Disclosure paper on the current commission disclosure issue in Australia,* provided by Mr John Hibberd, Association of Financial Advisers at the public hearing on 16 October 2000.

26 Policy/discussion paper entitled *Distribution Disclosure or Commission? Bias and Conflict of Interest Examined,* provided by Mr John Hibberd, Association of Financial Advisers at the public hearing on 16 October 2000.

27 *Australian Competition and Consumer Commission - Overview of consumer protection functions, October 2000,* tabled by Mr Allan Asher, ACCC, at the public hearing on 17 October 2000.

28 *Approval of external complaints resolution schemes,* tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

29 *A User's Guide to ASIC*, tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

30 *ASIC more than a corporate watchdog,* tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

31 *Educating Financial Services Consumers*, discussion paper tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

32 *Submission to the Review of the Code of Banking Practice,* tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

33 *Submission to the Parliamentary Joint Committee on Corporations and Securities inquiry into fees on electronic and telephone banking,* tabled by the Australian Securities and Investments Commission at the public hearing on 17 October 2000.

34 Documents provided by the ACCC in response to questions taken on notice at the public hearing on 17 October 2000.

- *Report to the Australian Senate on anti-competitive and other practices by health funds and providers in relation to private health insurance* for the period ending 30 June 2000;
- *Debit and credit card schemes in Australia. A study of interchange fees and access.* Reserve Bank of Australia, Australian Competition and Consumer Commission, October 2000;
- ACCC submissions – First, Second and Third - to the Financial System Inquiry (Wallis Inquiry) 1996 and 1997.

APPENDIX 4

AWAKENING THE 'CELTIC TIGER' —IRELAND'S INTERNATIONAL FINANCIAL SERVICES CENTRE (IFSC)

Introduction

1.1 The Organisation for Economic Cooperation and Development (OECD) has described the performance of the Irish economy during the 1990s as 'stunning'. No other OECD member has been able to match its growth, which has averaged over 9 per cent a year between 1995 and 1999.[1] It is this achievement which has had the world talking of the 'Celtic Tiger', coined in recollection of the economic achievements of 'Asian Tigers' during the middle decades of the 20th century.[2]

1.2 Commentators agree that it was an integration of sound economic and social planning over several decades that has allowed Ireland to capitalise on developments in the international trade and investment arena; principally the opportunities created by the establishment of the European Economic Community (EEC). This inturn has paved the way for the US-based foreign investment which has fuelled Ireland's present success.[3]

1.3 In 1987 the Irish Government recognised the growth potential of the international financial services sector. It saw that Ireland had the capacity to develop a strong international financial services industry, due to its having a well-developed financial infrastructure, a sophisticated internal and international communications system and a young highly educated population. It was against this background that the Government decided to establish the International Financial Services Centre at Custom House Docks, an urban renewal site in Dublin.[4]

Background—laying the foundations

1.4 For the first half of the twentieth century, Ireland had been virtually a Third World nation on the doorstep of Europe. After independence in 1922, it had concentrated on becoming economically self-sufficient. The economy was then based on small-scale agriculture, with primary produce imported to the United Kingdom market, and on manufacturing mainly for the domestic market. To nurture indigenous

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1 Sean Dorgan, 'Investment: Globalisation and the Benefits of Investment—the Irish Experience', *Outlook 2000*, vol. 4, 29 February–2 March 2000, p. 169.

2 'History of the IFSC', *IFSC* internet site: http://www.ifsc.ie/isfsc_history.htm (accessed September, 2000)

3 See for example Roy Green, 'Lessons of the Irish Miracle', *Australian Financial Review*, 2 December 1998.

4 'History of the IFSC', *IFSC* internet site.

industry a protectionist approach, which relied on high tariffs and a policy of import substitution, was adopted. [5]

Trading on your advantages

1.5 By the late 1950s Ireland was ready for fundamental change and controls on foreign ownership of businesses ceased. In the 1960s Ireland joined the General Agreement on Tariffs and Trade (GATT). In 1973 it gained membership of the EEC, deliberately removing itself from the colonial sphere of England and securing its place among European nations.[6]

1.6 As a companion to these initiatives, in the 1960s policy makers determined to drive Ireland's growth by adopting an export-led growth strategy. Particular emphasis was placed on gaining inward investment to generate employment and exports, and to import modern management and technical knowledge.[7] Ireland's low costs, investment incentives (as described below) and an efficient English-speaking workforce saw direct foreign investment increase by more than 27 per cent a year from 1973 to 1981.[8]

1.7 The United States has been the primary investor in Ireland. The US's economic boom, cultural ties with Ireland, and the latter's proximity to Europe made it the ideal location for American industries to launch their products into the unified European market.[9] Other substantial investments were followed from Germany, the UK, other European States, Japan, Korea and Taiwan.[10] By the 1980s many leading international companies had established facilities, mainly manufacturing plants, in the high technology sectors, such as pharmaceuticals, health care, electronics and computers.[11]

1.8 Ireland's geographic advantage was complemented by a demographic fortuity. Ireland has a young population (almost half under the age of 25) who are the well-educated products of the reformed Irish education system.[12] In 1963 an influential

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5 Dorgan, 'Investment: Globalisation and the Benefits of Investment—the Irish Experience', p.169.

6 Green, 'Lessons of the Irish Miracle', *Australian Financial Review*, 2 December 1998.

7 John Travers, Chief Executive Forfás, 'Science, Technology and Innovation: Policy and Practice in Ireland', presentation to the panel on Science, Government and Innovation, in Tallin 3 December 1998, p. 2.

8 Dorgan, 'Investment: Globalisation and the Benefits of Investment—the Irish Experience', p. 169.

9 The OECD has estimated that Ireland was the fifth largest recipient of US investment in all sectors by 1997. By the year 2000, the US was the source of 60–70 per cent of Ireland's inward investment, and over 80 percent of total capital in the last decade. Dorgan, 'Investment: Globalisation and the Benefits of Investment—the Irish Experience', pp. 173; 170.

10 Dorgan, 'Investment: Globalisation and the Benefits of Investment—the Irish Experience', p. 170.

11 Travers, Chief Executive Forfás, 'Science, Technology and Innovation: Policy and Practice in Ireland', p. 2.

12 'Quality People', *About the IDA* (Industry Development Agency) internet site: http://www.idaireland.com/yframes/wiqpy.htm (accessed September, 2000)

OECD report on education saw Ireland move to a new system which integrated the strengths of the humanities with science education. By the 1980s, this system had produced a surplus of highly qualified graduates looking for work in a relatively undeveloped economy. Their response was to leave Ireland in search of overseas opportunities, just as generations of Irish had done the past.[13]

1.9 While the inward investment strategy had been highly successful in attracting foreign investment, Irish indigenous industry lagged behind. The initial effect of joining the European Union (EU) had been devastating. In the fifteen years following 1973, three quarters of the domestic textile and apparel firms and half domestic metal and engineering firms collapsed. The Irish-owned industry sector, built behind protective tariff barriers, could not compete with the performance of the foreign-owned sector in terms of output growth, employment and productivity.[14] This, coupled with the mass migration of Ireland's youthful intellectual capital, was a grave and motivating concern to the Irish and to their government.

Consolidating for growth

1.10 Despite consistent growth rates of between three and four per cent, the global economic shocks of the 1970s and the failure to control public finances in the early 1980s meant that the benefits to Ireland of joining the EU had been limited.[15] By 1987, Ireland was in a public finance and employment crisis. The new elected government acted promptly. It severely cut public spending and negotiated a range of tripartite agreements between government, employers and unions.

1.11 This was the first of the series of 'Social Partnership' agreements, which provided for moderate wage increases, supplemented by cuts in personal income tax, and on consensus being gained over spending priorities on economic and social programs. These agreements were to set national development priorities over future decades while maintaining moderate-income increases during a period of rapid growth, so protecting national competitiveness.[16]

1.12 The initiatives of 1987 came as a partner to Ireland's new determination to embrace the opportunities provided by the EU's open markets, and to make local industry competitive and efficient.[17] The Government had consolidated domestic support and had further enhanced Ireland's attractiveness as a stable environment,

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13 Green, 'Lessons of the Irish Miracle', *Australian Financial Review*, 2 December 1998.

14 Travers, Chief Executive Forfás, 'Science, Technology and Innovation: Policy and Practice in Ireland', p. 2.

15 Dorgan, 'Investment: Globalisation and the Benefits of Investment—the Irish Experience', p. 169.

16 There have been a sequence of arrangements negotiated since that time. The latest was the 'Programme for Prosperity and Fairness'. See review of its implementation at Speech by the Taoiseach, Mr Bertie Ahern, T.D., at the Plenary Meeting with the Social Partners, in Dublin Castle on Thursday , 27 July 2000 at Press Releases and Speeches, *Ireland Government* internet site: http://www.irlgov.ie/taoiseach/press/current/27-07-2000.htm (accessed September 2000)

17 Dorgan, 'Investment: Globalisation and the Benefits of Investment—the Irish Experience', p. 170.

both politically and economically, to international investors. Dublin's International Financial Services Centre, established in that year, would be a key stone in the architecture of economic growth, and one that would secure employment at home for the youth of Ireland.

Establishment of the IFSC, Dublin

1.13 Dublin's International Financial Services Centre (IFSC) was established as a tangible manifestation of Ireland's new image as a dynamic economic opportunity on the threshold of Europe. It made Ireland a pioneer—as the creator of the first pan-European customer support and shared services centre—while simultaneously regenerating Dublin's Customs House Docks site as a community, residential and employment centre.

