PRODUCTIVITY COMMISSION REVIEW: BARRIERS TO SERVICES EXPORTS

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Australian Services Exports
Productivity Commission
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Submitted by email: services.exports@pc.gov.au

Thank you for the opportunity to provide a submission on the Productivity Commission issues paper on barriers to services exports. Please find our submission below.

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The Council has over 125 members who are responsible for investing more than $2.5 trillion on behalf of 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Should you wish to discuss this submission further please do not hesitate to contact me on (02) 9299 3022 or alternatively, Sara Dix (sdix@fsc.org.au) on (02) 9299 3022.

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INTRODUCTION

While Australia's financial services industry is large, exports make up a small proportion of the sector. Regulation has prevented Australia's industry from competing strongly against other jurisdictions with more attractive regulatory settings.

There have been numerous reviews examining the barriers to trade in financial services in Australia. These include the Johnson Review 2009 and the Financial System Inquiry 2014.

These reviews have outlined recommendations to increase Australia's exports and provided a clear reform agenda for Australia to follow. They have made clear what must be done to capitalise on our comparative advantage.

The Johnson Review stated:

> *This Report has stressed the enormous opportunities available to Australia as a result of the likely ongoing growth, development and opening up of financial markets in the region. The key recommendations need to be seen as a package, designed to remove obstacles to Australian based companies engaging in cross border business and also to offshore companies and investors conducting more business in and through Australia.*[1]

This reform agenda includes:

1. competitive taxation rates;
2. introduction of a varied Collective Investment Vehicle (CIV) regime consisting of a broader range of CIVs;
3. tax certainty for offshore investors including introduction of an Investment Manager Regime (IMR); and
4. regulatory architecture for exporting (such as through the Asia Region Funds Passport, Free Trade Agreements or Mutual Recognition).

Despite these reviews and recommendations, the reform agenda has not yet been implemented.

The policy reform process for increasing trade in financial services has not produced outcomes and progress has been slow. This reform agenda has not been implemented largely due to a lack of coordination between policy makers and somewhat due to incorrect calculation methodology of costing revenue impacts of tax changes (see tax section). This has hampered progress in this area.

If we are to benefit from increasing exports in this sector, policymakers must act now and implement the necessary regulatory and tax reforms outlined below.

We now provide an overview of financial services segments which we detail throughout the submission.

Life Insurance

Australia's trade in insurance services has been dominated by the domestic general insurers, a small number of which have established outposts in foreign markets.

These include QBE which has a small presence in Asia and North America and IAG which owns brands such as NRMA and CGU and has joint ventures in China, Vietnam, India, Malaysia and Thailand and is actively pursuing the Indonesian market.

[1] Mark Johnson 2009 'Australia as a Financial Centre: Building on our strengths' page 109

With respect to life insurance, Australian insurers have been heavily focused on domestic markets and have not invested strongly in Asia or any other regions globally.

Australian life insurance companies have lagged behind their European and American counterparts in entering the Asian market, despite our proximity to the region.

Competition for business is robust and the domestic and external barriers to doing business make international expansion expensive and time consuming. Some of these barriers include:

- foreign equity caps—the need for elimination of unjustifiable and anticompetitive foreign equity caps which are prevalent in Asia;
- limitations on cross border reinsurance—protectionist governments (India, Indonesia etc.) have made moves to restrict foreign reinsurance business;
- restrictions on cross border data flows—maintaining data in the policy holder's jurisdiction is restrictive and prevents efficient business practices made possible by centralising this work offshore; and
- regulatory predictability and transparency.

There are some risks to overseas expansion. KPMG has reported[2] it could take up to 7 years for insurance businesses to break even on their investments in China, but it could take up to two decades before they fully reap the benefits of their ventures.

Despite this, Australia is now a very mature market for life insurance and this is making overseas markets more attractive. Provided that the current barriers are removed or downgraded, Australian life insurers are well placed to capitalise on services trade growth.

Funds Management

Approximately only 3.6%[3] of total funds under collective management in Australia are sourced offshore. This compares to other countries in our region which have significantly higher levels of exports (Singapore with 80% and Hong Kong with 60% of funds sourced offshore).

As a heavily regulated industry, regulation impacts the competitiveness of the financial services industry. The 2009 Johnson Report into 'Australia as a financial centre' provided a framework to resolve many of the issues which were making it difficult for foreign investors to access Australian manufactured funds.

The Johnson report also identified Australia's comparative advantage in funds management – an advantage that derives from our proximity to Asia, highly skilled funds management workforce, and our first mover advantage in establishing superannuation.

The Johnson Review noted that Australia has arguably the most sophisticated and advanced financial sector in the region and that there are significant opportunities to expand our exports to the region from a very low base.

The Johnson Report provided the framework for increasing trade in funds management in Australia. We know what we need to do. Now we need to implement it. We urge the Productivity Commission to draw on this review and focus on implementation.

The report's framework outlined four areas of focus:

1. competitive taxation rates;

[2] KPMG, 2015, Perspective: Trends driving the insurance M&A landscape in 2015, pp. 4
[3] ABS 2014 December Quarter, Cat. No. 5655.0

2. introduction of a varied Collective Investment Vehicle (CIV) regime consisting of a broader range of CIVs;
3. tax certainty for offshore investors including introduction of an Investment Manager Regime (IMR); and
4. regulatory architecture for exporting (such as through the Asia Region Funds Passport, Free Trade Agreements or Mutual Recognition).

The Asia Region Funds Passport was a recommendation of the review which is well on its way to implementation.

However there are several Australian domestic regulatory reforms needed to ensure it succeeds, which are also discussed in this submission.

Government coordination of policy, regulation and international competitiveness issues has not occurred in Australia. The Free Trade Agreement process in Australia has not focussed on implementation to ensure market access commitments are actually made available to Australian firms.

By implementation, we typically mean establishing mutual recognition between regulators so financial services firms can export to offshore markets through licencing equivalency.

Australia requires a greater focus on tax and regulatory competitiveness issues as well as ensuring the provision of the necessary architecture to allow Australian firms to export financial services.

The Financial System Inquiry final report quoted 'Australia's financial sector is less open and internationally integrated than it could be now – and than it will need to be in the future'[4]. The FSC agrees with this statement and urges the PC to provide recommendations in its report to increase Australia's international integration.

AUSTRALIA'S FINANCIAL SERVICES EXPORTS

Despite having an end-to-end financial services industry with scale, sophistication and a record of innovation and delivery of quality outcomes to clients, the industry is neither a major source of export income nor is Australia recognised as a major financial centre with export capability.

The Asian region is expected to be a significant driver for growth of the global funds management industry in the future. This is due to economic and demographic changes that are occurring in the region:

- 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 rapidly – 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.

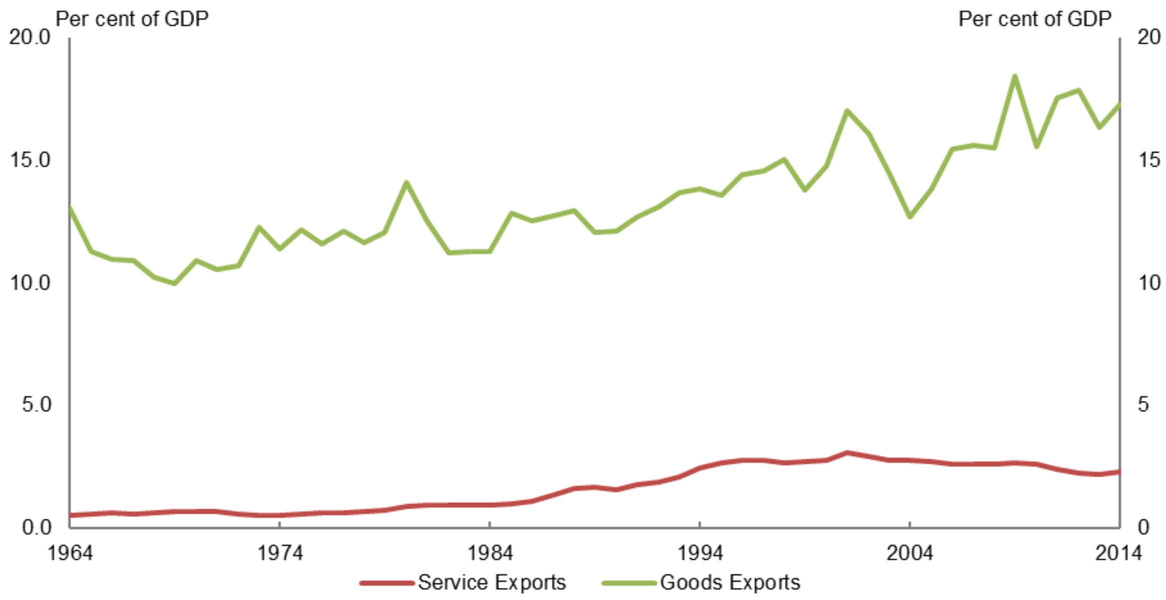
Funds under management (FUM) in the region is currently USD 3.410 trillion – this is only 12 per cent of world wide FUM, despite Asia's population sitting at 4.165 billion or 60 per cent of world's population.

Over the last 30 years, the major export story for the Australian has been the overall growth in trade as a result of lower trade barriers and reduced transport and communication costs. Good exports as

[4] Financial System Inquiry Final Report 2014, page 20

a proportion of the overall economy have grown from 11 per cent in 1960 to 17 per cent in 2014. Over the same period Service exports have increased from 0.4 per cent to 2.3 per cent (see Figure 1).

Figure 1: Australian Good and Service Exports (Per cent of Nominal GDP)



This overall increase in Australia's export capacity has occurred while the industry structure of the economy (as measured by the composition of output and employment) has dramatically shifted. The impacts of structural change in the Australian economy have been well documented.[5] Today, service industries as a proportion comprise approximately 67.5 per cent of total industry output, and 77.8 per cent of total industry employment.

As a share of total output, financial services has experienced the largest change, increasing by 4.6 per cent since 1975 (see Figure 2). Against this backdrop, manufacturing has significantly reduced as a proportion of the economy.

Today the financial and insurance services industry is the largest sector in the Australian economy at 9.8 per cent of industry output. It is also the largest service industry at 14.5 per cent of all service industries (see Figure 3).[6] When we take into account that the second and fourth largest service sectors in the economy – health care and social assistance, and public administration and safety – are generally non-traded as they represent public services the importance of the financial and insurance services industry to the Australian economy becomes more apparent.

[5] See for example Productivity Commission 2013, 'Looking Back on Structural Change in Australia: 2002–2012', Supplement to Annual Report 2011-12, Canberra.

[6] Since the mining boom began in 2002, the mining and construction sectors have both increased their proportion of total output by 1.8 percentage points, while financial services has come a close third increasing by 1.6 percentage points.

