FINANCIAL SERVICES COUNCIL

Opening Speech to FSC Annual Conference

Cairns Convention Centre

6 August 2014

Greg Cooper, FSC Chairman

Good afternoon Ladies and Gentlemen, on behalf of the Board of the Financial Services Council, welcome to the 2014 FSC Conference.

Let me start by saying thank you to our platinum partner KPMG for their ongoing support of the FSC Conference over many years and to our other sponsors and media partners.

At the outset of this conference it is fair to say that our industry is in the midst of a period of substantial change. The domestic regulatory framework has seen considerable change and the ongoing inquiries into taxation and broader financial system are likely to mean that this change is not yet over. However, while elements of our industry may be a matter of some introspection, we should not lose sight of the fact that Australia has a world class superannuation and savings system, with a world class regulatory framework that is the envy of most countries around the world. It is with this is mind that we should move forward in continuing to evolve the industry.

It is also with this world class structure in mind that we see the prospects for considerable growth in our industry, domestically, but also critically as a key export for the future. There will be plenty of focus during this conference on domestic issues, however It is on this latter point that I would like to concentrate my remarks today.

But firstly, I am pleased to announce that the FSC has accepted a number of new members over the past 12 months:

- Henderson Global Investors Australia Limited;
- Hollard Financial Services;
- Australasian Wealth Investments;
- Hamilton Blackstone Lawyers;

- Turks Legal;
- Lonsec Research; and
- A.T. Kearney.

I would like to thank and acknowledge the Directors of the FSC who have left the Board this year:

- Craig Mellor;
- Marc Lieberman; and
- Peter Crewe.

And welcome the new, or should I say, re-welcome a new member of the FSC Board:

- Pauline Blight Johnson.

John Brogden and FSC journey

I would also like to take this moment to acknowledge the work of John Brogden. Delegates, as you know, FSC CEO John Brogden, will be leaving the FSC at the end of the year to take up the position of CEO of the Australian Institute of Company Directors.

John began at the FSC almost five years ago.

Over this time the profile of the industry has risen significantly in the minds of the public and politicians.

I think it can be said that John and the FSC has had something to do with this – and it is a good thing.

The more Australians realise how significant their superannuation and life insurance is and how important the industry is to the economy, the more they engage with their financial future.

The past five years have seen many reviews that have affected the industry directly and in which John has led our advocacy and response. It is worth recalling these reviews and reforms:

- The Cooper Review of superannuation;
- The Johnson Review of Australia as a financial centre;
- The Future of Financial Advice reforms;
- MySuper;
- Superstream;
- The Henry Review of Tax; and now
- The Financial System Inquiry.

The amount of political and public scrutiny the industry has faced during John's tenure has been unprecedented and we have been fortunate to have John leading the industry.

John, and the team he built at the FSC, have led the industry positions on these significant policy issues.

During this time the FSC has also changed from being an organisation focused solely on the regulatory issues affecting the industry on a day to day basis to one that recognises the place the industry plays in the lives of all Australians and in the economy.

In the process the FSC has been lifted to an industry association that talks not just about what benefits our industry, but one that talks about issues that improve the economic environment in which we invest.

And the results are clear.

Our industry is now seen as one that is central to the Australian economy, one that is a driver or economic growth in its own right and one that influences the broader economy.

I aLso want to acknowledge John becoming a Member of the Order of Australia earlier this year for his work in social welfare, particularly Lifeline and his contribution to business life and the NSW parliament. We are grateful for Johns tireless service to our industry and the wider community.

Ladies and Gentlemen please join with me in thanking John Brogden for his past five years of work.

Trade Agenda

Ladies and Gentlemen for the past five years, the industry has rightly focused on domestic issues.

FoFA, MySuper and superstream have consumed a lot of time and resources for the industry and the FSC.

With these issues behind us it is time to move on – put an end to looking internally at regulation and reform and look outwards to new markets.

Over the past decade while we have been discussing Australia becoming a financial service centre in the region, we have become one:

- In the past two years we have moved from having the forth largest pool of funds in the word to the third largest;
- The Australian dollar is in the top ten traded currencies in the world;
- The Australian dollar and renminbi can now be directly converted and Sydney is expected to be a renminbi trading hub;
- Our banks are some of the largest in the world;

- The ASX $47 trillion interest rate derivatives market is the largest in Asia and among the biggest in the world; and

- We are one of the few countries that provide end-to-end financial services.