1.14 As the site for the IFSC, Dublin promotes itself as an English speaking city of 1.2 million, which offers lower living and operating costs to industries than other nations, and having attractive cultural and recreational resources.[18] Its shared time zone with Europe, frequent air services to major UK and European centres, and close proximity to London are cited as major drawcards. Dublin also claims advantage in having 'maximum overlap between the Asia–Pacific and the Americas'. The IFSC site itself is centrally located within Dublin, and only 30 minutes from Dublin International Airport.[19]

Development of the IFSC site

1.15 In 1986 the Irish Government established the Custom House Docks Development Authority to secure the redevelopment of the 11ha Custom House Docks site. The area was one the largest blocks of prime urban land in the city to be designated for redevelopment. The Government provided for urban renewal tax incentives to encourage investment in the area.[20]

1.16 The Authority prepared a Planning Scheme and invited submissions from the private sector to find a suitable partner to develop the site. Sixteen submissions were received from international and Irish developers and, in 1988, the Master Project Agreement was signed by the Authority and its preferred developer, the consortium Custom House Docks Development Co. Limited. In this partnership between private and public enterprise the Authority provided the land, tax incentives and planning powers while the private sector designed, built and financed the project.

1.17 Construction commenced in late 1988 and in April 1990 the first building, the West Block, was completed and occupied by Allied Irish Banks. By the end of 1997, over 1.2 million sq. ft. of office accommodation was completed. The development

18 'Profile of The IFSC', *IFSC* internet site.

19 ibid.

20 The information in this section is drawn from the 'History of the IFSC', *IFSC* internet site.

also comprised 333 apartments, a hotel, multi-storey car park and retail areas, including a pub and restaurants and the Dublin Exchange Facility.

1.18 In May 1997 the original Custom House Docks Development Authority was dissolved and the new Dublin Docklands Development Authority (DDDA) established. By the year 2000, a further 4.8ha had been redeveloped to provide International Financial Services Centre II.

1.19 The IFSC is now a US$640 million development, occupying a total of 39 acres (including the 12 acres of IFSC II, added in 1997). It provides almost two million. sq.ft. of office space, two hotels, two bars/restaurants, a large residential development, retail areas and creche. The National Collegue of Ireland campus will also be located at the site and is expected to open in 2001.

1.20 The DDDA has a commitment to further develop the Custom House Docks area to provide services in support of the financial sector of the economy. The DDDA is also contracted to the social, economic and the physical regeneration of 520 ha of the docklands site.[21] The site is now the focus of a round of cultural and community activities. The DDDA also administers grant aid to facilitate development of community amenities and services.[22]

IFSC—policy coordination and operational arrangements

1.21 Ireland's Department of Taoiseach has taken a lead role in development of the policy framework which supports the IFSC and operates the IFSC Clearing House Group, which ensures its effective implementation.[23] The Clearing House Group is chaired by the Secretary of General of the Department of Taoiseach and operates through a series of working groups: the ISC Funds Group, the Banking and Treasury Group, the Insurance Group, plus special sub groups established as needed.

1.22 The system aims to ensure that the IFSC has the highest support from Government, that there is coordination between government departments and agencies, and that industry has direct input into policy and access to officials. It also provides an opportunity for experts to give full consideration to technical issues in each area as they arise. Members of the Clearing House Group include representatives from Irish industry associations, the Department of Finance, the Industrial Development Authority, Revenue Commissioners, the Central Bank and the Dublin Dockyards Development Authority.[24]

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21 See 'Mission Statement and Objectives', *Dublin Docklands Development Authority* internet site: http://www.ddda.ie/ (acessed .September 2000).

22 See News About the IFSC, *IFSC* internet site.

23 The Irish Department of Taoiseach consists of the Taoiseach (Prime Minister) and 14 Ministers.

24 Irish International Services Centre, *Department of the Taoiseach* internet site: http://www.irlgov.ie/taosieach/organisation/ifsc/default.htm (accessed September 2000).

1.23 Operational management of the IFSC is overseen by the site's 'Management Company', which was set up by the Custom House Docks Development Authority, the forerunner of the DDDA and the original developer, Custom House Docks Development Co. Limited. Major lessees become members of this Management Company when they locate in the IFSC. An identical arrangement has been made on the adjoining IFSC II site.

1.24 Physical management of the IFSC premises is the responsibility of Integrated Facility Management Services (IFMS). A limited liability company, it was set up to discharge the estate management obligations of the Management Company under the various leases. Key operations and services include building and grounds maintenance, security, catering, cleaning and mail porterage. The IFMS employs around 40 people.[25]

ISCF—functions and services

1.25 The IFSC has quickly established itself as the second largest funds administration and custody centre in the world. In September 1999 over 485 international institutions were directly operating from within, with a further 503 managed entities approved to carry on business under the IFSC program. Top global financial institutions such as Merrill Lynch, XL, Deutsche Bank/Morgan Grenfell, Societe Generale, Sumitomo Bank, ABN AMRO, NatWest, Chase Manhattan, AIG, Citibank, IBM, BIL and Grand Metropolitan all engage in a broad range of activities at the Centre. The Centre claims to host more than half the world's top 20 insurance companies and more than half the world's largest banks.[26]

1.26 The IFSC has demonstrated a sturdy record of growth in the 1990s. By December 1999, IFSC funds operations managed investment funds were valued at over US$150 billion. In December 1998, IFSC banking operations reported assets of over US$70 billion and IFSC commercial and captive insurance and reinsurance companies had premiums of over 4 billion Irish pounds. FINEX, the financial division of the New York Cotton Exchange, traded over 590 000 futures and options contracts in 1996.[27]

1.27 As defined by the *Finance Act 1987* and subsequent legislation, a wide range of activities and their ancillary services can qualify for a place within the IFSC. They cover the following activities:

- banking, asset financing and leasing;
- corporate treasury management;
- fund management, investment management, custody and administration;

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25 'News About the IFSC', *IFSC* internet site.

26 'Profile of the IFSC', *IFSC* internet site.

27 ibid.

- futures and options trading;
- securities trading; and
- insurance, assurance, reinsurance, captives, broking.

It is a requirement that these activities must be carried out on behalf of non-Irish residents and in non-Irish currencies. [28]

1.28 At present, the primary business at the IFSC is done in funds administration and custody; corporate banking; treasury operations; and life and non-life/captive insurance services. The scope of these operations at the IFSC is briefly described.[29]

- *Funds administration and custody*

1.29 The IFSC is primarily a service centre for investment management. The investment decisions are made in the traditional locations of London and New York. The administration work is generally contracted out to third parties including Citibank and Chase Manhattan and can be divided into the roles of funds administrator and custodian.[30] Over one third of all jobs in the IFSC are in funds administration. More than 200 international fund promoters have operations in the IFSC including, Global Asset Management, Dresdner Bank, Fidelity Investments, Commerzbank, Goldman Sachs, and ING Barings.

- *Corporate banking*

1.30 Banks operating in the IFSC focus on the corporate and institutional markets, providing multi-million dollar loans to corporate bodies and governments for financing infrastructure such as power plants or aeroplanes. Dublin has developed into a major centre for aircraft leasing with banks and specialised aviation leasing companies operating from the IFSC, including Airbus Finance Co and Orix Aviation Systems. Of the world's top 50 banks, over half have operations in the IFSC. These include: Citibank, Chase Manhattan, ABN Amro, Dresdner Bank, Commerzbank, and Rabobank.

- *Treasury operations*

1.31 Over 350 treasury entities have been approved to operate in IFSC. Many companies are centralising their treasury operations and either managing these themselves or outsourcing them to a bank. Corporate treasury departments manage foreign exchange transactions, hedging operations, and the raising and investing of cash. Aside from cost savings, a centralised treasury operation enables better

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28 It is noted that other activities that can be broadly described as a financial service, and 'which will create substance', may also qualify. See 'Qualifying activities', 'Profile of the IFSC', *IFSC* internet site.

29 The following information is summarised from 'Services Provided by the IFSC', *IFSC* internet site.

30 Funds administrators calculate net asset values, handle sharer holder records and liaise with investment managers while, custodians, usually banks, hold the assets in trust for shareholders.

management of currency and interest rate risks. Some of the larger stand-alone treasuries in the IFSC are Bristol-Myers Squibb International Co, Diageo Finance Ireland, and Smurfit Capital.

1.32 Some IFSC treasury operations have extended their services to provide financing and leasing options to assist sales. Many corporate bodies are also applying for full banking licences from the Irish Central Bank. Hewlett-Packard, Pfizer, and Caterpillar have all received full licences in Ireland. This offers companies cheaper borrowing costs and allows them provide customer financing throughout Europe, which companies are prohibited from doing.

- *Insurance (life and non- life captive)*

1.33 The International Financial Services Centre (IFSC) is host to a large number of life and non-life insurers. Total premiums written by IFSC-based insurance companies is over 5 billion Irish pounds, twenty per cent of which is in life premiums.

1.34 Since the implementation of the EU Third Life Directive as national law in most countries in the mid-1990s, the number of life assurers has been growing. The Directive allows life insurers with headquarters in one EU country to engage in cross-border selling within the EU. The IFSC is attracting life assurance companies eager to market their savings and investment products on a pan-European basis. British insurers such as Scottish Mutual, Rothschild, and Scottish Amicable are representative. The EU Directive also gives non-EU companies establishing themselves in one member state a ‘passport’ to offer products and services throughout the EU. This cross-border selling has attracted North American insurers such as AIG, Household International Group, and Canada Life.

1.35 Since the IFSC’s inception on 1987, however, insurance activity has been weighted towards the non-life sector, primarily direct insurance such as property and casualty insurance, re-insurance and especially ‘captive’ insurance and its management. Many of the world’s largest re-insurers and catastrophe insurers have also set up operations in the IFSC, including Cologne Re, Swiss Re, and X.L.