Figure 2: Change in industry composition of total gross value added (percentage points) 1975 to 2014

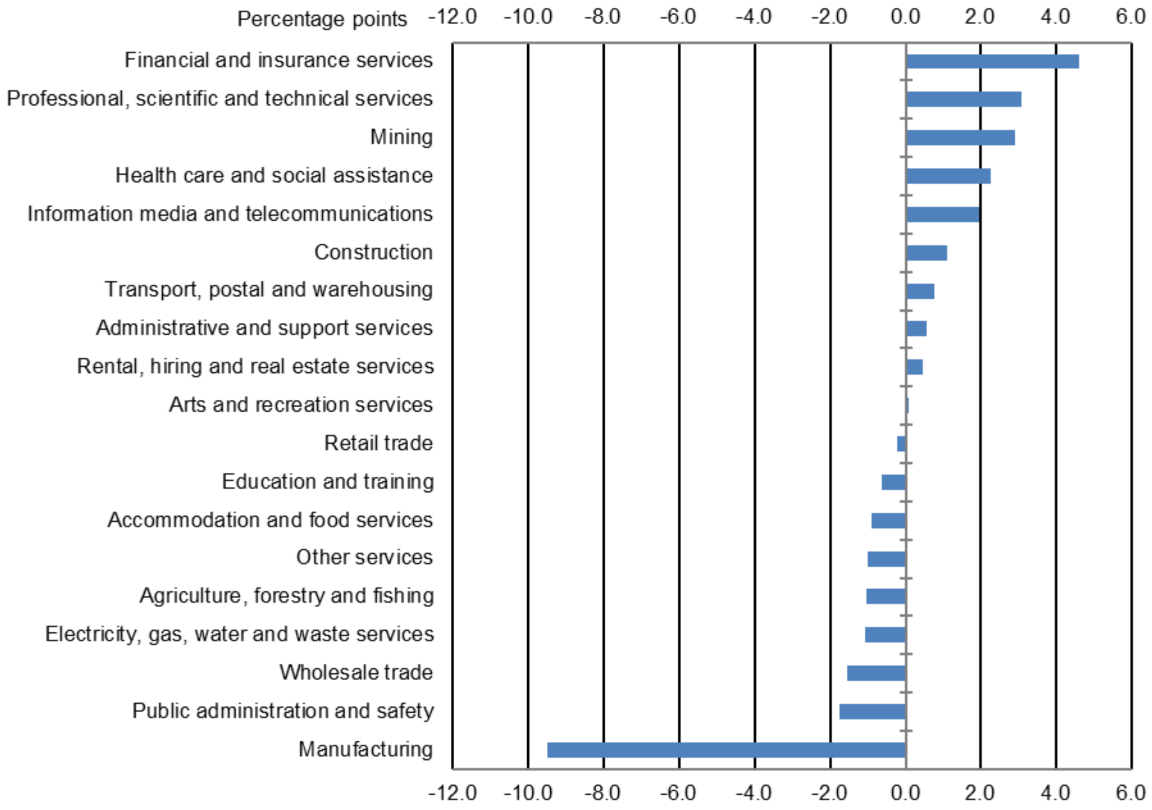
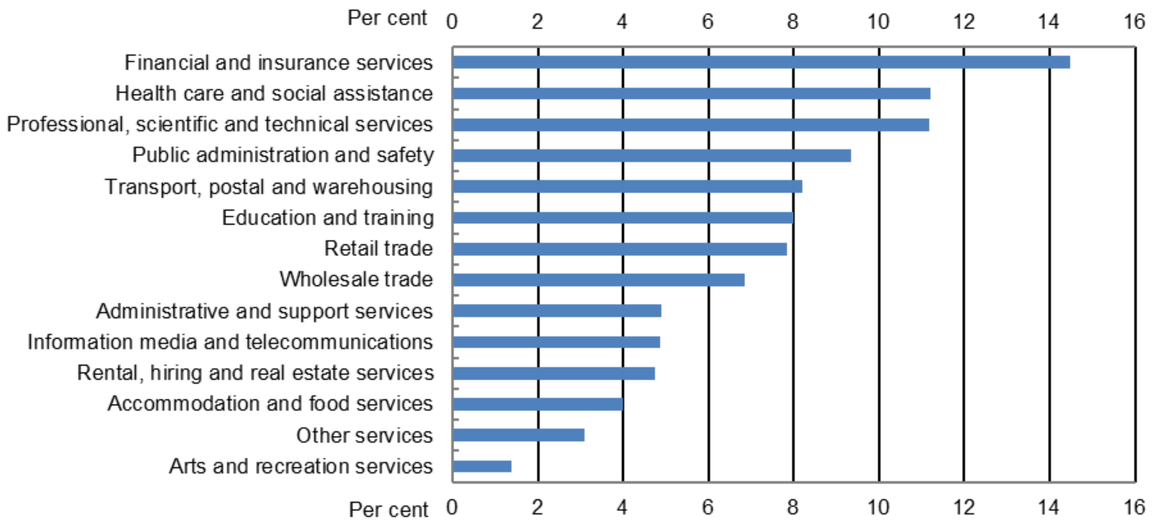


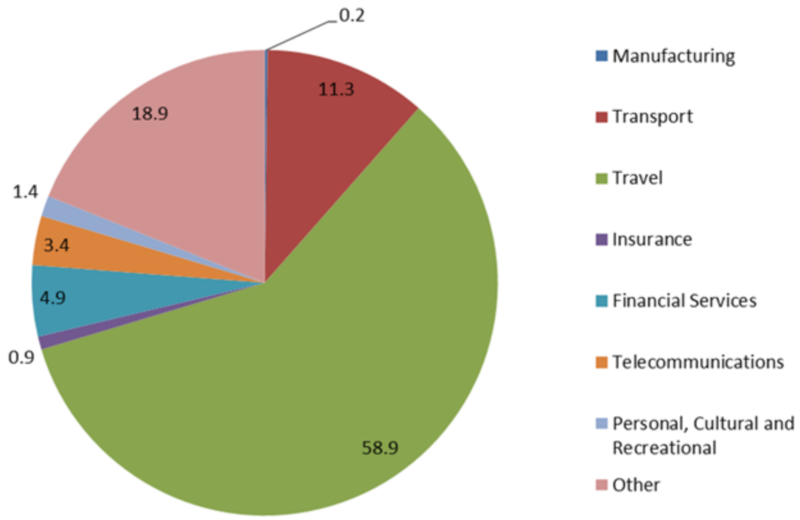
Figure 3: Per cent of total service industry output by industry



Interestingly, the shifting composition of the economy to date has not flowed through to a shifting composition of our service export base. Despite a relative factor endowment of skilled labour in financial services, a relatively large managed funds industry by global comparisons and significant expertise and know how suggesting a comparative advantage – the potential gains of trade and exchange between Australia and the rest of the world in relation to financial service exports is not apparent.

Of the 57.23 billion of billion of service exports in 2014, the lion's share was related to tourism services such as travel, representing 58.9 per cent of total service exports. Financial and insurance services, despite being the largest sector in the Australian economy, only made up 5.8 per cent of total exports (see Figure 4).

Figure 4: Per cent of total service Exports by type – 2014



Further, since the early 2000s all service exports have fallen as a share of the economy (see Figure 5 and Figure 6). This may partly be driven by the relative high exchange rate (proxied by the terms of trade) Australia has had since the onset of the mining boom.

The relationship between the terms of trade and the general moderation in service exports appears to be robust for tourism, and align with the mining boom (Figure 5).

However, in relation to financial services, this sector has seen its share of service exports as a proportion of the economy decline since the mid-1990s, suggesting other factors beyond the exchange rate have led to a trend decline in financial and insurance service exports (see Figure 6).

This trend is particularly puzzling given it occurs after the financial liberalisation of the Australian economy took place.

Despite an apparent comparative advantage in financial services, Australia's financial service exports are relatively low – both as a proportion of total service exports and when compared to the financial service industries relevance importance to the overall Australian economy as the largest industry in Australia.

Australia has a unique opportunity to capture a significant portion of trade in financial services, especially given the skills an expertise apparent in our financial services industry. However, we must not be complacent – as emerging market economies' factor endowments change (in particular their investment in skilled labour), so too will our comparative advantage.

Failure to reduce barriers to financial service exports will allow these economies to shield inefficient domestic industries from competition from Australian financial service provided. This lack of market access will over time lead to our comparative advantage in financial services eroding as relative factor endowments adjust.

Figure 5: Service exports - total and tourism (per cent of GDP) vs. terms of trade

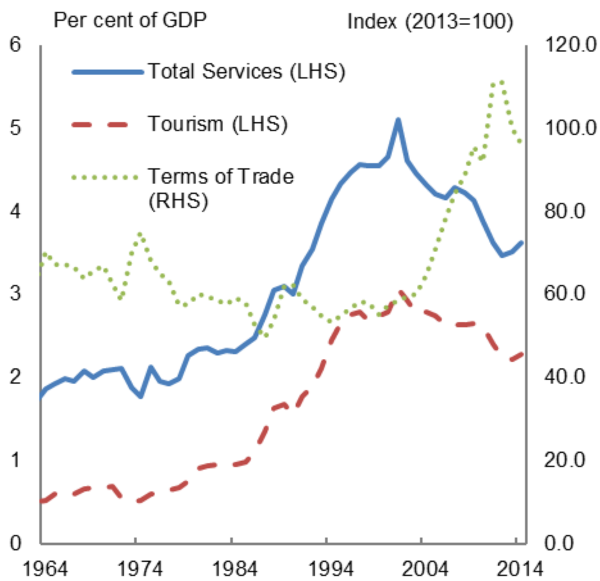
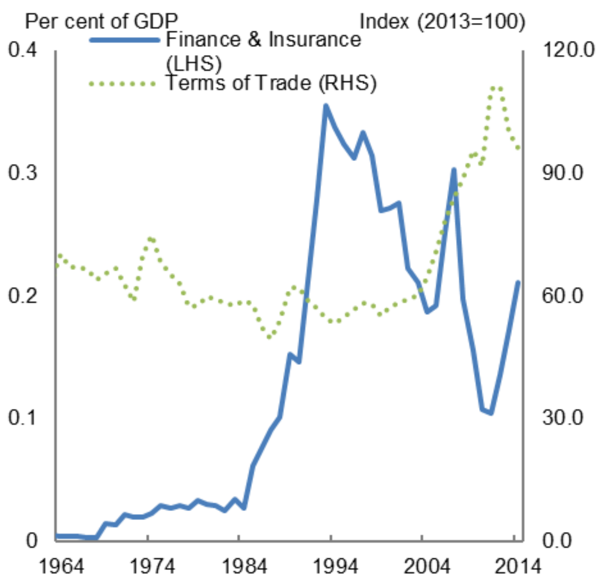


Figure 6: Service exports – finance and insurance (per cent of GDP) vs. terms of trade



Trends in financial services exports

Over the four year period from 1 January 2010 to 31 December 2013 Australian Bureau of Statistics ("ABS") data shows the amount of foreign sourced money managed by Australian managers rose from $49 billion to $81 billion.

Research by the FSC and Perpetual shows that the amount invested into Managed Investments Trusts (MITs) doubled over the same period, increasing from $20.3 billion to $40.4 billion.

This doubling of investment has occurred following a reduction in the Managed Investment Trust Withholding Tax (MIT WHT) rate for foreign investors. The MIT WHT rate was progressively decreased from 30% in 2008, with a rate of 7.5% applying from 1 July 2010. A noticeable increase in funds occurred from July 2010 onward and anecdotal evidence suggests this increase was as a direct result of the decreased withholding tax rate.

The withholding tax rate decrease was reversed with effect from 1 July 2012 and the rate was doubled to 15%. Again, a noticeable drop off in funds can be seen from December 2012, a direct result of the increased rate.

There is the potential for an exponential increase in foreign sourced funds under management if the right policy settings are implemented. The ABS data shows that changes in fund inflows are sensitive to changes in the withholding tax rate.

A further doubling of fund inflows is an achievable target. If the 7.5% rate had remained in place, the original growth trajectory from July 2010 could have been maintained instead of the step-drop in funds that occurred from December 2012.

