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Joint Standing Committee on Treaties: China Australia FTA

Opening statement

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Introduction

I thank the Joint Standing Committee on Treaties for the opportunity to appear at the public hearings into the China Australia Free Trade Agreement.

For this purpose, the FSC represents Australia's funds management sector.

The financial services industry makes a significant contribution to the Australian economy. It pays more corporate tax than any other sector, employs more than 400,000 people and contributes $130 billion to the economy each year. Australia has the third largest pool of managed funds in the world and the largest in Asia, at $2.5 trillion. This is larger than Australia's GDP and the capitalisation of the Australian stock exchange.

Our comparative advantage in funds management is an industry that has the potential to become a major exporter of services in the Asian century.

Despite our success in amassing a major funds management sector, less than 5 per cent of total funds are sourced offshore and therefore counted as an export. One of these reasons is we lack export architecture to countries such as China. Accordingly, this agreement is an outstanding free trade deal for Australia. It will create jobs and growth.

Let me be very clear, the agreement will create jobs in Australia as it builds new architecture for Australian financial services exporters.

Why China?

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

China is also a nation with a household savings pool of about $US8 trillion and growing.
The predictions are for one billion people to move into the Chinese middle class by 2030 (which will be 70% of the Chinese population).

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

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

China is starting from a relatively low base of capability - only 3% of the 145 trillion Renminbi (RMB) Chinese finance sector are assets are held in managed funds. It is early days for funds management in China – there 90 asset management companies - but one third are unprofitable.

This compares with Australia's 483 licensed fund managers.

What does the deal provide?

This deal provides preferential access to China's markets which has been made available to a very limited number of countries.

China has three schemes for trading and investment. All three have quotas as China is carefully managing the internationalisation of its currency and economy. Australia will now have access to all three.

The Qualified Domestic Institutional Investor (QDII) allows Chinese investors to trade offshore - with foreign fund managers from Australia, amongst others.
The ChAFTA allows Australian fund managers market access to China to sell to QDII investors. There are currently 132 approved QDII firms in China, which Australian fund managers will now be able to access.

The Renminbi Qualified Foreign Institutional Investor (RQFII) and Qualified Foreign Institutional Investor (QFII) schemes enable foreign investment into China.

Currently, only 12 countries have RQFII quotas, including Australia.

RQFII guarantees access for Australian fund managers to Chinese share and bond markets.
Under this agreement we have been granted an RQFII quota of $50bn RMB. Vanguard based in Melbourne plans to use part of it.

The free trade agreement goes beyond these schemes and broadens access to markets in China for Australian fund managers.

Some of this additional access is so far only available to Australia such as the ability for Australian firms to hold up to 49% foreign equity (which is above its WTO commitment of 33%) in joint ventures.

There is also a guarantee for brokerage and advisory firms to provide cross-border portfolio management, custody, trading and advice to QDII investors.

While ChAFTA has not removed all technical barriers to trade for Australian financial services providers, the coveted 'much favoured nation' clause provides scope to ensure future benefits conferred to other countries will automatically flow to Australia.

Next steps

ChAFTA represents a starting position from which to build on.

To capitalise on the benefits and opportunities, two things must occur – the ChAFTA must be implemented and Australian domestic regulation must be reformed.

A) ChAFTA implementation
It is imperative that the commitment to establish a financial services committee begins swiftly to maintain momentum. It is also imperative that ASIC is included in this committee so any licensing and regulatory issues can be resolved. The end goal must be full mutual recognition for fund managers between the Australian and Chinese regulators.

B) Domestic policy
We have a lot going for us apart from our time zone. Australia is the 6th largest offshore Renminbi (RMB) centre. Our regulators and central banks have strong relationships – an RMB clearing bank will be in Sydney. China is our number one trading partner.

And we have a disproportionately large asset management industry - 3rd biggest in the world.
But our lack of competitiveness in funds management regulation is holding us back.
For example, Australian companies with subsidiaries in Singapore are more likely to use Chinese investment quota in Singapore than Sydney - because they are better than us at regulatory competitiveness.

It doesn't have to be this way.

Mark Johnson provided us a reform blueprint in his 2009 review of Australia as a financial centre. Many of his recommendations have not been implemented.

To his credit, Chris Bowen commissioned the Johnson Report to secure Australia as a financial centre in the region. This was a major step forward but we need to implement Johnson's many unfinished recommendations to boost our competitiveness.

Some progress has been made and the Government should be applauded for the tax certainty we now have through the newly minted Investment Manager Regime - legislated 4 weeks ago by Josh Frydenberg. (Royal Assent 25 June)

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

1. New collective investment vehicle structures - as Australian unit trusts can be very unfamiliar to overseas investors, we need more options to offer them
2. Competitive tax rates - our withholding tax rates for foreign investors are a dog's breakfast and our company tax rates are too high
3. Multi currency classes fund capability - we need this functionality to issue China funds in different currencies – foreign investors do not pine for $AUD

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

4. Conclusion
This agreement is an outstanding achievement for Australia. It will create jobs and growth by allowing our industries to access the world's largest market.
It provides Australian fund managers with a significant advantage which is not enjoyed by large competitors such as the United States or Japan.

ChAFTA builds the architecture we need to compete in the Asian century.
It gives us a first mover advantage. Delaying the measures in the FTA would damage our future growth prospects and we recommend its swift implementation.

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