IFSC—foundational incentives

<u>Tax incentives</u>

1.36 Ireland’s integration with the fiscal environment of the EU has been a significant factor in its favour. An historic agreement reached with the EU in July 1998 confirmed an ongoing favourable fiscal regime, with the present 10 per cent corporate tax rate for trading profits to continue to 1 January 1993, when it will rise to 12. 5 per cent.[31]

1.37 The Irish Government has also demonstrated commitment to improve the IFSC's attractiveness to global players by the expedient manner in which relevant

31 This and following information is drawn from ‘Profile of the IFSC’, *IFSC* internet site.

regulatory and taxation legislation has been amended and introduced in recent years. In a major amendment to Section 29 of the Ireland's *1995 Finance Act* the income of certain foreign branches of Irish companies were exempted from all Irish taxes. The exemption, which covers both income and capital gains, is available to companies that create substantial new employment, coupled with an appropriate level of capitalisation.

1.38 This exemption has proven particularly attractive for financial institutions, such as major banks or insurance companies, and has encouraged institutions like Merrill Lynch and Bear Stearns to establish their headquarters in Dublin. They have converted existing international activities into branches of the Dublin headquarters, thus maximising their competitive advantage. These arrangements have generated considerable interest from other organisations.

1.39 Other direct industry specific incentives, in addition to tax incentives, are provided within the broader framework of industry policy carried by the Irish Government. These are described below under 'Supportive investment and industry strategies'.

Regulatory environment—towards a 'one stop shop'

1.40 Like Australia, Ireland values having a well-developed financial regulatory system. At present the principal regulatory authorities in Ireland are the Department of Finance (which oversees overall policy and fiscal issues relating to the IFSC), the Department of Enterprise and Employment (which regulates the insurance industry) and the Central Bank of Ireland (which regulates all non-insurance related activities).

1.41 The Department of Finance carries the responsibility for the development of the legal framework for most regulation of the Financial Services Sector carried out by the Central Bank of Ireland.[32] This framework, in turn, is responsive to the monetary policy established by the European System of Central Banks (ESCB).[33] The Central Bank of Ireland is thus the implementing body for ESCB decisions in Ireland.

1.42 Within this framework, the Central Bank, along with the Department of Enterprise and Employment, adopt a 'positive approach' to regulation. These organisations emphasise that they are opportunity-focussed and maintain an 'open door' policy to investors, with issues being discussed directly with project promoters to realise the best outcome.[34]

32 *Report of the Implementation Advisory Group on a Single Regulation Authority for Financial Services*, Ireland's *Department of Finance* internet site: http://www.irlgov.ie/finance/sra2.HTM (accessed June 2000).

33 Irish monetary policy is, effectively, that of the ESCB and so of all the eleven countries in the euro zone. See *Report of the Implementation Advisory,* Ireland's *Department of Finance* internet site, Chapter 4, p. 7.

34 'A Responsive Regulatory Environment', 'Profile of the IFSC', *IFSC* internet site.

1.43 To further assist investors, it has been mooted that a Single Regulatory Authority (SRA) should be established as a 'one stop shop' for financial advice and services. On 20 October 1998 the Irish Government agreed in principle to the establishment of such body for the financial services sector and to the establishment of an Implementation Advisory Group to progress its establishment.[35]

1.44 On 23 June 1999, the Government published the Advisory Group's report, in order to 'facilitate public consideration of the issues'.[36] The report ruled out concerns about having a single regulator, and advocated that:

> The SRA should be responsible for the implementation of both prudential regulation and consumer protection in the provision of financial services, and should provide a 'one stop shop' for the regulated bodies and customers.[37]

1.45 To achieve the objective of the 'one stop shop', a need was identified to establish a single statutory financial services Ombudsman, independent to the SRA. It was also agreed that there should be adequate compliance mechanisms and that the SRA should be fully accountable to the Department of Finance, to the Oireactas (Parliament) and, in part, to the Ombudsman.[38]

1.46 In addition, the Advisory Group recommended that the SRA should be responsible for all consumer issues related to the entities it regulates. Accordingly, it was recommended that the powers of all bodies handling such matters should be transferred to the SRA. To oversee this function a Consumer Protection Director would be appointed. Two advisory panels, chaired by a high ranking SRA official and representing consumer and industry interests, would also be established to ensure that SRA followed its regulatory duties and was advised of issues of concern.[39]

1.47 The report also saw that the SRA should be established according to terms which facilitate the IFSC's e-commerce objectives, noting in particular that legislation should be responsive to EU developments and the recommendations of the International Organisation of Securities Commissions (IOSCO).[40] Funding of the

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35 *Report of the Implementation Advisory Group,* Ireland's *Department of Finance* internet site, p. 1.

36 Press release 23.6.99– 'Publication of the *Report of the Implementation Advisory Group on a Single Regulation Authority for Financial Services',* Ireland's *Department of Finance* internet site.

37 *Report of the Implementation Advisory Group*, Ireland's *Department of Finance* internet site, Chapter 6, p. 1.

38 ibid.

39 ibid, Chapter 4, pp. 7–8.

40 ibid, Chapter 5, p. 9.

body would be provided by industry, but the report cautioned that the industry should not be subject to excessive charges.[41]

1.48 In Chapter 9 of its report the Advisory group recommended that the SRA should be established as a statutory body as quickly as possible. However, at the time of writing, there was no evidence that the SRA initiative had been progressed beyond the fielding public responses.[42]

Supportive investment and industry stategies

1.49 Ireland's Government has worked to support the IFSC by responsive industry policy making and review. The focus has always been on maximising foreign investment for a fertile development of foreign and locally owned industry.

1.50 In 1992 a major review of Irish industrial policy was completed. The review initiated a dramatic refocussing of industry policy to address all areas which might stimulate industry and investment—not only taxation, but infrastructure, education, competition policy etc. Forfás, the policy and advisory board for industrial development and science and technology, was established to oversee the process, which involved a complete restructuring of state agencies in these areas. Forfás would be supported by two implementation agencies: the Industry Development Authority (IDA) and Enterprise Ireland.[43]

Industrial Development Authority (IDA)

1.51 IDA Ireland was established to attract new investment to Ireland in manufacturing and international services and also to encourage existing foreign-owned firms in Ireland to expand their businesses, targeting the high value added sectors—electronics, pharmaceuticals and healthcare, engineering and international financial services.[44]

1.52 With the Irish Trade Board, the IDA facilitated growth by marketing Ireland through a network of overseas offices and by organising a range of market development, information and promotional activities. Underlying this is was a core financial incentive program. During its 1996 visit to Ireland, Australia's Parliamentary Delegation, heard from the IDA that grants valued at around £85

41 'Publication of the *Report of the Implementation Advisory Group on a Single Regulation Authority for Financial Services',* Summary recommendations: Chapter 8; 23.6.99–'Ireland's *Department of Finance* internet site.

42 Last internet site update at March 2000.

43 'Science, Technology and Innovation: Police and Practice', speech delivered by Mr John Travers, Chief Executive of Forfás, to the panel on Science, Government and Innovation, p. 1.

44 'About the IDA', *IDA* internet site.

million to £90 million per annum were paid as incentives to companies. In return the Irish Government collected £500 million in corporate tax alone.[45]

1.53 A key objective of the IDA is to develop regional industry. The incentive scheme described above was deliberately weighted to achieve growth throughout Ireland, with a higher percentage of grants being available to companies willing to establish in regional areas. The IDA continues to be generously funded by Government. The *Department of Finance International Development Association (Amendment) Act 2000* guaranteed a contribution of £20 million, as a twelfth replenishment, to the IDA.[46]

Enterprise Ireland

1.54 The IDA's activities dovetail with, and complement those, of Enterprise Ireland which is the body principally charged with promotion of Irish-owned industry development (in tandem with an international investment component). It also operates a seed investment fund, the 'Millenium Entrepreneur Fund', which provides capital to individuals or teams, involving a key Irish National who is willing to relocate to Ireland. The Fund offers the services of an Enterprise Ireland Development Adviser, a company mentor and sets up contacts with a 'patron company' (a successful Irish-based company).[47]

1.55 Enterprise Ireland's primary task is to network for 'Irish manufacturing and internationally traded services companies…and overseas food and natural resources companies operating in Ireland'; the objective being to ensure that international businesses can locate appropriate and competitive sources of supply in Ireland. Enterprise Ireland describes its a core mission as being:

> to work in partnership with client companies to develop a sustainable competitive advantage, leading to a significant increase in profitable sales, exports and employment.[48]

1.56 This network and partnering strategy has supported the growth of 'industry clustering', which has developed Irish indigenous firms around global supply chains. The success of this approach was demonstrated in Galway in 1993 when Digital closed its computer manufacturing plant. The skills pool developed in support of this plant—including business networks and telecommunications infrastructure—was

45 *Australia and the European Union: A Parliamentary Perspective,* Report of the Australian Parliamentary Delegation to the European Institutions, UK (Northern Ireland) and the Republic of Ireland, 13 September to 8 October 1996, March 1997, pp. 68–69.

