

Submission to Australian Financial Centre Forum

December 2008

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Submission to Australian Financial Centre Forum

1. Introduction

FICA supports the vision proposed by AFCF for Australia as a financial services centre:

The vision is of a financial services sector which is open, competitive and underpinned by strong, stable and sound institutions. It is a sector with a reputation for innovation, transparency, integrity and efficiency. It is a sector where the critical mass of skills, experience and reputation encourages national, international and regional participants to do business directly. It thus exhibits a high volume of cross border transactions in a wide variety of financial products and currencies.

It is, in short, a place where financial sector companies want and need to do business.

2. FICA Objectives

FICA members have agreed on a set of overall objectives for enhancing Australia's position as a financial services centre. These largely overlap, and are consistent with AFCF draft policy principles:

- (1) **Increased capital flows.** Attract increased capital flows into Australia.
- (2) **Competitive and transparent tax system.** Achieve a regionally competitive and transparent taxation system for the financial services industry.
- (3) **Offshore expansion.** Lower the offshore barriers and obstacles facing the Australian financial services industry.
- (4) **Integration with region.** Further integrate the Australian financial services industry with the Asia Pacific region.
- (5) **Industry regulation and structure.** Further enhance the regulatory framework and operation for all financial services participants in Australia.
- (6) **Enhanced foreign presence.** Continue to attract new entrants into the Australian financial services industry.
- (7) **Branding and positioning.** Enhance regional awareness of Australia's financial services sector, its strengths and capabilities.
- (8) **Quality workforce.** Attract and retain a high quality workforce.

3. FICA Recommendations

In order to facilitate AFCF consideration of the FICA submission, FICA recommendations are listed below by reference to both the draft AFCF policy principles and FICA's (largely equivalent) objectives (as stated above).

The AFCF draft principles have been reordered by industry priority for action.

The FICA recommendations are for priority reforms that we believe are able to be actioned in 2008/09. FICA's recommendations have very clear benefits and are focussed on the objective of developing Australia into an International Financial Services Centre.

Implementation of the recommendations will also ensure that progress towards the Australian financial services centre objective gains momentum and more widespread support from within and outside of the industry.

FICA would be pleased to discuss with Government and the AFCF, priority activities that industry could take on, as well as any assistance industry can provide towards timely implementation of the recommendations.

3.1 Principle: Liquid and diverse markets

(FICA: Increased capital flows into Australia)

Recommendation 1: Complete ASIC projects initiated in relation to enhancing capital flows into and out of Australia:

"ASIC has identified three key areas within its scope that would most contribute to increasing investment both into, and out of, Australia:

(a) maximising the use of recognition arrangements (whether unilateral, bilateral or multilateral);

(b) maximising and enhancing international cooperation arrangements; and

(c) facilitating cross-border financial services businesses (in and out of Australia)".¹

Recommendation 13 below responds to two of the three key areas identified by ASIC as within its scope to increase investment both into, and out of, Australia.

However, FICA proposes that, as part of ASIC seeking to facilitate cross-border financial services businesses, it work in close partnership with APRA, AUSTRAC, the RBA and Austrade to assist foreign entrants into the Australian market.

This assistance could take the form of an "online gateway" that streamlines and facilitates foreign entrants into the Australian market. This would provide a single point of contact and would assist them in navigating our regulatory regime and the processes involved in obtaining relevant licenses etc.

Australia's regulatory bodies could also provide a similar facilitation service to Australian enterprises by way of introductions to their counterparts in off shore jurisdictions.

In order to formalise this enhanced role, the Government could amend the respective enabling legislation of each financial regulator (e.g. Section 1(2) ASIC Act 2001, Section 8 APRA Act 1998 etc) to ensure that "facilitation of cross border activity" is a core element of their mandate.

¹ [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_134.pdf/\\$file/REP_134.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_134.pdf/$file/REP_134.pdf)

3.2 Principle: A competitive and efficient taxation system

FICA: Competitive and transparent tax system

Recommendation 2: Eliminate interest withholding tax on foreign-raised funding by Australian financial institutions, including offshore deposits.