Australia is already a financial service centre and can build on its strengths to have a significant role in the Asia region.

And we need to do this through engaging in Australia's trade policy agenda.

The FSC has led the development of the Asia Region Funds Passport.

We will also now lead the internationalisation of Australia's financial services industry through a coordinated approach to financial services trade.

The FSC supports the reduction of barriers to trade for four reasons.

First as the investors of the $1.8 trillion in retirement savings for all Australians, and the largest sector of the Australian economy, the financial services industry advocates for policies which affect the economy in which we invest. Lower barriers to trade allows Australia to focus on the sectors in which we have a comparative advantage, trade with other nations and increase economic growth.

Second, Australia has the third largest pool of funds in the world at $2.3 trillion, and as a result has a funds management industry which is large, highly developed and highly skilled. This is a significant comparative advantage for Australia. At the same time, Australia is geographically close to rapidly growing demand for professional investment management in Asia.

Third, lower barriers to trade allows Australian consumers of financial services access to a greater range of products.

While Australia's market for financial services is already one of the most open and well regulated in the world, free trade agreements provide the opportunity to broaden the range of products available to Australian consumers.

And as an industry we embrace competition.

Finally, free trade agreements, in particular bi-lateral FTAs, raise Australia's profile in the partner country.

While lower technical barriers to trade are important, the signaling effect of a bilateral FTA is important as it raises Australia's profile in the partner country and provides further impetus for Australian firms to export.

Murray and Internationalisation

The significance of this opportunity and the role it will play in the future of financial services has been recognised in the interim report of the Financial Systems Inquiry.

The Murray Review differs from previous reviews of the financial system – the Wallis Inquiry of the 1990s and Campbell Inquiry of the 1980s - in an important fundamental way.

The Murray Review is the first inquiry into Australia's financial system to consider financial services not just as an industry just to be regulated, or as a facilitator of growth in other sectors, but also as an industry that generates economic and employment growth in its own right.

Consumers, both domestic and overseas, demand financial services in the same way that they demand other goods and services.

Selling financial services to individuals or companies outside Australia is as much an export as selling iron ore or coal.

And the fees these services generate become wages for those employed, profits for shareholders and tax revenue for governments.

This demand grows with the wealth of a country and the average age of its population as the need for financial products to manage savings and retirement incomes grows.

The Murray Review's recognition of this is a significant shift in the mind set of the government and the industry.

It is a change that has come at the right time.

As the mining investment boom slows and as manufacturing evolves, Australia must find new sources of export growth if we are to sustain economic and employment growth.

The change in understanding and expectation of the financial services industry is acknowledged in the Murray Review's interim report which requests greater information and views on the options and alternatives to:

"Improve domestic regulatory process to better consider international standards and foreign regulation . . . mutual recognition and equivalence assessment processes."

The Financial Services Council has led efforts to change policy settings to increase financial services exports.

We have done this because the market on our doorstep is so large.

The potential market for Australian financial services in Asia is well known but is worth repeating

- Asia's middle class is growing quickly – this will drive demand for funds management as investors look for opportunities to invest and grow wealth;

- Asia's population is ageing quickly – hence a need for pension and retirement savings products; and

- many countries in the region do not yet have compulsory superannuation contribution systems for workers– again driving a need for individual savings plans.

The Asia region is currently punching below its weight in terms of share of global funds management activity; there is significant potential for Asia to increase its share.

Funds under management (FUM) in the region is currently USD 3.410 trillion – this is only 12 per cent of world wide FUM, despite Asia's population sitting at 4.165 billion or 60 per cent of world's population.

By comparison, the US manages 57 per cent of worldwide FUM but only accounts for 14 per cent of the world's population.

Thirty per cent of the world's FUM is managed out of Europe yet it accounts for only 11 per cent of world population.

With the centre of economic growth shifting to Asia our region will grow its share of global funds under management rapidly.

Deloitte exports research

While this data on the size of the potential market for funds management exports – that is the opportunity - are well known, the potential benefits for the Australian economy are not.

Today we are releasing research conducted for the FSC by Deloitte which quantifies the benefits to the Australian economy – in terms of growth, employment and tax revenue - of expanding Australia's funds management exports to levels consistent with the industry's comparative advantage.

Australia has a relatively low proportion of foreign sourced funds under management compared to other leading financial centres.

Only around 3.5 per cent of funds under management in Australia are sourced from offshore.

This compares to 80 per cent in Singapore and 65 per cent in Hong Kong.