The outstanding Johnson recommendations are an opportunity to create a step-change increase in fund flows to fuel growth in this sector; growth which in turn will have a meaningful impact on the Australian economy.

FSC Perpetual - Cross Border Flows Report

The Australian Investment Managers Cross-Border Flows Report was first commissioned in 2012 to determine the extent to which overseas sourced funds flowing into Australia had increased following tax policy changes introduced in 2010 as a response to the Johnson Report.

The Report provides the only available insight into which regions, asset classes and investor types have experienced the greatest growth (or loss) since these changes were implemented.

The Report provides a meaningful basis from which to analyse trends and better understand investment flows. It provides a unique insight into the nature of cross border fund flows, with fund managers surveyed in the report collectively managing $40.4 billion out of a possible total $80.82 billion of overseas sourced funds (from ABS data).

The results again show that Asia Pacific is the most common origin for funds inflow with 55% sourced from the region.

Japan accounted for 33% ($9.9 billion) of all investment flows. This finding shows the significance of Japan as an existing trading partner and highlights the potential for future opportunities under the Japan Australia Economic Partnership Agreement (JAEPA).

The JAEPA was signed on 8 July 2014 and provides substantial opportunities for Australia and Japan to mutually benefit from increased trade in financial services.

New Zealand and South Korea were also prominent investment sources in the Asia Pacific region contributing 14% ($4.3 billion) and 3% ($1.0 billion) to fund inflows respectively.

This shows the importance of both the Asia Region Funds Passport and the recent Korea Australia Free Trade Agreement, with both new policy initiatives having the potential to considerably increase fund inflows from these economies.

The investors using Australian based managers are predominantly Fund Managers (33%), Pension Funds (22%) and Private Investors (14%). Over one third of these fund inflows are being invested offshore (37%) into overseas based investments. This demonstrates that the expertise of Australian investment managers is being sought in managing global investment portfolios and supports conclusions drawn in the Johnson Report that Australian fund managers have world class capability.

Foreign fund flows contributed $434 million in total value added to the Australian economy in 2012-13. With the right policy settings in place, Australia can take advantage of the potential for domestic fund managers to form a significant and growing proportion of future export activity.

COSTS AND BENEFITS OF REMOVING DOMESTIC BARRIERS

Removing the current impediments to international financial integration could have large benefits for Australia in the way of increased trade revenue, an expanded financial services sector, growth in jobs and increased tax revenue.

Costs may include increased exposure to financial shocks and losses to Australian investors from latent prudential supervision in offshore markets. FSC believes the benefits outweigh the costs and that the potential downsides can be appropriately managed.

This section will discuss the economic costs and benefits of increasing exports of managed funds and the impact of the ARFP to the Asian region.

Deloitte Access Economics Report: The economic Impact of increasing Australian funds management exports

According to Deloitte[7], increasing exports of funds management services would have notable flow-on effects to the economy, increasing GDP and jobs and adding to tax revenues. The increased supply of additional funds from abroad in effect would also lower the cost of capital in Australia.

The size of the potential gains to key economic indicators (from Deloitte's modelling) indicates that there would be significant benefits to the Australian economy from increasing exports of fund management services.

There is significant scope for growth in exports of managed funds, from a very low base, given Australia's comparative advantage of a highly skilled workforce, proximity to Asia, and economies of scale due to our large superannuation system.

The report notes that looking at the broader measure of financial services; exports of financial services were $1.6b in 2012. As a percentage of GDP this is 0.11% compared to 5.76% for Hong Kong and 5.58% for Singapore. This highlights the gains that could potentially be made in this area.

The reports' analysis shows that the industry has a relatively high level of direct value added as a proportion of revenue.

This indicates the majority of revenue in the sector goes either to wages or gross operating surplus in the fund management firms themselves and remains in Australia. Including other indirect economic contributions and flow-on effects to other sectors of the economy, 98% of industry revenue is converted to value added.

There are also positive tax implications and increased government revenue from increasing exports of managed funds which would also be the case for financial services in general.

The report's modelling shows that a doubling in the value of funds management exports is estimated to lead to an increase in GDP of $362m (as the peak in 2020-21). It was also estimated to lead to an increase of more than 1400 extra jobs in 2020-21.

If the level of funds management exports were to grow more rapidly such that they reached the levels of fund management exports in Hong Kong by 2023-24, it would lead to a $4.2b increase in GDP above baseline levels in 2029-30 and 10,000 full-time jobs.

APEC Report – Asia Region Funds Passport

According to the recently released APEC report on the economic benefits and costs of the ARFP[8], the scheme could save investors around US$20 billion per year in fund management costs from increased efficiencies. The report notes:

> Once the ARFP is established, fund managers will be able to offer a single fund across multiple markets. It is expected the resulting larger client base will grow the fund size sufficiently to realise economies of scale. At the same time, increased competition, an increased number of funds and increased funds under management will help keep the fund size at an optimal level so as not to erode fund performance. Investors will also benefit from improved efficiency as direct access to offshore funds results in the elimination of an extra layer of fees and commissions changed by local operators.

The report notes that the ARFP will offer better fund performance in the form of higher returns for investment at the same or lower degree of risk.

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[7] Deloitte Access Economics 'The economic impact of increasing Australian funds management exports' May 2014

[8] APEC Policy Support Unit 'Asia Region Funds Passport: A study of potential economic benefits and costs' July 2014

Investors in some Asian economies currently have limited products available to them, due partly to strict regulations in those economies. Investors will gain from diversifying their investments across markets and reducing correlation that is, earning a higher return for the same level of risk or lowering risk for the same level of return.

The ARFP can also potentially create 170,000 jobs in Asia and promote sustainable economic development by directing the region's savings toward productive investment. The ARFP will enable local funds industries to gain from foreign technical know-how, competitive pricing, and higher standards of disclosure and performance.

An essential feature of the ARFP is that it will increase the demand for funds to be domiciled in Asia which would lead to increased job opportunities in the region.

The report discusses the potential risk of heightened vulnerability to shocks with increased financial integration. However, it also notes that the Passport will increase efficiencies in Asian financial markets and that deepening the integration of financial markets will mitigate the risks associated with large and volatile capital flows into the region.

> Adopting the ARFP can bring risks which are inherent with any cross-border financing solution in which shocks in one market can be amplified and transmitted to other markets. Many Asian economies can no longer afford inefficient financial markets that since the mid-2000s have resulted in persistently low investment rates in the region.

> As the benefits of the ARFP can only be optimised if the region possess the requisite infrastructure and institutions, Asian economies need to work together to upgrade and harmonise regulations and market practices, and develop mutually recognised regional standards. Regulators in Asia can learn from the European experience in striking the right balance between achieving market efficiency and investor protection. There is also an increasing impetus to put in place an institution that can coordinate the work of different regulatory agencies.

It will be paramount for Australia's regulatory environment to take into account international regulations and developments, and ensure we can integrate with Asian economies in order to gain fully from the benefits the ARFP will bring. As the report notes, it will be important to establish an institution that can coordinate the work of various regulators.

DOMESTIC BARRIERS TO SERVICES EXPORTS

Life Insurance

The Australian insurance market in the context of our region is relatively open to the establishment of new businesses by foreign companies. This has been largely to the benefit of consumers who have been afforded better pricing and choice from increased competition. Domestic insurance companies also benefit from a bigger pool of reinsurance capital which enables them to grow their businesses and improve insurance penetration in the Australian community.

APRA reviewed its life and general insurance capital standards in 2013 with a view to improving their risk-sensitivity and appropriateness and increasing alignment across industries. Australia's capital adequacy framework is based on a 'three-pillar' approach similar to capital requirements (Solvency II) for insurers in the European Union[9].

A competitive disadvantage is created when the prudential requirements of Australian regulators are significantly higher than those of Australia's competitors. Naturally this frees up capital for insurers in jurisdictions with favourable prudential requirements to invest in assets offshore while

[9] Price Waterhouse Coopers, 2013, Insurance Facts and Figures—Asian Region, pp. 5

maintaining an adequate return on capital. On this basis it is necessary for APRA to routinely review Australian capital requirements in the context of international competitiveness.

There are a range of other domestic barriers worth consideration, such as:

- complexity and time involved in meeting APRA licensing requirements make it difficult to establish a presence in the Australian market;
- acquisition of more than 15 percent of an Australian company requires approval from the Foreign Investment Review Board; and
- controls covering actuarial standards and recognition of trained professionals make it difficult for foreign employees to work in Australia.

Recommendation: APRA should routinely review Australian capital requirements in the context of promoting international competitiveness.

Funds Management

As noted in the introduction, many domestic barriers exist to the exporting of funds management services.

The recommendations at the end of this section are the key domestic impediments to international integration and trade and are based on the Johnson Review recommendations.

Several of these are in progress but yet to be implemented.

Barriers for the Asia Region Funds Passport

The Asia Region Funds Passport (ARFP) would provide a multilaterally agreed framework allowing the cross-border marketing of funds across participating economies in the Asian region.

This would provide the architecture through multilateralism in order to allow Australian fund managers to export to Asian retail investors. This is our preferred mechanism for cross border trade in funds management, alongside bilateral and multilateral free trade agreements.

There are many tax and regulatory structure reforms which are required in the next 12 months if the ARFP is to deliver for Australia and for investors in our region.

The following points outline what is required to break down these barriers and were recommended by the Johnson Review in 2009:

- Implementation of a CIV regime
    - including allowing funds to hold multi-currency classes.
- Establishment of an ARFP structure in the Corporations Act 2001 with a tax rate which is applicable solely to ARFP products.
- Introduction of a special MIT withholding tax rate of 5% for funds participating in the Asia Region Funds Passport.
- Implementation of an Investment Manager Regime.

It is critical these reforms are implemented to ensure the Passport is functional in Australia when it is launched in 2016. Australia must be able to compete with other countries in our region, and the Passport regime must be practical so as to compete with the UCITS, otherwise it will never be commercially viable.

There is strong demand from Australian investors for exposure to offshore assets.

However, typically retail investors are unable to meet this demand due to structural barriers. If implemented correctly, the Passport should remove some of these structural barriers and meet the demand.

In relation to the Passport, differences between jurisdictions include regulatory frameworks that require a separate custodian on fund assets; and legislative requirements that specify types of funds, outsourcing restrictions, diversification requirements, derivatives restricted and local currency required.

There are a variety of rules throughout Asia in relation to investments that are permitted, commonly (although not universally) prohibiting direct investment in infrastructure and real estate (in conflict with Australia) and limiting the use of derivatives.

The tax regimes in each jurisdiction are complex and represent a significant challenge to the success of an Asian Region Funds Passport, and also increased financial integration generally[10]. It is important that the Productivity Commission make explicit recommendations on taxation as taxation issues are central to Australian competitiveness.

Collective Investment Vehicle Reform

Australia is limited in the type and number of Collective Investment Vehicles (CIVs) that can be used by investors. Australia solely uses unit trusts, which are not well understood throughout Asia due to being structured differently to trusts of other jurisdictions.

The Johnson Review recommended that Australia provide a broader range of tax flow-through collective investment vehicles.

The Financial System Inquiry also outlined this point: 'Government should also consider developing a mechanism to enable Australian fund managers to use collective investment vehicles that are more common overseas, such as a corporate vehicle'[11].