46 'Legislation'—Acts 2000, *Houses of Oireachtas* (Parliament of Ireland) internet site: hhttp://www.irlgov.ie/bills28/acts/2000/default.htm

47 'Enterprise Ireland: Service Details', *Enterprise Ireland* internet site: http://www.enterprise-ireland.com/about.asp

48 'Enterprise Ireland: About Enterprise Ireland', *Enterprise Ireland* internet site.

sufficient for Galway to rebound as a major source of software and services. In 1998, Ireland was the second-largest exporter of software after the United States.[49]

1.57 From 1 January 2000, new EU guidelines regulating levels of regional aid for investment and for job creation were introduced.[50] In response to this, Enterprise Ireland has made a commitment to supports for increase of the 'capability' of Irish industry to 65 per cent in 2003, with 50 per cent support to be allocated in the western Ireland region.[51]

Conclusion: IFSC—product and producer of growth

1.58 The IFSC, as supported by the initiatives described above, has become the flagship of the internationalisation of the Irish economy. It has provided the economic infrastructure for the awakening of the 'Celtic Tiger'—a physical home and lodestar for international investors and services providers. A deliberate and coordinated investment and industry strategy on the part of the Irish Government has produced the environment which the IFSC both contributes to and benefits from. As a result, Ireland, has secured a drop in unemployment from 15.5 per cent in 1993 to 5 per cent in 1999, coupled with the already cited consistent growth rates of 9 per cent over the past five years.[52]

1.59 The Irish Government has targeted e-commerce as the next crest of the wave for value adding in Irish industry.[53] To facilitate e-commerce development, the Irish telecommunications industry has been fully liberalised and legislation has been put in place to validate e-commerce transactions. The Government has also invested in high capacity international broad connectivity which will make Ireland one of the most competitive sites in the world. Ireland is already a home base for a number of leading e-commerce businesses, such as AmericaOnLine/Netscape, EMC, Dell, DoubleClick, Hewlwett Packard and Oracle.[54]

1.60 The Government's recent report on E-Commerce has described the integrated strategies that Enterprise Ireland and the IDA have developed to help indigenous SMEs get online. Financial assistance, in the form of equity investment and grants, are being offered and consultancy and advice services established. A network of

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49 Green, 'Lessons of the Irish Miracle', *Australian Financial Review* 2 December 1998.

50 'Promoting Enterprise Development', Minister for Enterprise, Trade and Employment, February 2000, p. 7.

51 'Promoting Enterprise Development', Minister for Enterprise, Trade and Employment, p. 1.

52 Statement by the Minister for Finance. Mr Charlie McCreevey, TD, in response to Private Members Motion on Social Partnership, Wednesday 15 December 1999, p.1, Ireland's *Department of Finance* internet site.

53 See 'Publications' at the *Department of Taoiseach* internet site.

54 Dorgan, 'Investment: Globalisation and the Benefits of Investment—the Irish Experience', p. 173.

regional e-commerce initiatives have also been put in place to speed up regional development.[55]

1.61 The realisation of Ireland's international and regional development objectives occurred with the launching, in March 2000, of the IFSC internet portal by Irish-owned company *Vantage* Software Limited. The portal will provide potential IFSC clients and partners with access to information about all 600 companies operating in the Centre at a single information point.

1.62 *Vantage* intends to market the portal with media advertising in Europe, the Far East and America. On line finance information will be provided on everything from insurance and pensions to personal loans and mortgages. The site will also be used to promote recruitment for the IFSC. With the advent of full EURO compliance in 2003, it is intended that the facility will be expanded to other European sites and range and power of the 'Celtic Tiger' be vastly extended.[56]

1.63 Ireland's forward planning has yielded rich rewards: while indigenous industry was undoubtedly hard hit in the beginning, Irish companies have drawn strength from foreign investment in Ireland and there have been valuable social and economic spin offs.

1.64 In late 2000, the move to internet provision of financial services to Europe seemed sure to consolidate the future of Dublin's International Financial Services Centre, and Ireland's relationship with the EU. However, by early 2001 there were signs that the high growth levels were causing the Irish economy to overheat.[57]

1.65 Accordingly, the European Commission cautioned the Irish Government about its 2001 budget plans, which included tax cuts and increased public spending. The budget was seen to be inconsistent with the EU's Broader Economic Policy Guidelines and risked putting Ireland's economy into recession. This in turn, it was feared, would endanger the external value of the Euro, fuelling doubts that a single monetary and exchange rate policy was unsustainable in regions as diverse as the Euro-zone.[58]

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55 *Report on E-Commerce, the Policy Requirements—Development Agency Strategies* (Parliamentary Research Service resource)

56 'News about the IFSC', *IFSC* internet site.

57 'Republic of Ireland: Ireland Economy-Commission Demands Budgetary Restraint', Country Briefing, the *Economist* Intelligence Unit, 29 January 2001, *Reuters Business Briefing*, 2 February 2001.

58 ibid.

APPENDIX 5

COMPETITIVENESS OF AUSTRALIA'S FINANCIAL SECTOR —INDIVIDUAL MARKETS

1.1 Over the past fifteen years, growth in turnover in major markets in the Australian financial sector has generally exceeded 20 per cent, or about three times the growth of nominal GDP.[1] A survey of developments within these markets during the 1998–1999 period (with some updates to 2000), and gauging their relativities to other world markets, follows.

Equities

1.2 In 1998, the Australian Stock Exchange (ASX) demutualised, becoming one of the first exchanges in the world to list on its own market. Australian stock market capitalisation at the end of February 2000 was A$658 billion, four times its size a decade ago.[2] Turnover in the equity market grew strongly in 1998–99, increasing by 17 per cent, to a level of A$286 billion.[3]

1.3 The Australian stock market is the twelfth largest market by capitalisation in the world but deals, however, with only 1.2 per cent of the world total—compared with 33 per cent for Europe and 50 per cent for US.[4] Market capitalisation of overseas companies listed on the ASX at the end of February 2000 was at A$181 billion. The domestic market now has about 1 300 listed investors, with listed companies including many well-known Australian based multinationals, including the National Australia Bank, News Corporation, Fosters Brewing, BHP, Telstra, and QANTAS.[5]

1.4 The ASX reports that the number of retail investors has also increased, although shares are still a relatively new form of investment for many retail clients.[6] In line with US prices in the June 2000 quarter, share prices softened, but since then the Australian market has improved on the US with prices achieving record highs in July 2000.[7]

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1 Battellino, 'Australian Financial Markets: Looking Back and Looking Ahead', *Reserve Bank of Australia Bulletin*, March 2000, p. 19.

2 Department of the Treasury, Submission No. 12, Attachment A, p. 22.

3 *1999 Australian Financial Markets Report, Overview*, Australian Financial Services Association, p. 5.

4 ASX evidence to the Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Draft Financial Services Reform Bill*, August 2000, p. 20.

5 Department of the Treasury Submission No. 12, Attachment A, p. 22.

6 *Report on the Draft Bill on Financial Services*, Joint Statutory Committee on Corporations and Securities, August 2000, p. 20.

7 'The Economy and Financial Markets', *Reserve Bank of Australia Bulletin*, August 2000, p. 31.

Futures markets

1.5 In 1998–1999 the futures market experienced stable growth, with a turnover increasing to A$10 183 billion.[8] Its turnover of 29 million contracts in 1998, makes the Sydney Futures Exchange (SFE) the largest financial futures and options exchange in the Asia–Pacific region. It is ranked twelfth in the *Futures Industry* top 40 global futures exchanges (by volume).[9]

1.6 The SFE has recently closed its trading floor and moved to full electronic trading (SYCOM) in concert with other major exchanges such as London's LIFFE and France's MATIF. The SFE is in the process of installing trading hubs (SYCOM linkups) in other key financial centres, such as London, Tokyo, Hong Kong and Chicago.[10] This move is expected to provide better access for international customers to the Australian market.[11] The SFE also offers direct access to the New York Mercantile Exchange and trade futures and contracts over a diverse range of commodities.[12]

Foreign exchange

1.7 Australia's foreign exchange market is ranked at ninth in the world by turnover, with the Australian dollar being the seventh most traded world currency.[13] The foreign exchange market increased by 11 per cent in 1998–99 to A$19 131 billion. The presence of overseas banks increased by seven per cent during the period, signifying the continued internationalisation of the Australian foreign exchange market. However the growth in the market was in the form of internal and end-user transactions.[14] The foreign exchange market is actually reported to be smaller than it was two years ago.[15]

Fixed interest

1.8 The Australian bonds market has increased in seize by over 14 per cent over the last five years, to around A$188 billion.[16]

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8 *1999 Australian Financial Markets Report, Overview*, Australian Financial Services Association, p. 5.

9 Department of the Treasury Submission No. 12, p. 4.

10 *1999 Australian Financial Markets Report, Overview*, Australian Financial Services Association, p. 10.

11 ibid, pp. 9, 10.

12 Department of the Treasury Submission No. 12, p. 4.

13 ibid, p. 23.

14 *1999 Australian Financial Markets Report, Overview*, Australian Financial Services Association, p. 5.

15 John Edwards, 'Currency Debate a Regional Issue', *Australian Financial Review*, 23–24 September 2000, p. 24.

16 The Department of the Treasury Submission No. 12, p. 23.

Government debt securities

1.9 Long term government bonds have continued to move in line with those in the US. Prices peaked in early in 2000 and to present levels. The peak in the ten year yield was 7.25 per cent, and the current level is 6.1 per cent. [17] Turnover in the market overall fell by four per cent during 1998–99 to A$1 054 billion. This was, however, considerably less than the 21 per cent drop in turnover which occurred during 1997–98.[18]

Non government debt securities

1.10 Australia has a growing corporate bond market, with domestic and offshore institutions participating. Issues of Australian dominated debt by overseas institutions are now often referred to as being in the 'Kangaroo bond market'.[19] In 1998–99 non-government debt securities recorded a rapid turnover in growth of 82 per cent, increasing to A$150 billion. The primary drivers of turnover growth were bank securities, which increased to 90 per cent to A$61 billion and corporate securities which doubled to a level of A$61 billion in 1998–99.[20] Nevertheless, the market for non-government bonds is still relatively small by international standards. For example, only about 10 per cent of housing loans are securitised in Australia, compared with 50 per cent in the US.[21] This is an area which has been targeted for development by the financial services industry.