Deloitte modelled the potential benefits for the Australian economy of growing Australian funds management exports to the levels experienced Hong Kong.

Increasing Australia's funds management exports over the next decade to levels equivalent to Hong Kong would increase the level of GDP by $4.2 billion by 2029-30 and almost 10,000 additional jobs would be created.

Federal and state tax revenue would also rise as a result.

Funds managers pay corporate tax on the profits they make and payroll tax to the states for their employees; employees pay income tax to the Federal Government and GST on their expenditure to state and territory governments.

Growth in Australia's funds management exports to the levels experienced in Hong Kong would lead to Commonwealth tax receipts steadily rising to be $1.2 billion above the baseline in 2029-30.

State payroll taxes would also increase by $61 million above the baseline in 2029-30.

It is important to restate that these benefits to the economy and government budgets do not arise from multipliers derived from the kind of subsidies other industries have received.

The FSC agrees with the financial systems inquiry that subsidies and tax breaks are not appropriate policy for this industry or any other.

This is a long-standing position of the FSC.

The benefits outlined here arise from policies that remove barriers to trade, provide greater access to new markets, and improve the competitiveness of Australia's tax system rather than through direct subsidies.

Government policy

And there is much the government can do to reduce barriers to financial services exports.

The government, both the current and former, should be given credit for driving policy changes that can provide greater access to financial markets in Asia.

The completion of the Korea Australia Free Trade Agreement (KAFTA) and the Japan Australia Economic Partnership Agreement (JAEPA) which include strong financial services chapters are important developments.

Taking KAFTA as an example, the agreement formally allows access for Australian fund managers to provide services in Korea without having to establish a physical presence there.

However, removing legal barriers to trade is only part of what must be a larger strategy that will see the government and the industry work together.

By way of example, a significant factor holding back greater funds management exports to Korea is a lack of a deep market for AUD/ Won and a consequent lack of currency hedging services.

While this clearly reflects a lack of demand for hedging services, action by the Korean Government has an impact on the depth of the market.

Korea has a large sovereign wealth fund, the Korean Investment Corporation and a large Government operated pension fund, the National Pension Service.

Collectively, these two funds manage around $A400 billion. These funds will continue to grow with Korea's growing incomes and ageing population.

For Australian fund managers this is a significant opportunity to provide funds management services.

For Korea, the opportunity is to access Australian equities, bonds, infrastructure and other assets directly through Australian fund managers.

The lack of depth in currency hedging between the two countries reflects the low level of investment by these two funds in Australia.

While the FSC would not expect the Korean Government to intervene to increase this investment, there appears to be a market failure in terms of information asymmetry which can be addressed.

However, the Korean Government has established investment offices in the United States and the UK.

These offices act to reduce the gap in information available to Korean investors directly through the two government operated funds.

There is no equivalent Korean investment office in Australia. As a result, EU and US fund managers have an advantage over Australian fund managers and investment is flowing to these countries instead of Australia.

The establishment of a similar office in Australia would have a substantial benefit in providing for direct relationships between the two Korean Government operated funds and Australian fund managers and in turn facilitate the development of deeper currency hedging services.

The structure of Korean industry more generally can also make opening new business relationships in Korea difficult.

The Chaebol structure of large conglomerate businesses favours services provided by other subsidiary companies of the large Chaebol group.

For Australian financial services companies already active in Korea, this has meant they have had no choice but to partner with companies that are part of a Chaebol group to compete for contracts.

This issue is not one that can be dealt with easily through a free trade agreement. While the free trade agreement formalises non-discrimination against Australian companies in a legal sense, opening access requires a change in business culture.

While all businesses from outside Korea face similar hurdles, other countries have more established business relationships.

KAFTA raises the profile of Australia and Australian businesses in Korea and can assist in reducing the cultural bias to Korean companies and businesses with from other countries which have longer relationships with Korea.

The FSC and the government must continue to work together to further facilitate links between the Australian and Korean financial services sectors.

The ultimate goal – the equivalent of zero tariffs and quotas for the financial services sector is mutual recognition.

Put simply this means once a financial services product passes the licencing and regulatory tests in Australia, they can be sold directly into other countries.

Apart from the New Zealand Closer Economic Relationship – our bi-lateral free trade agreements do not yet provide this level of access.

However, they do provide an avenue for ASIC and APRA to work on mutual recognition of licencing and prudential regulation.