Below is the list of CIVs used in the Asian region:

- Australia: unit trusts and superannuation funds.
- Hong Kong: unit trusts e.g. equity fund, hedge fund, index fund, warrants fund, REIT etc.
- Japan: investment trusts (ITM funds). For alternative investments, other types of CIVs are used e.g. investment corporation, TK, TMK.
- Korea: investment trust, investment company, investment limited liability company, investment limited partnership company, investment limited partnership and investment undisclosed association.
- Singapore: unit trusts and limited partnerships.

Australia's limitations in terms of CIVs could reduce the ability of Australian managed funds to sell to Asian investors. Paradoxically, the lack of restrictions on existing Australian trust law CIVs may conflict with Asian regulations on investment types, outsourcing, diversification, leverage, derivatives or local currency denomination.

Multi-currency collective investment funds

Current Australian tax rules make the issuing of multiple currency class investments ineffective because any currency gains or losses must be netted off across classes.

[10] PWC/FSC, 'Asia Region Funds Passport: The future of the funds management industry in Asia' 2010
[11] Financial System Inquiry Final Report 2014, page 279

The result is that managers wanting to offer different currency denominations must establish a separate fund for each currency class. This is expensive, results in unnecessary duplication and is inconsistent with the features available for funds in jurisdictions such as the United Kingdom and Luxembourg.

Further, the ability to offer multi-currency class investment funds will be necessary for Australian managers to fully capitalise on the opportunities presented by the Asia Region Funds Passport. Without this functionality, managers will be unable to leverage existing Australian or US dollar denominated (Australian domiciled) managed funds into the Passport regime. Instead additional funds will need to be established in each of the relevant currencies (i.e. Singapore dollar, South Korean won, New Zealand dollar).

Tax barriers

Australia needs to implement competitive taxation policy settings in order to attract foreign investment. Importantly, taxation policy must be focussed on how to attract more capital to Australia, both in terms of direct investment into Australian assets but also foreign capital that can be managed by Australians for foreign investors.

The Johnson Review[12] examined impediments to international integration and made a number of recommendations to improve Australia's competitiveness. It outlined a clear pathway to reform Australia's taxation settings.

The Johnson Review also recommended that the Financial Centre Taskforce monitor progress on implementation of the tax recommendations in the report.

Despite bipartisan support for the report's recommendations, changes have been slow and many recommendations are still outstanding six years on. Part of the reason for this delay is that some changes are complex and require interaction between multiple government agencies to implement.

All too often, however these policy changes are being delayed due to the anticipated 'cost to revenue'. Ironically, the only cost to revenue which occurs in reality is the missed opportunity for more economic activity to be generated in Australia earlier.

Recommendations:

Review taxation rates for foreign investors through the Tax White Paper process.

Introduce a Collective Investment Vehicle ("CIV") regime comprising a broader range of tax flow-through CIVs to allow Australian based fund managers to compete more effectively internationally.

Continue the commitment to deliver a world class Investment Manager Regime ("IMR") with wide application to a variety of offshore investor types. The regime must strive for equality of taxation outcomes for foreign investors so that investors using an Australian intermediary receive the same treatment as those investing directly.

Amend taxation law to specifically allow multiple fund classes to specifically allow multiple fund classes to be operated for different currencies.

[12] Mark Johnson AO – Building on our Strengths – Australia as a Financial Centre 2009

Costing methodology changes

A fundamental shift in approach to policy costings is required for Australia to successfully compete within the Asian region and globally. The traditional approach to costing policy changes must differ when the policy is directed at improving Australia's ability to attract highly mobile capital.

The focus on 'cost to revenue' must be adjusted when examining policies targeted at increasing economic activity that would otherwise be located offshore. Australia is competing in a global economy and the alternative for investors is to choose a jurisdiction with better tax treatment and a more flexible investment regime.

Instead of costing policy measures using a framework that treats foreign investors as taxpayers who are captured within the Australian economy, the focus must be lifted to Australia's ability to attract foreign investors in the global economy.

Calculating 'cost to revenue' on the basis that foreign investors would otherwise be subject to 30 per cent corporate tax within Australia is flawed logic. In reality no foreign investor would subject themselves to this rate when they can legitimately utilise service providers from alternative jurisdictions and be subject to a lower rate. Offering a competitive tax rate and policy settings that attract and respect foreign investors will result in additional revenue that Australia would not otherwise receive.

Recommendation: Taxation policy targeted at attracting foreign investor activity must be costed on the basis of the investor's options in a global economy and consideration must be given to the impact of taxation.

Removing uncertainty to create competitive tax settings

The tax system needs to be designed so that initiatives such as these can be implemented quickly, in response to changes in competitor jurisdiction offerings.

The following policy initiatives are examples where taxation policy settings have not kept pace with developments in the global market place. As a result Australia has been left behind.

Competitive Withholding Tax Rates

Australia charges foreign investors a number of different withholding taxes, including on:

- Dividends;
- Interest;
- Royalties; and
- Managed Investment Trust fund payments (MIT fund payments).

The withholding tax rates for dividends, interest and royalties are determined by reference to whether Australia has a tax treaty with the counterpart jurisdiction. Without a tax treaty the rate is 30 per cent. With a tax treaty in place the rates vary from zero to 15 per cent.

The MIT fund payment rate is dependant on whether the counterpart jurisdiction has an effective exchange of information arrangement with Australia. Without such an arrangement the rate is 30 per cent. The Johnson Report recommended a reduction of the MIT fund payment tax rate from 30 per cent. Whilst the rate was reduced to 7.5 per cent, it was subsequently increased to 15 per cent from 1 July 2012 and remains at 15 per cent today.

A feature of Australian managed investment trusts is that income characters are retained as they are passed through the trust to the end investor. The result is that a trust distribution made to a foreign investor may have amounts of each of these withholding taxes withheld from it by the fund, each calculated at its relevant rate based on the investor's jurisdiction.

In addition to the complexity of the system there are distortions. The current MIT fund payment rate is inconsistent with interest withholding tax rate of 10 per cent and is encouraging investment to be structured as debt instead of equity.

Impact of withholding tax on competitiveness

Overall Australia's rates are higher than other funds management centres. The table in Appendix A provides a comparison of the rates between Australia and leading funds management centres.

The complexity and rates of withholding tax is making Australia uncompetitive and an unattractive investment destination. The result of a highly complex and expensive withholding tax regime is that investors will choose to invest elsewhere or will choose investment managers from jurisdictions with more attractive treatment.

Whilst existing (and inappropriate) costing methodologies would suggest that reduction in withholding taxes will result in a cost to the revenue, an expensive withholding tax regime results in no revenue being generated at all.

Recommendation: the government streamlines the withholding tax regime to be simpler and more globally competitive.

Impact of withholding tax on Asia Region Funds Passport

Compared to the equivalent rates in those jurisdictions participating in the Passport, a rate of 15 per cent is highly uncompetitive.

The Financial System Inquiry noted, 'withholding tax increases the required rate of return for non-residents, which reduces the attractiveness of Australia as an investment destination'[13].

Recommendation: the government should introduce a special MIT withholding tax rate of 5% for funds participating in the Asia Region Funds Passport.

Foreign exchange hedging treatment

Portfolio foreign exchange hedging to mitigate against currency movements is a legitimate form of hedging undertaken by many funds. Taxation treatment of portfolio hedging activities must be allowed on capital account. Current rules do not provide appropriate treatment.

Recommendation: Funds must receive appropriate treatment under TOFA subdivision 230E in relation to portfolio FX hedging.

These recommendations will ensure that Australia remains an attractive destination for foreign capital to be invested as well as ensuring the competitiveness of Australian funds in the Passport regime.

[13] Financial System Inquiry Final Report 2014, page 18

TRUSTEE SERVICES

This section covers a proposal for an Alternative Trusts Act in Australia to assist in the exporting of Australia's trusts – this is separate to Managed Investment Schemes discussed above.

Australian Trust Law is a century's old form of the law and is not well understood throughout Asia. Updating the law on trusts in Australia would greatly assist financial integration within the Asian region.

Trust law as a barrier to exports

Trust law is part of the basic infrastructure that supports Australia's financial services industry, and plays an integral role in the wealth management, corporate/traditional trustee and private banking sectors.

Without reform to our trust law, Australia risks falling behind its Asian neighbours, and forfeiting its position as a major financial centre in the region. Australian trust law is no longer fit for purpose, as it remains firmly grounded in century's old British law devised for the narrow purpose of intergenerational wealth transfer.

Today, trust structures are used for much broader purposes including large-scale commercial ventures. Other jurisdictions in our region such as Hong Kong and Singapore have already undertaken trust law reform in order to attract foreign resident trust users and provide financial services that meet the needs of today's settlors and investors. Similarly, the US and UK have undertaken trust law reforms in order to solidify their status as sophisticated financial system economies.

Australia's trust law should be modernised and codified, through an Alternative Australian Trusts Act, so as to ensure that our corporate structures remain internationally competitive.

The application of anachronistic, out-dated trust law principles to modern commercial or private trust arrangements can result in undesirable outcomes for settlors and investors, thereby stifling the export of valuable Australian financial services to a rapidly growing regional market.

Trust law reform is also a critical precursor to other Johnson Report recommendations, including the Asia Region Funds Passport.

Australian Alternative Trusts Act Proposal

Supported by detailed research, the FSC advocates for the creation of an Alternative Australian Trusts Act (Cth) ("AATA") which would work to enhance financial integration, especially in the Asia Pacific region, and provide new, fit for purpose, legal infrastructure for Australian trusts. Such legislation would provide a modern, codified and nationally consistent trust law.

A case is presented in support of an AATA, so as to boost the trustee, wealth management and private banking sectors, which in turn will promote GDP, tax revenue and employment growth in Australia.

Modernising and codifying Australian trust law is essential to ensure that Australia's regulatory structures are competitive with other sophisticated financial system economies, including the UK, US, Singapore and Hong Kong. Such a reform would serve the dual domestic and international objectives of enhanced consumer protection and increased financial services exports.

Not only would an AATA strengthen corporate governance in the trust sector, it would also make a major contribution to the underlying regulatory infrastructure governing Australia's financial services markets.

The AATA proposal is clean reform - instead of creating another layer of regulation it gives trust users a choice of legal infrastructure – that is, it would operate as an alternative regime which users could choose to opt-in to.

Three key benefits would arise from the adoption of an AATA. The first is that an AATA regime would provide certainty where there is currently ambiguity and therefore a lack of confidence, especially in respect of foreign resident participants in Australia's financial market.

The current system of State and Territory laws is unduly complex and differs across jurisdictions. The certainty and stability of an AATA would attract offshore investors from the broader Asia Pacific region and would bolster protections of domestic retail clients because the role and powers of the fiduciary intermediary would be more certain.

Secondly, an AATA could deal with trust insolvency, and regulate the proper distribution of risk amongst financial market participants. If trusts are to continue to be used as an instrument of commerce, it is critical that the risk profile of trust entities be determined by public policy.

Lastly, the AATA proposal would establish a specific regime to empower and regulate licensed, capital-backed, fiduciary financial institutions.

Such fiduciary institutions could better serve as gatekeepers for the financial services industry by taking a more active role in protecting consumers, which in turn could relieve some of the regulatory burden on ASIC and APRA.

Accordingly, the FSC encourages the Government to adopt the necessary trust law reforms to better protect consumers and help bolster Australia's financial services exports. The AATA serves as a useful model to achieve these objectives.

Recommendation: The FSC recommends that the Government introduce an Alternative Australian Trusts Act which would support financial integration, especially in the Asia Pacific region, and provide new, fit for purpose, legal infrastructure for Australian trusts.