Banking

1.11 Australia adopted the Basel capital framework for banks and benefited from deregulation in the 1980s.[22] As a result, the banking sector comprises significant numbers of foreign owned banks and their subsidiary branches in addition to the four major Australian-owned retail banks (which hold 64 per cent of total retail deposits), a number of regional banks and a large number of smaller institutions. Banks have also diversified services and now offer a range of insurance and lending products.

1.12 As at January 2000 there were 50 authorised banks in Australia, of which 36 were foreign-owned and 14 domestically-owned. As at 31 December 1999, there were also 108 merchant banks operating in Australia. These are primarily involved in wholesale and investment banking, and have half of their assets owned by foreign

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17 'The Economy and Financial Markets', *Reserve Bank of Australia Bulletin*, August 2000, pp. 25–26.

18 *1999 Australian Financial Markets Report, Overview*, Australian Financial Services Association, p. 5.

19 Submission no. 12, p. 23.

20 *1999 Australian Financial Markets Report, Overview*, Australian Financial Services Association, p. 5.

21 Mr R Battellino, Assistant Governor (Financial Markets), 'Australian Financial Markets: Looking Back and Looking Ahead', *Reserve Bank of Australia Bulletin*, March 2000, p. 19.

22 ibid, p. 17.

banks (as at June 1999).[23] In terms of profitability Australian banks are seen to be comparable with equivalent sized overseas banks in Canada, the US and UK.[24]

Managed funds

1.13 As noted above the value of Australian managed funds in December 1999 was A$646 billion, representing growth of 15 per cent over the previous twelve months.[25] The sector slowed to three per cent growth in the March 2000 quarter.[26]

1.14 Superannuation is the fasting growing sector with the largest concentration of funds, taking over from banks. At 31 March 2000, there were 2 551 corporate funds managing A$75 billion in assets; 77 industry funds managing A$34 billion; 42 public sector funds managing $106 billion, 188 retail funds managing A$129 billion; and 205 089 small funds managing A$64 billion in assets. Total superannuation assets were $454.7 billion as at March 2000.[27] Growth in Australian superannuation assets is the second fastest growing in the OECD, with the volume of funds managed exceeding that held by Hong Kong , which reported US$121 billion at the end of April 1999, and Singapore, which reported US$83 billion in June 1999.[28]

Life insurance

1.15 Australia has a very broad range of financial institutions offering life insurance products. As at June 2000 there were 43 life insurance companies operating in Australia, managing around A$190 billion in assets backing both Australian and overseas liabilities. Life insurance companies operating in Australia for year 1999-2000 received A$37 billion in premium income (that is, regular premiums at the end of the year plus the new single premium business).[29]

1.16 During the March 2000 quarter, superannuation premiums represented 87.3 per cent of total life office premiums.[30] Non-superannuation (known as ordinary) business of life insurance companies now accounts for only 15 per cent of premiums. Around 34 per cent of all superannuation assets are held in life insurance policies.[31]

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23 Submission No. 12, p. 24.

24 Battellino, 'Australian Financial Markets: Looking Back and Looking Ahead', *Reserve Bank of Australia Bulletin*, March 2000, p. 23.

25 Submission No. 12, p. 3.

26 'The Economy and Financial Markets', *Reserve Bank of Australia Bulletin*, August 2000, p. 30.

27 APRA, Superannuation Trends, March Quarter 2000, *APRA* internet site: http://www.apra.gov.au/iands/Marketstats/life_stats.htm

28 Submission No. 12, p. 25.

29 APRA Life Insurance Market Statistics, June 2000, *APRA* internet site.

30 APRA, Life Insurance Trends, March Quarter 2000, *APRA* internet site.

31 APRA Life Insurance Market Statistics, *APRA* internet site.

1.17 Foreign owned life insurance companies account for 28 per cent of assets managed by the industry and 29 per cent of premiums received. Bank owned life insurance companies account for 20 per cent of assets managed by the life insurance industry, and 28 per cent of all premiums.[32]

General insurance

1.18 General insurance is regarded as a mature highly diversified and competitive market. It covers all insurance and reinsurance other than life and health insurance. In February 2000, there were 159 general insurers in the private sector licensed under the *Insurance Act 1973*. Total private sector general insurers assets at 31 March 2000 were A$62.5 billion.[33]

32 APRA, General Insurance Trends, March Quarter 2000, *APRA* internet site.

33 ibid.

APPENDIX 6

AUSTRALIA'S REGULATORY FRAMEWORK —THE PRINCIPAL PLAYERS

Introduction

1.1 Following recommendations made in the Wallis inquiry, responsibility for Australia's financial regime moved to three principal regulatory bodies—the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission.

1.2 Meanwhile, the Department of the Treasury assumed policy responsibility for reform of financial services, and the Australian Taxation Office for the implementation of the New Tax System. The Reserve Bank of Australia shares responsibility with the former to maintain stability within the financial system, retaining its independent control of monetary policy. A brief description of the responsibilities held by these organisations follows.

Australian Prudential Regulation Authority (APRA)

1.3 The Australian Prudential Regulation Authority was established on 1 July 1998 by the *Australian Prudential Regulation Authority Act 1998* as part of the Federal Government's drive to strengthen Australia's regulatory regime and to make it more responsive to the trends described above. APRA assumed the role of sole prudential regulator responsible for supervision of banks and other deposit takers, such as building societies and credit unions, of life and general insurance, and of larger superannuation funds and retirement income accounts. APRA is funded by industry levies collected on behalf of the Commonwealth Government.[1]

1.4 APRA's principal responsibility, in overseeing Australia's deregulated market system, is to maintain the integrity and soundness of the operators within the market without unduly restricting competition and therefore market efficiency.[2] In establishing APRA, the Government sought to respond to the changing nature of Australia's financial institutions; in particular, the diversified conglomerates which now dominate world finance. APRA advised the Committee that:

> Supervisors in other countries with responsibilities which span the financial sector as ours do, have generally retained an organisational structure which mirrors the traditional industry divisions of banking, insurance and pension funds. APRA has formed the view that such a structure would not capture the synergies and efficiencies that are expected of a single prudential regulator. Accordingly, all policy development in APRA is the

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1 *Australian Prudential Regulation Authority, Annual Report, 1999*, p. 14.

2 Its annual report for 1999–2000, APRA notes that: 'The maintenance of financial solvency is at the heart of any system of prudential supervision', see p. 23.

> responsibility of a single division and for the purposes of frontline supervision the financial sector is divided into diversified institutions (conglomerates) and specialised institutions (those which operate mainly in only one of the traditional industry lines).[3]

1.5 APRA regards its regulatory function as an evolution of 'living instruments' which respond to identified, and changing, needs.[4] As part of this process, the year 2000 has seen the organisation subject to two significant structural changes with the transferring of the Australian Government Actuary Office from APRA to the Department of the Treasury on 1 April, and the transfer of regulatory responsibility for self-managed superannuation funds from APRA to the Australian Taxation Office from October 1999.

1.6 In policy development, a major objective continues to be the harmonisation of arrangements across different industry groups, over and above what was possible when these were under the supervision of the Reserve Bank of Australia and the Australian Financial Institution Commission, which APRA replaced. Key initiatives during the 1999–2000 period were in harmonising prudential standards for authorised deposit-taking institutions (with guidelines released on 11 September 2000); commencing a review of prudential supervision for general insurers (draft released on 13 September 2000); and in substantially completing a comprehensive prudential supervision framework for conglomerate groups.[5]

1.7 Another focus is on aligning established Australian standards with international best practice. APRA is active in a number of international fora such as the International Actuarial Association and the International Association of Insurance Supervisors, participating in the latter's revision of insurance core principals and the development of a methodology for assessment against core principles. In May 2000 APRA also took part in the second Conference of Integrated Financial services, a group it was involved in establishing in 1999.

1.8 In addition, APRA is an active member of the Basel Committee on Banking Supervision and has representatives on its Core Principles Working Group. This year APRA representatives participated in the Committee's review of the 1998 capital accord for banks.[6] Seeking to reduce the costs of effective prudential supervision, APRA also continues to engage with other international regulators—in Canada, the

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3 APRA Submission No 8, p. 2.

4 ibid, p. 5.

5 These initiatives involve amendments to the Financial Sector (Shareholdings) Act, the Banking Act and the (non-life) Insurance Act. See Submission No 8, APRA, pp. 4–8; and *APRA Annual Report 2000*, pp. 4–5, and for guidelines see 'APRA Releases Harmonised ADI Standards(00.31)' *APRA Media Release, No 00.31*, 11 September 2000**,** and 'Draft Prudential Standard on Risk Management for General Insurers' *Press Release No 00.32*, 13 September 2000 *APRA* internet site: http://www.apra.gov.au/mediareleases/00_32.htm

6 *APRA Annual Report 2000*, pp. 5, 3.

US and the UK—to work towards a framework by which the relative costs and benefits of prudential regulation can be more rigorously assessed.[7]

1.9 Responding to the rapid growth and significance of the electronic provision of financial services globally, APRA is also working to assess whether current supervisory polices adequately address the increased risk profiles generated by these transactions. A consultative document, which will focus on developing an appropriate balance between protecting consumers and supporting innovation in this new area, will be released later in the year.[8]

Australian Securities and Investments Commission (ASIC)

1.10 The Australian Securities and Investments Commission is an independent Commonwealth Government body established by the *Australian Securities and Investments Commission Act 1989*. It commenced operation in January 1991 as the Australian Securities Commission to administer Corporations Law. In 1998, it received new responsibilities for consumer protection and began operations under its current name.[9] ASIC also has powers under part 15 of the *Retirement Savings Accounts Act 1997* and under Part 29 of the *Superannuation Industry (Supervision) Act 1993*, and must report annually on the exercise of its powers under these Acts.[10]

1.11 ASIC's principal concern is market conduct, ensuring that market participants act with integrity and that financial service consumers are protected. In this context, it both regulates and enforces laws that promote honesty and fairness in financial markets, products and services in Australian companies, thus upholding the strength and international reputation of Australia's markets.