ARFP

A more effective and efficient way of delivering the same outcome is through a regional or multilateral agreement.

A number of countries in the region are working together under the umbrella of APEC to develop the Asia Region Funds Passport – a set of regulations for funds management which would be common across all countries that agree join.

Once operational, the Passport will permit investment funds domiciled in one country to be sold directly to retail investors in participating jurisdictions and vice versa.

At the APEC Finance Ministers' Meeting in Bali in September last year four countries – South Korea, New Zealand, Singapore and Australia - agreed to develop a pilot of the Passport.

Subsequently Thailand and the Philippines have also agreed to join development of the Passport.

The APEC Secretariat has estimated that by improving efficiency in the sector, the Passport could save the region's investors US$20 billion annually in fund management costs and offer higher rates of returns.

The progress on the Asia Region Funds Passport through the support the Government has provided at an international level is very pleasing and exactly the kind of low cost industry policy that the government should be adopting.

Domestic tax changes

However, there is no point spending time and resources negotiation free trade agreements or mutual recognition if Australia's domestic tax settings are uncompetitive when compared to other financial services centres in the region.

The Johnson Report found that in order to maximise the opportunity arising from Australia's comparative advantage in funds management, a series of ongoing domestic policy changes were required.

While parts of the Johnson Report have been implemented and others are currently being implemented, many remain outstanding.

At the same time competitor economies remain very focused on maintaining their position as leading financial centres in the region.

One of the most important recommendations of the Johnson Report recommended a reduction of the Managed Investment Trust withholding tax rate. Which was then 30 per cent.

Whilst the rate was reduced to 7.5 per cent per cent under the former government it was subsequently increased to 15 per cent from 1 July 2012.

This rate is inconsistent with interest withholding tax rate of 10 per cent and is encouraging investment to be structured as debt instead of equity.

It is also not competitive with other financial services centres in the region.

As a result Singapore and Hong Kong are at a significant advantage as funds management centres in the region.

The Johnson Report also recommended Australia introduce an Investment Management Regime (IMR) for foreign investors to facilitate the use of Australian investment managers by non resident investors.

Fundamentally, the IMR seeks to ensure internationally consistent and unambiguous investment outcomes for non-resident investors who use Australian investment managers.

For Australia to improve its competitiveness in financial services, it is necessary to be cognisant of the preferences of international investors.

Many foreign investors do not come from a common law jurisdiction.

Consequently, these investors are not familiar with trusts and often prefer to invest in a Collective Investment Vehicle (CIV) which has either a contractual basis or is a corporate entity.

Currently the unit trust structure is the only allowable CIV in Australia.

Establishment of alternative flow through vehicles, particularly for foreign investors is necessary for Australian based fund managers to service these clients from Australia, as opposed to the establishment of off-shore CIVs in competing jurisdictions.

Coordination Policy

It is clear that there are many different strands to the push to increase Australia’s financial services exports:

Multilateral, bilateral and regional trade negotiations; mutual recognition; double tax agreements; trade promotion and marketing; Australia's place in the internationalisation of the renminbi; and tax reform and reform of domestic regulation.

These issues cross many different government departments, and agencies and the work of these organisations and the industry needs to be coordinated.

In many countries, government agencies and regulators have begun to coordinate their approach through formal arrangements and legislation.

However, in Australia, a lack of coordination in international integration has slowed progress.

Australia urgently requires a coordination body to be established to progress international financial integration and promote Australia's financial services in the region.

The various coordination and promotion bodies in the region and beyond indicate Australia is lagging in this area, and the low level of our financial services exports reflects this.

The City of London and the Hong Kong Financial Services Development Council provide templates which Australia can draw on.

The body should be resourced by the government and must have power in legislation to deal with tax and regulatory issues affecting the industry.

And for the body to be effective it also has to have advisory representatives from industry and sit with-in the Treasurer's portfolio.

Conclusion

Ladies and gentlemen, over the past five years, the FSC has led the financial services industry to take its rightful place at the centre of the Australian economy.

The proof of this is the acknowledgement by the Murray Review that we are an industry that is a driver of economic and employment growth in our own right.

Now that we have come through the Strongersuper and FoFA reforms it is time to go beyond the concerns of domestic regulation.

Over the coming five years the FSC will lead the industry's push for deeper and broader engagement with Asia through a coordinated trade and export agenda.

Ladies and Gentlemen, thank you again for attending the conference and thank you to our platinum sponsor KPMG and other sponsors and media partners.

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