AUSTRALIA'S DOMESTIC REGULATORY PROCESS: THE ARCHITECTURE

Australian regulators should take international regulatory systems, especially those of Asian countries, into account when implementing regulations and policies that may affect trade in financial services.

The Financial System Inquiry Final Report stated that 'policy makers should avoid adopting unique Australian regulatory approaches that are inconsistent with international practice'[14].

Further, the Johnson Review recommended 'periodic reviews of the regulatory rules and framework applying to the financial sector' focussed on unnecessary regulation and ensuring Australia's framework is best practice.

The low proportion of funds sourced globally in Australia's managed funds pool demonstrates a barrier to entry or disconnect between the policy settings of Australia and the rest of the region.

[14] Financial System Inquiry Final Report 2014, page 21

Globally, financial system regulation was tightened following the global financial crisis in order to protect domestic economies from shocks.

From now, as Australia looks to increase financial integration particularly with Asia, we must re-assess our regulatory and tax settings to ensure we are competitive as a financial centre.

The government's recently launched 'economic diplomacy' policy aims to support Australia's prosperity through promoting trade, encouraging growth, attracting investment and supporting Australian business. In a response to the policy, Lowy noted:

> Because economic diplomacy requires domestic policy settings which reduce barriers to trade, economic growth and investment, DFAT, along with its two ministers, will need to lead a whole-of-government, whole-of-society effort to achieve positive economic outcomes through diplomacy.

Australia's regulatory and international relations process is governed by several government bodies – Treasury (Passport, International financial organisations), DFAT (International organisations and FTA negotiation), ASIC (mutual recognition and domestic regulation), Austrade (trade promotion), the RBA and APRA.

While these bodies attempt to coordinate as much as possible, it doesn't always work efficiently in practice. There is no one sole body responsible for coordinating Australia's regulation in the financial sector and for promoting Australia as a financial sector globally. This lack of coordination has led to inadequate progress in trade of Australia's financial services.

Free Trade Agreement Process

Several major FTAs have been negotiated by Australia with major Asian trading nations. Both the Korean and Japanese agreements have excellent sections on financial services, however many of the previous commitments in financial services have never been implemented or established within Australia so they can actually be used by businesses.

This is because there is no agency responsible for the implementation of the agreements. This could explain the lack of impact of FTAs and the low functional usefulness of the mutual recognition arrangements negotiated thus far.

Australia has a poor record of realising the benefits of bilateral free trade agreements. Where market access commitments are made within the financial services chapter of an agreement, it is essential that a whole of government implementation occurs. ASIC and DFAT should develop an implementation policy for financial services chapters of free trade agreements and mutual recognition agreements.

The government should look to further strengthen financial services trade with both Korea and Japan following the successful negotiation of the KAFTA and the JAEPA. It is essential that these agreements are fully implemented so that both jurisdictions can capitalise on these cross border relationships.

In order for this to occur, the FSC urges ASIC to ensure that market access is gained so both of these agreements are fully leveraged for Australian industry. Commencement of discussions with the relevant Korean and Japanese regulators should be progressed as soon as possible.

In particular, investigation of the potential for mutual recognition of financial service licensing and investment product offerings should be undertaken in conjunction with ASIC's counterparts in Korea and Japan.

Mutual Recognition

Australian regulators should take international regulatory systems, especially those of Asian countries, into account when implementing regulations and policies that may affect trade in financial services.

A roadmap should be developed on how market access (through licensing and mutual recognition) will be facilitated by the regulators. ASIC should take an active role in this process as the Australian securities regulator which would need to work with its Korean and Japanese counterparts.

The Johnson Review recommended as part of the ARFP implementation:

> *ASIC negotiates bilateral mutual recognition arrangements with key jurisdictions in the region. In doing this, the Forum recommends that ASIC attempt to ensure that investment restrictions allow a relatively broad range of funds to be offered across borders, and that licencing requirements are as streamlined as possible*[15]*.*

Accordingly, we welcome the Memorandum of Understanding that ASIC has signed with the Korean FSS on 11 February 2015.

In seeking a roadmap for implementing the agreements, we believe the pitfalls in the existing mutual recognition arrangements ASIC has developed for managed funds must be avoided.

Case Study: Hong Kong-Australia 2008 Declaration

While at first glance, the Declaration seemed to remove barriers, the finer detail created considerable barriers to entry. The mutual recognition program with Hong Kong commenced in 2008 but not one fund has been sold through this mechanism in either market.

It appears that the reasons for failure have differed between Australian managers wanting to access Hong Kong and Hong Kong managers wanting to access Australia.

Hong Kong – failure of Australian funds to use the 2008 Declaration

The reasons for this failure are multifaceted. Although Australian MISs are no longer required under the Declaration to demonstrate full compliance with the SFC's requirements, under the SFC's Code on Unit Trusts and Mutual Funds ("the Code"), the relevant Australian MIS must still comply with the Code in respect of the following matters:

a) appointment of an ASIC-regulated custodian that holds an Australian Financial Services Licence and is separate from the responsible entity for safe custody of scheme assets;
b) core investment restrictions;
c) the monthly dealing requirement; and
d) the appointment of a Hong Kong representative and an approved person.

A number of these provisions have caused problems. Investment managers have issues where:

1) the Responsible Entity for Funds are able to hold the "scheme property" because where funds are over $5m NTA (and will from 1 July 2014 have $10m NTA), they are not required to appoint a separate custodian. Yet the SFC's Code requires the appointment of a separate custodian;
2) Investment restrictions are more restrictive than those in the Australian market.

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[15] Johnson Review 2009, page 121

There are also non-legal issues such as a lack of distributor appetite for non-UCITS product and lack of familiarity with Australian MIS/RE settings.

Our understanding of an "ideal" mutual recognition framework is that where a fund is approved and fully compliant in its local jurisdiction, it should be fully recognised in the corresponding jurisdiction. In other words, if it's good enough for ASIC, it should be good enough for the SFC.

Australia – failure of Hong Kong funds to use the 2008 Declaration

Tax remains a significant barrier to Australia exporting managed funds. It is most acute in nations where we do not have a double tax agreement in place.

In the case of the 2008 Declaration, tax has singlehandedly undermined the ability for Hong Kong funds to access the Australian market under this agreement.

Table 1: List of existing mutual recognition arrangements

Arrangement	Mutual recognition between governments
Mutual recognition of securities offerings in NZ and Australia (2009)	Allows an issuer in Australia and New Zealand to offer securities or interests in collective or managed investment schemes in either country using one disclosure document prepared under regulation in its home country.
Mutual recognition of cross-border offering of MIS/CIS between Hong Kong and Australia (2008)	Allows most funds registered in Australia for offer to retail investors in Hong Kong while making available to Australian investors similar funds authorised in Hong Kong.
Mutual recognition framework between US and Australian Stock exchanges and broker-dealers (2008)	Framework for the SEC, the Australian government and ASIC to 'consider regulatory exemptions' to permit U.S. and eligible Australian stock exchanges and broker-dealers to operate in both jurisdictions, based on home country regulation. No exemptions granted under the Framework as yet.
Arrangement	**Unilateral recognition of foreign providers by ASIC**[16]
Relief for foreign financial service providers from Australian Financial Services Licensing requirements	Exempts foreign providers of financial services from Australian licensing requirements. Available for foreign providers of wholesale services operating in 'sufficiently equivalent" regulatory regimes. Class order relief granted to financial service providers from UK; US; Singapore, Hong Kong; Germany. Individual relief from ASF licensing granted to one overseas operator since June 2010.
Relief for foreign collective investment scheme from other regulatory requirements	Discretionary relief granted to foreign collective investment scheme (FCIS) operators authorised in other jurisdictions with a 'sufficiently equivalent' regulatory regime (registration; licensing; and product disclosure). Granted for NZ, US, Singapore, Hong Kong FCIS operators (as well as operators who conduct few Australian trades).
Relief for foreign providers from product disclosure and reporting requirements	Relief granted from product disclosure statements and prospectus provisions and financial reporting and auditing provisions in the Corporations Act 2001 to foreign companies.

[16] ASIC has powers under the Corporations Act 2001 and the Corporations Regulations 2001 to recognise overseas regulatory regimes that are 'sufficiently equivalent' to the Australian regulatory regime. ASIC also has discretionary powers to grant relief from the provisions of the Corporations Act 2001. ASIC may grant relief through two instruments; 1) class order (for multiple applications) 2) individual relief instrument. ASIC have preference for granting relief through class orders (where they have "power and it is appropriate to do so"). Where class orders are not appropriate or ASIC do not have the power to make class orders, ASIC can exercise discretionary powers on a case-by-case basis (i.e. individual relief instrument).

In relation to managed funds, only the Hong Kong and New Zealand agreements would permit Australian investment managers to theoretically access other markets.

Recommendations:

Australian regulators should take international regulatory systems, especially those of Asian countries, into account when implementing regulations and policies that may affect trade in financial services.

The FSC recommends that cooperation between regulators occurs to ensure international competitiveness is considered in decision making.

ASIC should appoint a commissioner to deal directly with international competitiveness.

ASIC should work with DFAT in negotiations of financial services chapters of free trade agreements.

ASIC should develop a roadmap for pursuing mutual recognition and subsequently negotiate mutual recognition with regulators in our region.

BARRIERS IN AUSTRALIA'S KEY TRADING COUNTRIES

FSC engaged ITS Global to undertake research into the barriers in Australia's key trading countries – with specific case studies on Japan and Thailand. The report stocktakes Australia's FTAs and outlines barriers to trade faced by Australian fund managers and life insurers. The report also outlines a mechanism for Australia in negotiating FTAs in the future which is discussed in the next section.

Barriers to Australian wealth management in the Asia Pacific region

Market access for Australia's wealth management industry across the region is constrained by a highly regulated operating environment, combined with range of controls on foreign investment and services delivery.

In more advanced markets like Japan, market access is affected by local presence requirements, plus compliance with local licensing and authorisation procedures.

In developing country markets, such as Thailand, foreign insurance and funds management providers face more direct barriers to market entry such as limits on FDI, and local incorporation requirements.

In most markets local services delivery and investment is subject to a range of restrictions - on permitted investments, type of service, and marketing activities. Controls on outsourcing also apply.

Two key markets for the Australian wealth management industry - Japan and Thailand - were selected as representative markets for a review of barriers faced by foreign providers. Key barriers identified were:

- Limits on foreign investment – caps on foreign equity participation, FDI approvals.
- Nationality requirements – limits on foreign participation for boards of directors and voting shares;
- Local presence requirements – local establishment and incorporation requirements;
- Minimum capital requirements;
- Licensing and approval procedures – compliance with domestic licensing criteria and conditions;

- Restrictions on scope of service – controls on the type of service or investment permitted, form of delivery and marketing activities in the local market;
- Controls on outsourcing of core and support functions;
- Lack of transparency in procedural decision making for licensing and approvals, and;
- Advantages to government entities competing in the market.

Examples of the type of barriers affecting life insurance and funds management in Japan and Thailand are summarised below. See also Appendix B for more detail on specific life insurance barriers.