1.12 To support its disclosure objectives, ASIC maintains a public database on Australia's 1.2 million companies to provide certainty about their commercial dealings. It is one of the largest government internet sites and had recorded 200 000 visits each month by June 2000.[11]

1.13 ASIC works closely with other regulatory and supervisory bodies.[12] The Chair of ASIC is an ex-officio member of the Council of Financial regulators (which comprises ASIC, APRA, and the Reserve Bank of Australia). To advance its disclosure campaign, ASIC has also conducted an effective joint manoeuvre with the Australian Stock Exchange to reduce opportunities for insider trading.[13] It is also represented on a task force implementing the Australian Business Register, as part of

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7 *APRA Annual Report 2000*, pp. 5, 3.

8 ibid, p. 3.

9 *ASIC Annual Report 1999–2000,* p. [i].

10 As determined by Section 138 of the ASIC Act. See *ASIC Annual Report 1999–2000,* p. 58.

11 ibid, p. 46.

12 ibid, p. 13.

13 ibid, p. 30.

the Australian Taxation Office's implementation of the Australian Business Number initiative.[14]

1.14 In enacting its enforcement powers, ASIC collaborates with the Commonwealth Director of Public Prosecutions who decides on and prosecutes all its indictable criminal matters. The Commission brought successful action against 25 individuals and banned 16 corrupt investment advisers for life during the past year. It has targeted performance measures and aims, for example, to complete prosecution of all investigations within a 12 month period, up from 85 per cent in the past. In relation to this, ASIC has predicted that 'new economy' developments may expose weakness in financial reporting and corporate governance. To further strengthen its enforcement and regulatory role, the Commission plans to extend its disclosure regime to cover newly listed companies and those that raised back door listings.[15]

1.15 Like APRA, ASIC also works in partnership with other international regulatory bodies to build international financial architecture. It played an important role in Australia's Economic and Financial Management Initiative to build financial management skills and infrastructure in the region, following the Asia currency destabilisation.[16] With the Federal Reserve Bank of San Francisco, ASIC facilitated two APEC workshops in Malaysia for securities and banking regulators in the Asia Pacific region. The first workshop featured a case study of ASIC's training strategies in deposit taking, insurance, superannuation and consumer protection; the second featured an e-commerce case study.[17]

1.16 ASIC has principal responsibility for overseeing Corporations Law and expects to oversee considerable change initiated by the implementation of the Financial Services Reform Bill. The implementation of CLERP 7, which would change obligations, processes and fees payable for every Australian company, would mean that these businesses may no longer have to lodge an annual return through ASIC.[18]

Australian Competition and Consumer Commission (ACCC)

1.17 The Australian Competition and Consumer Commission was formed on 6 November 1995 by the merger of the Trade Practices Commission and the Prices Surveillance Authority. It administers the *Trade Practices Act 1974* and the *Prices Surveillance Act 1983*. It has additional responsibilities under other legislation,

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14 *ASIC, Annual Report 1999–2000,* p. 12.

15 ibid, p. 12, 35.

16 Announced by the Prime Minister at the APEC Leaders meeting in Kuala Lumpur in November 1998. The Hon Mark Viale MP, Minister for Trade, Submission No 35, p. [3].

17 *ASIC, Annual Report 1999–2000,* p. 52.

18 See the Hon. Joe Hockey, MP, Address to the Financial Planning Association Luncheon, 25 May 1999, Melbourne, p. 5. *Department of Treasury* internet site.

including the *Telecommunications Act 1997* and the Telecommunications (Transitional Provisions and Consequential Amendments) Act. [19]

1.18 The Commission's overall mission is to foster competitive and well-informed markets while providing consumer protection for all Australian consumers. It seeks to promote competitive pricing wherever possible and restrain prices in markets where competition is less effective. The Commission is the only national agency dealing with competition matters and the only agency with responsibility for enforcement of the Trade Practices Act and the associated State/Territory competition rules.

1.19 The ACCC falls within the Treasurer's portfolio. The Treasurer is the minister responsible for the restrictive trade practices provisions of the Trade Practices Act and pricing policy. The Minister for Financial Services and Regulation is responsible for the consumer protection provisions of the Act, including where those provisions apply to small business.

1.20 Despite recommendations made by the Financial System Inquiry, the ACCC lost broad jurisdiction over consumer protection in financial services after the new regulation arrangements were implemented. Amendments to the Trade Practices Act took jurisdiction for general insurance, health insurance and superannuation away from ACCC, giving them to ASIC. The Commission retained residual responsibilities for consumer protection in financial services: foreign exchange contracts, health insurance, GST in relation to financial services, e-commerce and unconscionable conduct in small business transactions. The Commission retained responsibilities for credit products and banking services but not for investment products.[20]

1.21 To ensure that the full range of responsibilities can be dealt with appropriately, the ACCC works, where possible, closely with ASIC. The Commission has also signed Memoranda of Understanding with ASIC to overcome ambiguities in the regulatory regime and a member of the ACCC acts as agent on behalf of ASIC on some matters.[21]

1.22 The ACCC is currently working on a range of consumer protection and competition issues relating to the interconnection of Internet networks. In 1997 the Government introduced major reforms to telecommunications regulation, including the introduction of Parts XIB and XIC of the Trade Practices Act. These reforms brought telecommunications regulation closer to general competition regulation. The ACCC sees that this will provide the Commission with the opportunity to enforce competitive safeguards within domestic telecommunications markets.[22] It has been

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19 Information in this section is drawn from 'Australian Competition and Consumer Commission, Overview of Consumer Protection Functions', October 2000, document tabled Committee Hearing 17 October 2000, passim.

20 Drawn from above and ACCC, Committee Hansard, pp. 856–57.

21 Committee Hansard, p. 857.

22 *ACCC Annual Report 1998–1999*, p. 8.

engaged to date in a range of enforcement, research and liaison activities with the object of strengthening the ACCC's capacity to detect, identify, locate and gather witnesses and evidence of Internet related breaches of the Act.

1.23 Extending its focus to the international arena, the ACCC, maintains an extensive network of formal and informal relations with agencies in Australia and overseas to help it realise its objectives on trade related issues. It is a member of the International Marketing Supervision Network, an informal network of consumer protection agencies, and has a strong involvement in its work and cooperative relationship with its members. This engagement strengthens the Commission's cross border enforcement activities.[23]

1.24 In 1999 the ACCC participated in the OECD joint Trade and Competition group conference which explored options for multilateral cooperation and coordination of competition enforcement. In 1998–99 it engaged with the OECD Committee on Consumer Policy over a range of issues relating to global and internet developments, including the refinement of OECD Draft Guidelines on Consumer Protection on E-Commerce. The ACCC also participates in APEC workshops on competition law and deregulation and provides technical assistance and training to countries in the Asia-Pacific region and also to Africa.[24]

Reserve Bank of Australia (RBA)

1.25 The Reserve Bank of Australia is established as Australia's central bank by the *Reserve Bank Act 1959.* The Bank's powers are vested in the Reserve Bank Board and the Payments System Board, both of which are chaired by the Governor. It has two broad responsibilities: monetary policy; and, the maintenance of financial stability, including stability of the payments system. In carrying out its responsibilities, the Bank is an active participant in financial markets and the payments system. It is also responsible for printing and issuing Australian currency notes.[25]

1.26 The RBA acts independently of Government in determining Australia's monetary policy, but the Reserve Bank Act does provide for consultation at various levels.[26] The joint Statement on the Conduct of Monetary Policy, agreed between the Treasurer and the Governor of the Reserve Bank of Australia in August 1996, is indicative of this relationship. The statement recognised the Bank's independence in the conduct of monetary policy (as provided by statute) but formalised the target of

23 This information and following is from the *ACCC Annual Report 1998–1999*, pp. 140–144.

24 See *ACCC Annual Report 1998–1999*, pp. 140–144.

25 Drawn from 'History' and 'About Us', *RBA* internet site: http://www.rba.gov.au/about/ab_over.html

26 'About the RBA', Monetary Policy, *RBA* internet site.

keeping inflation between 2 and 3 per cent on average, over the economic cycle to guard against recessions caused by hyper-inflation.[27]

1.27 Under the division of the responsibilities prescribed by the Financial Systems Inquiry, the RBA's mandate to safeguard the stability of the economy was reconfirmed and given a sharper focus. The new regulatory arrangements saw the establishment of the Payments System Board within the RBA, taking effect from July 1998, to promote the safety and efficiency of the payments system. The Board has undertaken a number of 'benchmarking' exercises to determine the efficiency of the domestic payments system and is also participating in the development of new international arrangements for the settlement of foreign exchange transactions.[28]

1.28 The RBA has a strong network of international contacts and participates in a wide range of fora. Since the onset of the Asia financial crisis in 1997, the RBA has enhanced its international profile, working on major global and regional initiatives to restructure the international financial system. The Governor of the RBA represents Australia on two recently formed and influential groups: the Financial Stability Forum, which was established by the G7 in 1999; and the new international group, the G20.[29]

1.29 The RBA also has an extensive regional network and participates in the Executive's Meeting of Asia-Pacific Central Banks (EMEAP), the Manila Framework Group (consisting of Ministries of Finance and Treasuries of twelve Asian countries plus the US, Canada and international institutions; APEC, and the Four Markets and Six Markets Groups of the major financial centres in the Asia-Pacific region. The RBA provides technical assistance to a number of countries, mainly in the Asia Pacific region.[30]

1.30 The RBA cooperates with the Department of the Treasury and the Department of Foreign Affairs and Trade in these initiatives, and also provides support to Axiss Australia in its efforts to promote Australia as a global financial services centre.[31] It works, for example, with Commonwealth e-commerce groups to foster e-commerce in Australia's financial system, and among Commonwealth Agencies.[32] In keeping with Wallis recommendations, it works closely with the Department of the Treasury, APRA and ASIC and is represented on the Council of Financial Regulators which facilitates cooperation between these bodies.[33] The RBA is also represented on the

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27 Department of the Treasury Submission No 12, p. 9.

