



Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (b)

Submission No. 15

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“The opportunities and constraints for Australia to become a centre for the provision of global financial services”

Vanguard in Australia

The Vanguard Group, Inc, is the second largest mutual fund complex in the United States managing over A\$900 billion in assets for over 14 million investors.

In 1996 Vanguard opened the Australian arm of the group in Melbourne, Vanguard Investments Australia Ltd, as a first step in its process of going global. Vanguard hopes that Vanguard Investments Australia Ltd can be its regional headquarters for the South East Asian region.

Vanguard Investments Australia Ltd now manages over A\$9 billion in assets for over 2000 institutional and retail clients in Australia and Asia. The company has over 50 employees and employs the services of numerous Australian organisations.

Vanguard Investments Australia Ltd in partnership with MLC Financial Services has also established Plum Financial Services which provides top quality member investment choice superannuation solutions to Australian employers. Plum currently employs 55 people.

Australia as a Global Financial Services Centre

Vanguard is very supportive of the development of Australia as a global financial services centre. Australia has many advantages and attractions for overseas based fund managers including its large and growing funds management market, sophisticated capital markets and its well-educated labour market.

However, there are a variety of regulatory impediments which retard Australia's development as a global financial services centre. I often characterise these as making funds management in Australia the “no-import, no-export” industry. Naturally, if it is difficult or impossible to import or export funds management services, Australia is unlikely to gain its maximum potential as a global centre.

I would like to break my comments into three segments. The first addresses areas for improvement in the domestic funds management industry; the second issues relating to importing funds; the third relates to issues involved with exporting services.

Each of the areas discussed provides an opportunity for the Australian Government to make a meaningful difference to the attractiveness of Australia as a global financial services centre.

Fortunately, 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.

Issues relating to the Establishment of Funds Management Operations

Introduction

The establishment of a funds management business in Australia is by no means simple. The industry is highly regulated and undergoing constant regulatory and taxation changes. Whilst Vanguard does not object to the highly regulated nature of the industry as such, the pace and uncertainty of regulatory change and in particular taxation changes are often a concern.

In particular, recent taxation changes have the ability to threaten the competitiveness of the funds management industry in Australia. Some key issues are discussed below.

Collective Investment Vehicles

- One of the basic premises of a managed fund is that it should put the investor in a similar tax position to that if the investor had invested directly in the underlying assets of the fund.
- “Flow through” treatment of taxable income and capital gains is paramount to this premise.
- Flow through tax treatment in Australia will only be available where a fund is a “Collective Investment Vehicle” (CIV) under Government proposals.
- The proposed definition of a CIV is too restrictive and will hinder new starters in the funds management business.
- For example, 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 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).

Capital Gains Tax Regime

- One of the basic premises of a managed fund is that it should put the investor in a similar tax position to that if the investor had invested directly in the underlying assets of the fund.
- The new CGT regime provides for a discount on CGT for long term gains.
- These discounts will not be available to managed fund investors in certain circumstances particularly where the size of the fund is growing quickly – a problem for start ups.
- Where a fund has less than 300 members and greater than half of fund assets are less than 12 months old the discount will not be available to a redeeming investor in the fund.
- Until 1 July 2001, and potentially beyond, investors in managed funds may also not get the full discount on long term capital gains due to a Government imposed reduced cost base rule for such investors.

Issues relating to the Export of Funds Management Services

Introduction

There are difficulties associated with exporting Australian based managed funds. Vanguard Investments Australia Ltd has lost a number of client opportunities in countries such as New Zealand, Singapore and Hong Kong.

In these cases potential clients have been referred to our US and Europe based fund offerings which have a greater degree of flexibility, international recognition and taxation advantages over our Australian funds. Some key issues are discussed below.

Withholding Tax

- Non-resident investors in Australian managed funds are subject to withholding tax (WHT) on distributions of income and capital gains.
- The level of WHT varies depending on the nature of income or gains but can be up to the top marginal tax rate.
- The imposition of WHT deters most foreign investors whose own tax rates are often less than the WHT rate or because of double taxation issues.

Foreign Ownership Rules

- In a number of circumstances where a non-resident investor owns more than 10% of the units in an Australian managed fund, CGT is payable by the investor in Australia.
- Ownership of 10% of the value of a managed fund is easily attained in the start up phase of a Australian funds management business aimed at Australian and, for instance, Asian investors.
- The possible imposition of tax in these circumstances deters most large foreign investors from investing in an Australian domiciled managed fund.
- Individual non-resident ownership in excess of 15% and collective in excess of 40% will also create difficulties for an Australian managed fund under foreign investment rules administered by the FIRB.

Foreign Recognition of Australian Managed Funds

- Managed funds in Australia are subject to extremely comprehensive, world class regulatory requirements aimed at investor protection.
- Despite this Australian managed funds are not “recognised” in a number of foreign jurisdictions making the offer of these funds difficult in countries other than Australia.

Offshore Banking Unit Rules

- Special rules are applied for declared offshore banking units.
- These rules in certain circumstances can overcome some of the issues discussed above in relation to WHT and foreign ownership.
- However, the qualification requirements for an OBU often make it inefficient for an Australian fund manager to establish such a unit because of costs associated with establishing the unit and the necessary duplication of operations required. It would be