Table 2: Summary of barriers to life insurance and funds management providers in representative markets

Barrier	Japan	Thailand
Limits on foreign investment	No limits on foreign investment in insurance companies or funds, however prior approval from the Prime Minister and authorization from the regulator is required to become an insurance holding company or acquire 20% or more of the voting rights of a Licensed Insurance Company.	FDI for insurance firms, brokers, securities businesses is limited under the Foreign Business Act. Foreign equity stakes in insurance companies are limited to 25%, up to 49% with approval. Foreign brokerage service providers may apply to own 100 percent of a securities company. For other securities business up to 49% is permitted.
Nationality requirements	None specific.	Insurance companies must have a minimum 75% of Directors of Thai nationality with more than 75% of voting shares.
Local presence requirement	Insurance companies must be locally incorporated as stock companies or mutual companies (and be licensed) in order to sell insurance to persons or market services in Japan. Foreign companies undertaking management and sales of investment trusts must have a branch or office in Japan.	Firms must incorporate as a public liability company in Thailand or establish a branch office in order to sell insurance in Thailand. Insurance brokers must have a head office in Thailand. Foreign re-insurance companies may offer services from abroad, without the need to set up locally or operate through a local broker. Local incorporation is required to (be licensed to) sell securities and to market a fund.
Minimum capital requirements	Minimum capital requirement of JPY1 billion for an insurance license. Every licensed foreign insurance company must deposit JPY200 million with the deposit office in Japan. Insurance brokers must deposit JPY20 million. Minimum capital requirements for a funds management license holder are JPY 50 million.	Minimum capital requirements for a Life insurer/reinsurer are THB500 million, and for a General insurer/reinsurer THB300 million. Minimum capital requirements for being granted a license to market a fund are 500 million baht for the application, submitted from January 1 2012.
Licensing and approval procedures	Insurance companies, agents/brokers and new products must be licensed. Additional licensing criteria applies for foreign insurance providers - i) Prior approval of home country supervision, ii) recognition of home country supervision. Foreign companies undertaking management and sales of investment trusts, providers of mutual funds and pension funds and their branches must undertake the full application and compliance process, including providing evidence of home country supervision. A CIV must be authorised or registered. Disclosure documents must be in Japanese.	Insurance firms, brokers and agents must be licensed. Branch offices must be licensed. Securities business must be licensed as well as personnel providing investment advice. Foreign securities companies may provide investment advice on foreign securities through local securities firms without the need to apply for a license in the category of securities/derivative investment advisor. Disclosure documents must be in Thai.
Restrictions	Restrictions on type of service – not permitted	Restrictions on permitted investments by

on scope of service	to deliver both life and non-life products. Representative offices are not permitted to engage in sales and marketing. The Japan Securities Dealer's Association marketing rules determine which foreign investment trusts can be marketed to investors other than qualified institutional investors in Japan. Requirement for a local agent which is located in Japan to authorise, register, distribute funds to investors other than qualified institutional investors in Japan.	insurers and fund managers, eg: infrastructure investment generally not open to foreigners. Restrictions on type of service. Providers are not permitted to deliver both life and non-life products. Insurers must be licensed domestically to market insurance services. Permitted activities are part of the domestic license.

MECHANISMS FOR ADDRESSING BARRIERS TO SERVICES EXPORTS

Australia's FTAs have delivered little benefits to growing trade in financial services. Policymaking and implementation must be improved. The FSC is of the view that there is scope for this to be achieved in future FTAs. It requires a template on how market access outcomes, in particular for life insurance and funds management, might be better addressed in Australia's free trade agreements.

The following section outlines a template for improving outcomes for life insurers and fund managers in bilateral and multilateral trade negotiations, which can be used as a guide for government.

Outcomes for wealth management under Australia's FTAs

Australia's recent FTAs with Japan and Korea, as well as the Australia USA FTA (AUSFTA), generally improve market access for Australian insurance and funds management operating in the region. However, significant barriers remain.

The most significant improvements in access arise from opening of the market to 'cross border' trade for insurance providers and fund managers - the supply of services by institutions which are organised and located in Australia, to institutions in or nationals of Japan. They open trade for the supply of new services, transfers of financial information and data processing.

The FTAs do less to alleviate the regulatory impediments associated with establishment and operation in the market. Sale and marketing of products of Australian providers in most FTA markets is still restricted, particularly at the retail level. A local branch office is often required. Compliance with domestic licensing procedures can be onerous and non transparent. Limits on foreign equity apply in some cases. It is usual that a right to regulate for prudential reasons is maintained by government.

Outcomes vary by market and by agreement. The most liberal regime exists between Australia and the US under AUSFTA. Greater market opening is achieved under KAFTA and JAEPA though the Korean and Japan markets remain more protected than the US.

The depth and scope of market access is more modest in FTAs with ASEAN countries, such as TAFTA, SAFTA and AANZFTA. Barriers in ASEAN are high compared to more advanced economies.

The outcomes for the life insurance and funds management industry in Australia's FTA are assessed below in terms of i) commitments made to improve market access and ii) remaining barriers. Agreements with Japan (JAEPA) and Thailand (TAFTA and AANZFTA) are each assessed first as these are the representative markets from which barriers were identified. Agreements with Korea, the US and Singapore are also covered for completeness. Please see Appendix C for detail on each FTA.

Table 3: Summary of measures for market access under Australia's FTAs

Commitment	JAEPA	KAFTA	AUSFTA	AANZFTA	SAFTA	TAFTA
Cross border delivery of financial services	Yes, qualified	Yes, qualified	Yes, qualified	Limited	Yes, qualified	No provisions
Prohibition on market controls	Yes, exemptions	Yes, exemptions	Yes	Yes, numerous exemptions	Yes, numerous exemptions	Yes, numerous exemptions
Investment treatment & protection	Yes	Yes	Yes	Yes, limited	Yes	Yes, limited
Disciplines for regulatory decision making	Yes, no timelines	Yes	Yes	Yes	Yes	No provisions for financial services
Frameworks to address regulatory constraints	Yes	Yes	Yes	Yes	Yes	No provisions for financial services
Mandate for review	Yes	Yes	Yes	Yes	Yes	Yes
Mobility of financial services professionals	Yes.	Yes.	No provisions	Some. Regulatory disciplines.	Yes.	No commitments

Improving access for wealth management in Australia's FTAs

The role of FTAs

Australia's FTAs are key instruments for improving market access for the Australian financial services industry and in promoting more open financial services markets in the region.

The key bilateral and multilateral trade deals of greatest significance to the financial services industry are:

- The bilateral FTAs with Japan, Korea, USA, Singapore, Taiwan, China and India. The Korea and USA FTAs have significant market access for Australian businesses (see Appendix D).
- The Regional Comprehensive Economic Partnership (RCEP) which has large potential for inclusion of key financial services market access provisions and covers key trading partners in Asia including growth markets.
- The Trade in Services Agreement – it will be important to include financial services, however arguably the countries included may have less significance for Australian financial services exports.
- The Trans Pacific Partnership deal - however this has neared completion with regrettably little scope for funds management exports.

They now not only grant legal rights for Australian financial institutions to trade and invest in foreign markets but are broad policy instruments which can be used to shape the regulatory environment in FTA partners, particularly growing economies in Asia.

There are limits on the extent of regulatory change FTAs can achieve. They are legal agreements primarily concerned with removing discriminatory treatment for foreign operators, or 'levelling the playing field'. They can create frameworks for measures to support regulatory integration and reform. Ultimately implementation is undertaken by regulators of the governments concerned.

The FTAs create a 'foot in the door.' Initial commitments are typically low, but increasingly in FTAs there are provisions for ongoing negotiations to increase market access and reduce regulatory barriers.

Key principles and negotiating goals are outlined below (please see Appendix D for the full template).

Negotiating goals

Future FTAs should improve on outcomes in existing FTAs and reduce barriers to life insurance and funds management in key markets.

- For bilateral FTAs (e.g.: India, Taiwan) the focus should be on removing barriers which are important to the Australian wealth management industry in the market in question and establishing a process for ongoing discussion to reduce regulatory impediments.
- For the RCEP the focus should be on improving market access commitments in existing FTAs, particularly for the ASEAN economies (AANZFTA and the bilateral FTAs), where barriers to services and investment are generally high. Market access should be supported by more binding disciplines to address 'beyond the border' regulatory constraints.
- TiSA provides a mechanism to achieve multilateral market access outcomes in important markets with which Australia does not have bilateral FTA, or are not party to either the RCEP or TPP (e.g.: Taiwan, EU).

Key principles

1. Achieve a degree of market opening of trade and investment for insurance and funds management which is equivalent to or greater than AUSFTA;
2. Apply market opening across the board with 'exempted measures' included in an Annex. Commit not to make measures more restrictive over time;
3. Reduce the impediments to foreign providers arising from regulatory procedures for licensing and authorisation in the FTA market;
4. Facilitate regulatory reform and closer economic integration with FTA partners on issues of importance to the wealth management industry; and
5. Secure agreement to establish ongoing bilateral processes to reduce regulatory impediments.

Recommendation: the Government use the template outlined in this submission when negotiating future Free Trade Agreements covering financial services.

CONCLUSION

Increasing trade in financial services by removing domestic barriers and developing the regulatory architecture should be government and industry's top priority.

The many reviews into the barriers to trade in financial services have resulted in little action and many of the recommendations remain outstanding.

We know what is required to increase exports, particularly of funds management and insurance. These must now be implemented as a matter of urgency:

1. Competitive tax rates;
2. Implementation of a CIV regime;
3. Tax certainty for offshore investors; and
4. Regulatory architecture to allow cross-border trade in financial services.

The FSC has outlined several specific recommendations in this submission to guide the Government as well as a template to follow in future negotiations of FTAs. We urge the Productivity Commission to again recommend implementing these recommendations and work with Government to achieve this.

SUMMARY OF RECOMMENDATIONS

1. APRA should routinely review Australian capital requirements in the context of promoting international competitiveness.

2. Review taxation rates for foreign investors through the Tax White Paper process.

3. Introduce a Collective Investment Vehicle (“CIV”) regime comprising a broader range of tax flow-through CIVs to allow Australian based fund managers to compete more effectively internationally.

4. Continue the commitment to deliver a world class Investment Manager Regime (”IMR”) with wide application to a variety of offshore investor types. The regime must strive for equality of taxation outcomes for foreign investors so that investors using an Australian intermediary receive the same treatment as those investing directly.

5. Amend taxation law to specifically allow multiple fund classes to specifically allow multiple fund classes to be operated for different currencies.

6. Tax Recommendations:
    a. Taxation policy targeted at attracting foreign investor activity must be costed on the basis of the investor’s options a global economy and consideration must be given to the impact of taxation.
    b. The government streamlines the withholding tax regime to be simpler and more globally competitive.
    c. The government should introduce a special MIT withholding tax rate of 5% for funds participating in the Asia Region Funds Passport.
    d. Funds must receive appropriate treatment under TOFA subdivision 230E in relation to portfolio FX hedging.

7. The FSC recommends that the Government introduce an Alternative Australian Trusts Act which would support financial integration, especially in the Asia Pacific region, and provide new, fit for purpose, legal infrastructure for Australian trusts.

8. Australian regulators should take international regulatory systems, especially those of Asian countries, into account when implementing regulations and policies that may affect trade in financial services.

9. The FSC recommends that cooperation between regulators occurs to ensure international competitiveness is considered in decision making.

10. ASIC should appoint a commissioner to deal directly with international competitiveness.

11. ASIC should work with DFAT in negotiations of financial services chapters of free trade agreements.

12. ASIC should develop a roadmap for pursuing mutual recognition and subsequently negotiate mutual recognition with regulators in our region.

13. The Government use the template outlined in this submission when negotiating future Free Trade Agreements covering financial services.