28 Such as in initiatives aimed at reducing foreign exchange settlement risk (the Continuous Linked Settlement Bank), *Reserve Bank of Australia Annual Report 1999*, p. 36.

29 *Reserve Bank of Australia Annual Report 2000*, pp. 19–21.

30 ibid, pp. 22–24.

31 ibid, p. 25.

32 ibid, p. 41.

33 *International Banks and Securities Association of Australia Annual Report1999*, p. 8.

APRA Board, and APRA has a representative on the Payments System Board. The two bodies also have a common Coordination Committee established to provide a framework for information sharing.[34]

The Department of the Treasury

1.31 The Department of the Treasury is the generator and overseer of all regulatory policy to be affected under the new regulatory arrangements. The three new regulatory agencies are responsible for operational and administrative polices, and have substantial autonomy in that, but their boards of directors or commissioners are accountable to the Treasurer and the Parliament for their performance.[35]

1.32 Under the extended mandate awarded by the Australian financial system reforms, the Treasurer has wide ranging responsibility for: economic and fiscal policy; taxation; prices surveillance; competition policy; national and occupational superannuation; fiscal matters, debt management; banking; insurance; currency and legal tender; foreign exchange; foreign investment in Australia, census and statistics; business law and practice; corporate and securities law; corporate insolvency; and valuation services. Some of these areas of responsibility are delegated to the Assistant Treasurer.[36]

1.33 In 1998 the Hon. Joe Hockey MP was appointed as the Minister for Financial Services and Regulation, taking over responsibility for corporate and securities law, banking and prudential regulation, competition policy and consumer affairs. The main objective of the Minister's portfolio is to build and promote Australia as a centre for global financial services, with the establishment of the portfolio being a response to the changes in the financial service industry described in this report.[37]

1.34 To carry out his responsibilities, the Minister is advised by the relevant group functions within the Department of the Treasury—the Budget, Economic and Markets Groups. The Budget Group carries responsibility for tax reform. The Economics Group conducts domestic economic analysis and macroeconomic policy. Its International Finance Division manages Australia's contributions to important international fora, including the International Monetary Fund (IMF), the Asian Development Bank (ADB), the OECD, the G-22 and APEC.[38]

1.35 The Markets Group has principal responsibility for policy relating to the financial sector and to the establishment of the global financial centre initiative.

34 *Reserve Bank of Australia Annual Report 1999*, p. 28.

35 'Reform of the Australian Financial System', Statement by the Treasurer, the Hon Peter Costello, MP, House of Representatives, 2 September 1997, *Treasurer Press Release No 102*, p. 3.

36 See 'About the Portfolio', *Department of Treasury* internet site.

37 'About the Portfolio', *Minister Joe Hockey* internet site.

38 'About the Treasury—Economics Group', at *Department of the Treasury* internet site.

Responsibilities are divided between its Foreign Investment Policy Division, Structural Reform Division, and Consumer Affairs Division:

- the *Foreign Investment Policy Division* provides the secretariat for the Foreign Investment Review Board, which was established in 1976. The Division is responsible for all aspects of policy advice relating to foreign investment in Australia, including international commitments and agreements. It is usually the first point of contact for foreign investment applicants and prepares draft reports on proposals;
- the *Structural Reform Division* is responsible for policy advice on microeconomic reform and national competition policy as well as the competition provisions of the *Trade Practices Act 1974*. It works closely with the Productivity Commission, the Australian Competition and Consumer Commission (ACCC) and the National Competition Council;
- the *Financial Markets Division* provides policy advice on the integrity of financial markets and investor protection in the financial services industry. It is responsible for policy relating to Australian Securities and Investments Commission (ASIC) regulation of the financial markets. Jointly with the Corporate Governance and Accounting Policy Division, it is also undertaking the Corporate Law Economic Reform Program's reform of the regulatory framework for financial products, markets and service providers;
- the *Financial Institutions Division* provides policy advice and monitors developments relating to the financial sector, particularly prudential regulation and payments system issues, covering APRA and the Payments Systems Board of the Reserve Bank of Australia. The Division monitors and advises on developments concerning competition in, and the efficiency of, the financial system including new entrants and products, new technologies, mergers and takeovers, and the impact of these developments on particular sectors of the economy. The Division is also involved in efforts to promote Australia as a global financial centre; and
- the *Consumer Affairs Division* provides advice on consumer policy and consumer protection law. Key functions of the Division include promoting self-regulation through codes of conduct and industry dispute resolution mechanisms, administering the consumer protection provisions of the *Trade Practices Act 1974*, consumer education and representation initiatives, and policy advice on consumer aspects of electronic commerce. The Division provides secretariat services to the Ministerial Council on Consumer Affairs and the National Advisory Council on Consumer Affairs.[39]

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39 'About the Treasury—Markets Group', at *Department of the Treasury* internet site.

1.36 Axiss Australia is also located within Department of the Treasury's Markets Group. By functioning as 'a vehicle for high–level strategic dialogue between government and finance sectors' Axiss aims to ensure Australia's financial sector is at the cutting edge by building a collaborative relationship between regulators and the industry.

1.37 To assist its work, the Government has established a Regulatory Advisory Committee (RAC) which meets regularly to consider regulatory and promotional issues relating to Australia's role as a global centre for financial services. Its membership comprises Axiss Australia's CEO along with representatives from the Commonwealth Department of the Treasury, Reserve Bank of Australia, the APRA, the ASIC, the Australian Taxation Office and the Australian Bureau of Statistics.

1.38 The RAC reports directly to the Treasurer and the Minister for Financial Services and Regulation. Each of these agencies has as one of its key objectives, the promotion of the efficiency of the Australian financial services sector.[40]

The Australian Taxation Office (ATO)

1.39 The ATO is part of the Treasury portfolio and has principal responsibility for implementing the major taxation reforms initiated by the Ralph Review. The ATO took the opportunity to create 'a new tax office for a new tax system' in implementing the reforms. Throughout 1998–99 the ATO committed considerable resources to developing the framework and procedures needed to successfully introduce the new tax system. Initial work included helping to set the policy, drafting law and producing revenue estimates.[41] During the 1998–99 period, the ATO prepared legislation for 53 amendment bills which covered changes for the New Tax System and to superannuation, insurance and excise matters.[42]

1.40 To fulfil its mandate for revenue collection, the ATO is structured into divisions known as business and service lines, which fall within the Office's Income and Other Taxes Program. The business lines are responsible for a major market segment, such as individuals, small business and large business. As part of restructuring for tax reform a Goods and Services Tax business line was created within the Income and Other Taxes Program, and a Reform Program Office was established with Corporate Support. The latter is responsible for integrating and coordinating tax reform initiatives within the ATO and reports to the ATO's Office of Commissioners.[43]

1.41 The Goods and Services Tax business line is responsible for designing, developing, and implementing the new tax collection system goods and services. It

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40 'About Axiss Australia', *Minister Joe Hockey* internet site.

41 *Commissioner of Taxation Annual Report 1998–1999*, p. 8.

42 ibid, see Legislation, pp. 103–09.

43 ibid, p. 3.

has established infrastructure and support mechanisms, trained staff and is implementing a comprehensive community and business education program about the New Tax System.[44] The Large Business and International line within the program works to ensure the Australian tax system is responsive to the realities faced by large business and associated key individuals in domestic and global markets, and ensures that Australia gets its fair share of tax. It informs the ATO about: the tax implications of global business; interaction of Australia's tax system with those of other countries; international tax policy and practice; degree of alignment between the tax system and industry policy; how the tax system operates in each industry segment; flow-on effect of large and international business activity for the rest of the tax system; where the balance lies and those of the community; and understanding and influencing compliance.[45]

1.42 Superannuation laws are also shaped within this program. From October 1999, the line took responsibility for the supervision of self-managed funds after changes were initiated in the 1998 Budget.

1.43 The ATO maintains high profile engagement with international fora on a wide range of tax-related issues. It has participated in the Pacific Association of Tax Administrators, the Commonwealth Association of Tax Administrators and the Study Group on Asian Tax Administration and Research. Focus groups have worked on tax havens, benchmarking, compliance measurement, risk management and tax competition.[46]

1.44 A major area of the ATO's work with the OECD has been on the opportunities and challenges posed by e-commerce. The ATO hosted the OECD tax administration workshop in May 1999 to design a website for the dissemination of tax administration advice. It also made significant contributions to the OECD strategy paper 'Electronic Commerce: Taxation Framework Conditions' which was considered at the Ottawa OECD Ministerial Conference: 'A Borderless World: Realising the Potential of Global Electronic Commerce' in 1998.[47]

1.45 This focus is also reflected within the ATO itself which is at the cutting edge of technological innovation in furthering its compliance and information networking objectives. In relation to the first, a key initiative of 1998 was the Business Entry Point. A joint development by the ATO, with the Department of Employment, Workplace Relations and Small Business, and ASIC, it is designed to streamline communication between business and all levels of Government, and reduce

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44 *Commissioner of Taxation Annual Report 1998–1999*, p. 25.

45 ibid, p. 23.

46 ibid, p. 39.