Appendix A: Comparison of withholding tax rates globally

Table 4: Withholding tax rates globally

Australia	No-treaty rate	Note
Interest	10%	10% in most treaties
Dividend	30%	Unfranked dividends to non-resident. This rate is lowered to 15%, 10% or 5% according to tax treaties
Royalties	30%	5%, 10% and 15% according to the tax treaties.
MIT Payments	15%	15% for foreign residence from Exchange of Information Countries, otherwise 30% applies. Further, the rate is 10% for the newly constructed energy-efficient commercial buildings
CGT	30%	CG for Australian companies are taxed at the corporate income level at 30%. Foreign residents are subject to CGT if the asset is "taxable Australian property". The government will introduce a non-final withholding regime to support the foreign CGT regime, effective from 1 July 2016.

Hong Kong	No-treaty rate	Note - (Tax Treaty with AU? - NO)
Interest	0%	Non-resident persons are exempt from tax in Hong Kong.
Dividend	0%	
Royalties	4.95%/4.5%	4.5% to individual and 4.95% to corporations. 3% in the treaties with some countries
CGT	0%	Generally, investment income and capital gains are not subject to GST in Hong Kong. However, there is property tax imposed on the income from land and building located in HK

Luxembourg	No-treaty rate	Note - (Tax Treaty with AU? - NO)
Interest	10%	10% for resident; 0% for treaty countries
Dividend	0/15%	no tax withheld if paid to qualifying company under the EU parent-subsidiary directive; 0,5,10 and 15% according to the treaties, varing by the shareholding. For no-treaty countries, 0 rate applies if the shareholding exceeds 10%
Royalties	10%	0% rate for treaty countries
CGT	21%	Specialized Investment fund is exempted from corporate income tax, municipal business tax and net worth tax. It only has a 0.01% subscription tax, calculated on the quarterly net asset of the fund

Singapore	No-treaty rate	Note (Tax Treaty with AU? - YES)
Interest	15%	SG and AU has tax treaty that withheld tax rate for interest is 10%. Ranging from 5- 15% for different countries. Exemption: Interest paid by approved bank on deposits held by non-residents, other than individuals or permanent establishment in Singapore, is exempt from tax if the non residents do not have a permanent establishment in Singapore and do not carry on business in Singapore by themselves or in association with others or do not use the funds from the

		operation of a permanent establishment in Singapore to make the deposit.
Dividend	0%	Dividends paid by a Singapore tax-resident company are exempt from income tax in the hands of shareholders, regardless of whether the dividends are paid out of taxed income or tax-free gains. No withholding tax on dividend
Royalties	10%	SG and AU has tax treaty of 10%
CGT	0%	capital gains are generally not taxed.

UK/London	No-treaty rate	Note (Tax Treaty with AU? - YES)
Interest	20%	20% as general. UK and AU has tax treaty: 10% for interest income
Dividend	0%	Withholding tax is not levied on dividends. A tax credit, 1/9 of dividend, is available to UK resident individual shareholders on dividends received. For non-residents, full or partial dividend may receive according to tax treaties. Foreign resident from Australia have no tax credit
Royalties	20%	20% as general. UK and AU has tax treaty: 5% for royalties income
CGT	23%	tax on capital gains are generally not levied on non-resident companies. From 6 April 2013, capital gains tax at a rate of 28% may be charged on the disposal of residential property by companies.

China	No-treaty rate	Note (Tax Treaty with AU? - YES)
Interest	10%	CN and AU has tax treaty: 10% for interest income; Other countries may be lower
Dividend	10%	CN and AU has tax treaty: 10% for dividend income; Other countries may be lower
Royalties	10%	CN and AU has tax treaty: 10% for royalties income; Other countries may be lower
CGT	25%	China-sourced CG for non-resident companies subjects to a 10% withholding rate. In addition to income tax, real property gains tax is imposed on transferring real properties

South Korean	No-treaty rate	Note (Tax Treaty with AU? - YES)
Interest	22%	KN and AU has tax treaty: 15% for interest income; Other countries may be lower
Dividend	22%	KN and AU has tax treaty: 15% for dividend income; Other countries may be lower; different treatments/rates for controlling parent and other shareholders
Royalties	22%	KN and AU has tax treaty: 15% for royalties income; Other countries may be lower; different treatments/rates for controlling parent and other shareholders
CGT	22%	CG for companies are taxed as ordinary taxable income; Australian companies faces 15% of corporate income tax rate

Appendix B: A Focus on Life Insurance Barriers

While there is vast information on the barriers to trade in funds management, there is less so on life insurance. We provide some more detailed information on life insurance below.

The FSC is a strong supporter of international trade liberalisation, open markets and regional global efforts to remove unnecessary barriers for the efficient provision of life insurance and reinsurance. Life insurance is an area where there is a great potential for growth in exports trade and to this end the FSC has been involved in various international working groups, such as the Global Federation of Insurance Associations, who have been actively lobbying for trade liberalisation around the globe.

It is worthwhile outlining what barriers exist which still need to be addressed:

1. Foreign equity caps

A primary issue is the need for greater elimination of unjustifiable and anticompetitive foreign equity caps, which are particularly prevalent in Asia. Currently there are foreign equity caps for insurers in India, Malaysia, Myanmar, Philippines, Thailand and Indonesia. The size of these caps varies but all have an undeniable negative impact on the ability of Australian insurers to operate effectively and holistically overseas. Under the current foreign investment rules foreign insurance companies must partner with local insurers to gain market access to some markets. Snapshots of the foreign equity caps in the Asia region are provided in table below.

Table 5: Foreign equity caps (Asia region)

Country	Foreign Equity Cap
Australia	N/A. Over 15 percent will require FIRB approval[17]
China	China only permits foreign companies to participate in Chinese-foreign joint ventures, with foreign equity capped at 50 percent[18].
Hong Kong	No restrictions on foreign investment[19].
India	49 per cent foreign investment cap Investment of up to 26% is permitted under the "automatic route"[20]
Indonesia	Foreign insurers must partner with a licensed local insurer or receive the appropriate exemptions from the Indonesian Government[21].
Japan	N/A
Korea	N/A
Malaysia	There is a 70 percent limit on foreign equity owners. This can be extended on a case-by-case basis.

[17] Price Waterhouse Coopers, Insurance Facts and Figures—Asia Region, 2013 (rules vary for jurisdictions captured in Free Trade Agreements)
[18] United States Government, Trade Summary, China, 2014, pp. 9, https://ustr.gov/sites/default/files/2014%20NTE%20Report%20on%20FTB%20China.pdf
[19] Deloitte, Taxation and Investment in Hong Kong, 2014, pp. 2, http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-hongkongguide-2014.pdf
[20] Linklaters, Foreign Direct Investment in Indian Insurance Sector, 2015, http://www.linklaters.com/Insights/Pages/Foreign-Direct-Investment-Indian-Insurance-Sector.aspx
[21] Allens Linklaters, An overview of the Indonesian insurance industry for foreign investors, 2014, pp.2, http://www.allens.com.au/pubs/pdf/asia/foasia28feb14.pdf

New Zealand	N/A
Philippines	100 percent foreign ownership in the insurance sector is possible however its General Agreement on Trade in Services allows only 51 percent[22].
Singapore	N/A
Taiwan	N/A
Thailand	Foreign ownership is capped at 49 per cent. There have been no new insurance licenses issued in many years[23].
Vietnam	Foreign ownership is capped at 49 percent however this can be increased with the approval of Ministry of Finance[24].

2. Limitations on the conduct of cross border reinsurance

Reinsurance is a global risk transfer mechanism designed to diversify risk, reduce risk concentrations in local markets and provide additional capacity and coverage to local markets often against the occurrence of low frequency, high intensity events.

The presence of international reinsurers is a vital element in risk protection for any country because it makes additional capital available and it relieves domestic insurers of partial or entire risks that are too large for their own capital base. It will also transfer international know-how to the local market and provide local insurers with proven international expertise in assessing complex risks and handling large, complex claims. There have been changes in Brazil and Argentina in 2012, India in 2013 and Indonesia in 2015 that have sought to place additional constraints on reinsurers' business operations, which risks pushing up prices, limiting capacity for local consumers and increasing local risk concentrations.

There are some specific limitations imposed by some jurisdictions which must be addressed. These include:

i. Ability to perform reinsurance retrocession:

Retrocession occurs when one reinsurance company has another reinsurance company partially underwrite some of its reinsurance risk. This essentially diversifies its risk portfolio and limits its potential losses as a result of a catastrophe. This is standard practice for reinsurers in developed markets globally.

ii. Ability to write quota-share treaty agreements:

In quota-share reinsurance agreements a reinsurer agrees to cede to the quota-share reinsurer a percentage of all premiums arising from a book of business in exchange for the reinsurer bearing the same percentage liability for losses.

3. Restrictions on cross border data flows

The FSC believes that all requirements that data be maintained in a given jurisdiction should be prohibited. Foreign companies doing business in a foreign country should be permitted to transfer

[22] United States Government, Trade Summary—Philippines, pp. 4, https://ustr.gov/sites/default/files/2013%20NTE%20Philippines%20Final.pdf

[23] Price Waterhouse Coopers, Insurance Facts and Figures—Asia Region, 2013, pp. 109

[24] Price Waterhouse Coopers, Insurance Facts and Figures—Asia Region, 2013, pp. 116

electronic information out of that country for processing offshore. Companies should be free to supply data from headquarters, through affiliates, through regional centres, and through third party vendors as long as the data protection requirements of the local jurisdiction are satisfied. Forced domestication of data processing in Korea is already the subject of dispute with several of its trade partners, and proposals in other countries would put many global companies in a conflict of laws predicament between their home country supervisor's requirement for comprehensive group risk management and reporting.

4. Regulatory consistency and predictability

Other issues of strong interest include provisions supporting regulatory predictability and transparency, provisions addressing unfair competition from State-Owned Enterprises and clearly articulated and transparent investment protections. Ultimately achieving a balance between consumer protection and industry sustainability is vital.

One area where life insurers have had a poor experience is with the Indian regulatory process in the Unit Linked Insurance Product (ULIP) market, which made up 85 per cent of life insurance sales. In this case the Indian Ministry of Finance reauthorised the Insurance Regulatory and Development Authority to regulate these products and in the process mandated far reaching changes to the structure of ULIPs and the way in which agents could be compensated.

While the changes were necessary in order to protect consumers, the very limited nature of consultation with the life insurance industry, including inadequate notice and comment period and no regulatory impact assessment, caused overnight changes including widespread cancellation of policies. ULIPs now make up just 12 percent of total premium.

Life insurance premiums have been detrimentally impacted by this episode which has caused year-on-year premium decreases and a substantial drop in life insurance premiums as a component of Indian GDP.