47 ibid, p. 39.

compliance costs and paperwork by introducing a single registration point for tax file numbers, sales tax and the prescribed payments system.[48]

1.46 The ATO continues to oversee significant amendments to legislation evolving out of the Ralph Review. On 7 August 2000, the Treasurer announced that the Government had implemented a Ralph recommendation to establish a Board of Taxation to advise on the development and implementation of business tax legislation. The Board is a non-statutory body, which will advise the Government on the design and operation of Australia's tax laws, including on issues relating to the integrity and functioning of the tax system. The Membership of the Board was announced on the 10 August and consisted of representatives from the business and community sector. The Board's secretariat is provided by the Department of the Treasury.[49]

48 ibid, p. 42.

49 'Board of Taxation: Membership', the Treasurer, *Press Release No 083*, 10 August 2000, *Treasurer* Internet site.

APPENDIX 7

COMPANY MOVEMENTS TO AUSTRALIA AND COMPANY MOVEMENTS FROM AUSTRALIA

(Source: Axiss Australia, Attachment to Submission No. 22)

Company movements to Australia

Financial Services

- **Nicholas-Applegate** will open an Australian office in July 2000 as part of its Asia Pacific investment activities. The Office in Melbourne will be used to grow local operations and manage its Asian business. Nicholas-Applegate managed in excess of A$300 million for its clients and is planning to launch a global equities trust soon. (*Australian Financial Review*, 26/6/00, p.37)
- At least three US card specialists—**Capital One, MBNA and First USA**—plan to launch local operations in Australia in the next 12 months. The *AFR* reports that most Australian banks already have contingency plans to ensure their card operations stay viable in the face of discount competition from the US companies. (*Australian Financial Review,* 9/6/00, p.68)
- **Moody's Investor Service** has moved part of its global mining and metals, oil and gas portfolio to Sydney. The new "outpost" will be headed by former Westpac analyst, Terry Fanous, who will cover 20-30 companies, including some Asian names and report to the New York office. (*Australian Financial Review,* 29/5/00, p. 54)
- The AFR reports that executives from **PFPC**, a subsidiary of Pittsburgh-based PNC Bank (largest administrator of mutual funds transfers in the US, and the second largest provider of accounting services to fund managers) will be arriving in Sydney to begin a scoping study of the Australian market. PFPC is considering using Australia as a base for the Asian market, and is seeking meetings with government officials. (*Australian Financial Review,* 10/5/00, p.41)
- **UBS** moved its Australian credit derivatives trading book from Singapore to Sydney. (*Australian Financial Review*, 8/5/00, p.46)
- **Royal Bank of Canada** moved its financial exchange headquarters from Singapore to Sydney. RBC's Sydney branch will lead trading in the euro, yen and other G7 currencies. The bank will relocate about 15 people to Sydney over the next few months. (Dow Jones Newswires 21/1/00, Asian Wall Street Journal, 24/1/00)

- **Charles Schwab** will open a new company in Australia. Due to open in early-2000, Charles Schwab Australia will offer the Australian marketplace full broking service, as well as on-line trading in both US and domestic securities. (*Australian Financial Review*, 21/12/99, p.21)

- **St. Paul Companies**, one of America's largest property-casualty insurers, has selected Australia as the regional platform for its Asia-Pacific business. The group chose Australia, as it only enters markets where the regulatory structure is transparent, and there is a total premium base of A$6 million, a strong broker distribution network, and no barriers to foreign capital investments. In December 1999, St. Paul Insurance Australia received approval to sell liability insurance. The group will use its platform in Australia to offer liability insurance products for the technology, finance, marine, surety and marine sectors throughout the Asia-Pacific region. *(Australian Financial Review,* 8/12/99, p.37)

- Australia will be the first country outside of the US, where Merrill Lynch will expand its new online stockbroking service. **Merrill Lynch** plans to launch similar online trading businesses in the UK and Japan by the end of 2000. The firm said that they chose Australia, because its regulatory environment is conducive to good business. *(Financial Times,* 1/12/99, p. 19) In September 1999, Merrill Lynch announced the move by 11 of its biggest international funds into Australia. This was in response to the Australian Government's tax reform legislation. *(Australian Associated Press,* 21/09/99, via Reuters Business Briefing)

- On 25 November 1999, **Goldman Sachs** announced that it plans to double its Australian investment banking and equities business in the next year. The Australian market is a primary target for the firm's activities in the region. *(Australian Business Review,* 25/11/99, p.28).

- In August 1999, **Goldman Sachs** established a full services equities business in Australia. *(Australian Banking and Finance,* 16/08/99, via Reuters Business Briefing)

- **SSB Citigroup Asset Management**, part of Citigroup, will base its global research group in Melbourne. SSB Citigroup is confident that Australia will emerge as a fund management hub, saying that "the Australian market will be one of the top five or six markets globally in terms of total available assets under management." *(Australian Financial Review,* 24/11/99, p.47)

- **Morgan Capital,** one of the world's biggest private equity businesses, moved its Asia–Pacific headquarters from New York to Melbourne in November 1999. Morgan Capital will invest up to $US 150 million a year in emerging operations in the Asia-Pacific region. *(Australian Financial Review,* 22/11/99, p.8)

- **Western Union Financial Services** located its regional headquarters in Sydney in mid November 1999, basing its 24-hour Asia–Pacific Regional Operations Centre there. Mr Ed Fuhrman the President of Western Union Financial Services said that Australian-based business grew by 60 per cent in 1998, and that he expects the growth rate to continue to increase. *(Australian Financial Review,* 19/11/99, p.64)

- In the week of 15 November 1999, **Alliance Capital Management**, the largest publicly traded investment manager in the United States, launched 17 mutual funds onto the Australia retail market. The company has been operating in Australia since 1991 and has A$4 billion under management here. *(Australian Financial Review,* 17/11/99, p.48)

- In October 1999, **HSBC** announced that Melbourne would be the regional headquarters for its $102 billion asset management arm. *(Australian Financial Review,* 20/10/99, p. 49)

- In October 1999, **MasterCard International** announced that it would relocate its regional headquarters of credit and risk management to Sydney from Singapore. *(Australian Financial Review,* 07/10/99, p. 40)

- In October 1999, Deutsche Bank announced the relocation of its Deutsche Asset Management regional headquarters from Tokyo to Sydney, with the Sydney office responsible for the bank's asset management businesses in Australia, South East Asia and Japan. *(Australian Financial Review, 20/10/99,* p. 49)

- In October 1999, **Rabobank** announced that it will launch into commodity risk management and will further expand into transactional banking in 2000 in an effort to maintain the growth it has achieved since moving into the Australian marketplace in 1994. *(Australian Financial Review,* 12/10/99, p. 27)

- In August 1999, the **Asia Pacific Loan Market Association** (APLMA), an association of 105 international financial institutions announced it would establish their regional financial operations in Sydney. *(Economist Intelligence Unit,* 18/08/99, via Reuters Business Briefing)

- In August 1999 **the Royal Bank of Scotland** announced that it would establish a project financing team in Sydney. *(Business Review Weekly,* 06/08/99, p.61, via Dow Jones Interactive)

- In mid-1999, it was announced that **Morgan Stanley Dean Witter** would expand their operations in Australia. *(Herald Sun,* 16/07/99, p.34; via Dow Jones Interactive)

- In December 1998, it was reported that **Deutsche Bank** had decided to relocate its Euro short-term money market from Singapore to Sydney. *(Australian Business Intelligence, Australian Financial Review,* 15/12/98, p.42, via Reuters Business Briefing)

- In October 1998, **Citibank** chose Sydney as the site for its Asia Pacific regional processing centre. *(Australian Financial Review,* 08/10/98, p.61, via Reuters Business Briefing)

- In 1998, **Chase Manhattan Corporation,** transferred its Asian custody functions to Sydney from Hong Kong. Sydney will become Chase Manhattan's third largest custody operation centre after New York and London. *(Dow Jones International News,* 09/02/98. See Dow Jones Interactive). Chase had centralized its bullion operations in Australia in 1994.

- In early 1998, **Banque Transatlantique** part of the CIC Group, opened a representative office in Australia, The company targets high net worth individuals, and provides a range of personal and family asset management services. *(European Business Review,* 01/04/98, p. 73 via Dow Jones Interactive)
- **Vanguard Investments,** the second-largest fund manager in the world, launched into the Australian superannuation and master funds market with the release of three indexes. *(Australian Financial Review,* 18/12/96, p.30, via Reuters Business Briefing)
- In 1995, **State Street Bank** located its regional operations in Sydney with this office becoming State Street's largest outside Boston. *(Business Review Weekly,* 19/06/95, p.30, via Dow Jones Interactive).

Related Financial Services

- The **World Bank** will relocate its office covering operations in East Timor, Papua New Guinea and the Pacific islands from Washington to Sydney. (Reuters)

Company movements from Australia

- **GE Capital** moves part of its call centre function to India. (Sun-Herald, 21/11/99, p.3)
- **CBA** will pass control of it's a$1.8 billion global funds management business to Legal & General. (*The Australian,* 8/12/99, p. 26)
- **Rothschild Australia Asset Management (RAAM)** will outsource it's a$800 million international equities portfolio to US based pension manager Putnam Investments in Boston. *(Investor Weekly,* 17-23/1/00, p. 23).
- **Invesco Asset Management** has shifted responsibility for the management of its AUD 80 million in Australian investments from Sydney to Hong Kong. (*Australian Financial Review*, 29/2/00, p.39)
- **HSBC Australia** has downsized its "full-service" brokerage business and has axed 33 jobs, most of them in research. *(Australian Financial Review, 3/5/00,* p.50 Street Talk)
- US Investment company, **Massachusetts Financial Services** will depart Australia at the end of May 2000. The firm-had two employees. (*Australian Financial Review*, 3/5/00, p. 46)
- **HSBC Institutional Stockbroking** closed down its Australian institutional stockbroking operations. *Via Reuters Business Briefs 7/6/00.*