Appendix C: Assessment of Free Trade Agreement Outcomes

Table 6: Summary of existing barriers to life insurance and funds management under Australia's FTAs

Barrier	JAEPA	KAFTA	AUSFTA	AANZFTA	SAFTA	TAFTA
Limits on foreign investment	No.	Yes.	No	Yes.	Yes	Yes.
Nationality requirements	Yes. CEOs only.	Yes, CEOs only	Yes, CEOs only	Yes	Yes	Yes
Local presence requirements	Yes	Yes	Yes	Yes	Yes	Yes
Minimum capital requirements	Yes	Not known	Not known	Not known	Not known	Not known
Licensing and approval procedures	Yes	Yes	Yes	Yes	Yes	Yes
Restrictions on scope of service	Yes	Yes	Yes, some	Yes	Yes	Yes
Controls on outsourcing	Yes	Not known	Not known	Yes	Not known	Yes
Lack of procedural transparency	Some	Some	No	Yes	Some	Yes
Advantages to government entities	Yes	Yes	None relevant	Not known	Not known	Not known

Japan Australia Economic Partnership Agreement (JAEPA)

Market access

JAEPA has delivered beneficial market access outcomes for wealth management. The agreement:

- Opens the Japanese market for 'cross border' delivery of some insurance services, as well as wholesale securities transactions, wholesale investment advice and portfolio management services[25] by Australian institutions which are located and established in Australia, without the need to establish a representative office or be resident in Japan. The transfer and processing of financial data may also be supplied 'across borders';

[25] Services covered include trade in wholesale securities transactions, wholesale investment advice and portfolio management services (including asset management, all forms of collective investment management, pension fund management, custodial, depository and trust services), transfer and processing of financial data as well as some insurance services and services auxiliary to insurance.

- Prohibits a range of controls which can inhibit operation in the local market, such as restrictions on the number, type or value of services, type of legal entity required. This extends to services delivered from Australia and those supplied through branches and representative offices as well as subsidiaries in Japan;
- Grants Australian investors and investments rights such as those relating to minimum standard of treatment, freedom of transfers, and compensation for expropriation;
- Creates institutional frameworks to improve on market access outcomes and facilitate recognition of regulatory requirements;
- Permits an unlimited number of visas for certain categories of workers including short term business visitors, intra corporate transferees, accounting and taxation specialists;
- Accords any better treatment given to other parties by Australia or Japan under subsequently negotiated free trade agreements to JAEPA ('most favoured nation' or MFN treatment[26]). This ensures Australia receives the benefit of any further liberalisation of the Japanese market.

Barriers

Several of the barriers of significance to the industry remain. Market opening is subject to prudential regulation. Japan continues to apply a range of restrictions which are exempted from the agreement.

- Australian providers still need to establish a local presence in order to market or deliver their services in Japan (except for cross border services delivery as noted above). Solicitation of securities-related transactions must be conducted by a securities firm in Japan;
- JAEPA does not alleviate the compliance burden of licensing and authorisation requirements. Australian insurers and fund promoters, managers must undertake the full domestic licensing process. Licensing may still be required for cross border services delivery;
- JAEPA does not prevent Japan from requiring Australian entities to establish or maintain a representative office or any form of enterprise, or to be resident in Japan as a condition for supply of services through a commercial presence in the market. Japan may also prescribe limits on the form of commercial presence for prudential reasons, provided the same treatment applies to Japanese firms.
- There are no specific provisions to ease controls on outsourcing;
- Provisions to improve the transparency of decision-making are weak – no timelines are set for issuance of licenses.

Thailand Australia Free Trade Agreement (TAFTA) and ASEAN Australia New Zealand Free Trade Agreement (AANZFTA)

Market access

TAFTA and AANZFTA provide for more limited market opening than JAEPA. TAFTA includes no specific commitments on financial services. It provides for further improvements to be negotiated over time.

AANZFTA delivers more substantial improvements in access to Thailand's financial services market

[26] For example, any better treatment Japan accords to financial service suppliers under the TPP will then apply to Australian or Japanese financial service suppliers under JAEPA.

than TAFTA. It:

- Guarantees certain legal protections for investment. There are disciplines governing treatment of investment by service suppliers through commercial presence;
- Permits transfers of information for the conduct business by financial service suppliers;
- Includes provisions to support enhanced transparency for licensing procedures and sets timelines for the review of licensing applications;
- Provides for the negotiation of additional commitments including those for licensing matters;
- Eases the mobility of senior management and specialists supplying insurance services, subject to authorisation.

Barriers

Improvement in market access for financial services is modest. Access for life insurance and funds management remains constrained by a range of controls:

- Foreign equity limits for life insurance, asset management and securities companies remain. More than a majority of Directors must be Thai nationals.
- Foreign companies are still required to incorporate locally (as per local companies) in order to establish, sell or market their services in Thailand.
- Domestic licensing procedures must be complied with.
- MFN treatment is not guaranteed but subject to consultation between the affected parties.

Korea Australia Free Trade Agreement (KAFTA), Australia United States Free Trade Agreement (AUSFTA) and Singapore Australia Free Trade Agreement (SAFTA)

Market access

KAFTA and AUSFTA both provide a comprehensive framework for liberalisation of trade in financial services that delivers market access that is equivalent to or better than JAEPA.

KAFTA delivers significant improvements given the extent to which the market is protected, though the US market is more open. Both, particularly AUSFTA, include mechanisms to deal with regulatory issues and support further integration.

SAFTA is similar to AUSFTA and KAFTA, though commitments to market opening are more limited.

- Like JAEPA, both KAFTA and AUSFTA preserve access for the cross border supply of insurance and fund management services by Australian institutions to Korea and Korean nationals. Commitments in SAFTA apply to establishment as well as cross border supply, but are undermined by significant exemptions.
- The free transfer of financial information and the supply of new services is guaranteed.
- Controls that impede the supply of services once established in the market are prohibited, subject to measures exempted by each party.
- There are rights for foreign affiliates to perform functions in the market.
- KAFTA and AUSFTA set timelines for regulatory decision making with respect to licensing.
- KAFTA and AUSFTA both grant MFN treatment in the event of subsequent liberalisation.

The AUSFTA and KAFTA, and to a lesser extent SAFTA also create institutional frameworks, but not binding commitments, for bilateral recognition of regulatory requirements and professional qualifications.[27] KAFTA and SAFTA permit mobility of professionals, albeit to differing degrees. KAFTA is the most extensive in its reach.

Barriers

- Like JAEPA, commitments for cross border services delivery are qualified, for example, they do not permit Australian providers to solicit business in the Korean market.
- Agreements do not provide relief from compliance with domestic licensing and authorisation procedures. Sale and marketing activities are subject to licensing in Korea. There is a general carve out from liberalisation for prudential measures.

Restrictions still apply on the delivery of services in the local market, for example in Korea on the type of business which can be conducted by branches, the manner and sales of insurance products, and restrictions on payments in Korean won and conversion. Singapore maintains numerous restrictions that are exempted from liberalisation commitments.

[27] The Financial Services Committee was established under the AUSFTA with an express mandate to consider regulatory issues refereed to it by the parties and to discuss cross border issues relating to securities. Australia had pushed under the FTA for commitments to allow eligible US and Australian stock exchanges and broker-dealers to operate in both jurisdictions, without the need for them to be separately regulated in both countries. Under the auspices of the Committee an arrangement was concluded between the US SEC, the Australian government and ASIC to allow authorities to "consider applications for exemptions" from licensing requirements. No formal agreement has yet eventuated, partly due to political factors. The FSC established under KAFTA has a general mandate to consider financial services issues and cooperation. A similar body does not exist under SAFTA.

Appendix D: Template for negotiation of FTAs

Core elements

Market access

- Include a commitment to the ultimate removal of *all* restrictions on the capacity of Australian service providers to operate in the markets of FTA partners, not only those related to cross border delivery. If immediate access is not is not immediately acceptable, make it a long term goal of the agreement, and record commitments to partial removal of restrictions in the interim;

- Seek removal of controls, and ultimate elimination of measures, which inhibit operation in the local market, such as restrictions on the number, type or value of services, type of legal entity required.

- Provide for any subsequent liberalisation given to third parties to be accorded to Australian providers (include an MFN provision);
- Provide for minimum standards of treatment and protection for investors and investments, for pre and post establishment;
- Create a mandate for regular review of regulations inhibiting the freedom to trade and development of new measures for the progressive reduction of remaining barriers.

'Beyond the border' regulation

- Establish disciplines to address 'behind the border' regulatory constraints which affect the business environment, such as licensing procedures and transparency of decision making;
- Retain a right for parties to regulate for prudential reasons on a non-discriminatory basis.

Regulatory integration

- Include commitments to ease the mobility of senior management and financial services personnel, including brokers and insurance specialists.
- Establish institutional frameworks to support bilateral recognition of regulatory requirements (such as licensing) and professional qualifications. Approaches in the Financial Services Committee established under the AUSFTA could serve as a template. Australia could build on ASIC's experience in granting mutual recognition and unilateral relief for foreign services suppliers from financial services licensing and other requirements on a case by case basis.

Suggested measures

Based on the outcomes of existing FTAs, and remaining barriers in representative markets, the following measures in future FTAs would benefit the wealth management industry:

Table 7: Suggested measures in FTAs for the wealth management industry

Barrier	FTA goal	FTA provision
Limits on foreign investment	Remove foreign equity limits for life insurance, asset management and securities companies	Commit to permit 100% foreign equity and shareholder participation in life insurance and funds management Commit to permit foreign establishment without restriction on type of entity or local staff requirement.
Nationality requirements	Remove nationality requirements for Boards of Directors	Prohibit nationality requirements for Boards of Directors, except for CEOs
Local presence requirements	Remove the need for Australian entities to establish or maintain a representative office or any form of enterprise, incorporate locally or to be resident in as a condition for supply and marketing of services. Allow treatment for prudential reasons.	Commit to non discriminatory treatment for establishment in the market to deliver services. Commit to market opening of a broader range of cross border financial services. Cover delivery of services through internet. Permit functions such as marketing, issuing of capital as part of cross border delivery. Include the transfer and processing of financial data. Permit prudential regulation on a non discriminatory basis.
Minimum capital requirements	Reduce burdensome capital requirements	Set capital requirements on non discriminatory basis, subject to prudential regulation
Licensing and approval procedures	Alleviate the need for Australian providers to undertake the full domestic licensing process for either cross border services delivery or for services delivery in the local market	Agree to ensure licensing and approval procedures do not constitute barriers to trade Apply licensing criteria on a non discriminatory basis Commit to permit prudential regulation on a non discriminatory basis Provide for regulators of each country agree to recognize as equivalent, licenses held by the other for the purpose of offering investment and services in the domestic market. Establish a /working Group to facilitate recognition agreements among/between regulators of licensing and broader regulatory requirements. Tasked with a specific time bound mandate. Include side letters to the FTA which highlight agreement between governments on priority issues.
Restrictions on scope of service	Remove restrictions on the delivery of services in the local market, for on the type of business which can be conducted by branches, the manner and sales of insurance products, solicitation of products, and restrictions on payments.	Prohibition restrictions in the local market including the number, type or value of services or type of legal entity required, once established. Subject only to prudential regulation.
Controls on outsourcing	Remove limits on outsourcing of functions	Commit not to restrict outsourcing of core functions
Lack of procedural	Expedite processing of licenses and related authorization/approval requirements. Improve transparency	Set timelines for issuing of licenses and approvals. Require information to be public, accessible and known

transparency	of procedures including that governing retail distribution for financial investment and advice.	in advance.
Restrictions on mobility of professionals	Remove visa limits/restrictions on duration of stay and authorization requirements for professionals	Commit to permit temporary entry for insurance specialists and brokers on long and short term basis. Waive visa limits and remove prior approval requirements for senior managers. Establish a Working Group on Professional Services to facilitate recognition of Australian professional qualifications in foreign market.
Process	Provide a process for continuing liberalisation	Mandate a review of current commitments and commit to an ongoing process to improve market access Provide for regular meetings with regulators to review regulation and consider new market opening commitments.

Provisions should adopt terminology consistent with business terms and practices. This would better enable business to articulate impediments faced in foreign markets in ways which could be understood and addressed in FTAs by officials. It would also help business understand and assess the terms and scope of FTAs which are negotiated.