Australia already has several exemptions from interest withholding tax, which otherwise generally applies (broadly speaking) at the rate of 10% on the gross amount of interest paid by Australian borrowers to non-resident lenders.

The main exemptions are for institutions which raise debt through the “public offer” of debentures to non-residents, for foreign superannuation funds and the more recent exemptions for financial institutions in Australia’s tax treaties negotiated since 2001. There are no exemptions currently available for deposits raised by Australian banks from offshore customers.

Because the existing exemptions are both incomplete and subject to serious constraints, they effectively deny Australian banks and other borrowers access to cost effective funding from a variety of foreign sources, most importantly wholesale funding sources which have been impacted severely by the current worldwide crisis. Extending the exemption to offshore customer deposits would have the additional benefit of diversifying the sources of funds available to Australian banks.

Since the market convention is that foreign lenders will not “absorb” Australian interest withholding tax, the existence of withholding taxes distorts the flow of funds in global capital markets and in practical terms increases the cost of funds to Australian borrowers.

Banks and other financial institutions are effectively cut off from certain pools of liquidity in global capital markets (at least when the markets are functioning normally, which is the bulk of the time) with no taxation benefit to the Government.

Under the current regime, if Australian institutions raise deposits overseas (excluding certain categories of tax exempt investors such as central banks), those deposits are subject to interest withholding tax when directly repatriated to Australia. As a result, Australian banks generally do not raise and directly repatriate deposits. Once again the Government raises nil revenue and the Australian banks are effectively cut off from these pools of liquidity. Foreign banks, including Singaporean and Hong Kong based banks, are instead able to globalise their pool of funds, to ensure better access to diversified funding sources.

Recommendation 3: Remove interest withholding tax on intra-bank funding.

Branches (permanent establishments in tax terms) are a key mode of operation for financial institutions that operate on a global basis. Australia’s tax rules for branches must be enhanced if we are to maximise our potential as an international financial centre.

If Australian foreign bank branches borrow from their overseas parent to fund their lending in Australia, they incur a 5% interest withholding tax cost. While

branches can use a s128F exemption when borrowing from third parties offshore, this relief is not available if they borrow from their parents.

Interest withholding tax on intra-bank funding inhibits regional cross-border capital flows. Using a branch in Australia to actively manage regional liquidity involves constantly moving funds into and out of Australia which is made uneconomic by interest withholding tax, thus undermining the Government objective of promoting Australia as an international financial centre. Moreover, the withholding tax creates a bias for a foreign bank to lend directly from overseas to an Australian company (free of withholding tax under a tax treaty) rather than use the Australian branch or subsidiary for this business.

These disincentives have been made worse in recent months as the global credit crisis has made it more difficult and expensive for branches to find third party credit offshore, forcing them to seek funding from their parents and pay withholding tax, creating windfall tax revenue gains.

In more normal times, branches would not generally pay interest withholding tax as they would source their funds from third parties.

Removal of interest withholding tax would improve the ability of international banks to conduct international business from Australia and improve the efficiency of tax administration for their branches here.

Recommendation 4: Remove the LIBOR cap on branch parent funding.

The Tax Act limits the tax deductibility of interest paid by a branch on funds borrowed from its parent to the London Interbank Offered Rate (LIBOR).² The asymmetric nature of the cap means that it imposes a penalty on foreign bank branches that fund from their parent even, as actual borrowing rates will fluctuate around LIBOR (which is an average rate). Foreign bank branches reduce the problem by minimising borrowing from their parent but at a cost to efficient funding.

The global credit crisis has exacerbated the problem because some branches have been forced to have recourse to parent funding and not all banks of good credit standing can fund at LIBOR given the current market stress. The LIBOR cap was adopted purely as a convenient way to administer the tax law. There is no basis to now retain this provision in the law.

Recommendation 5: Remove interest withholding tax on related party funding by financial institutions.

The adverse impact of the credit crisis has also affected Australian subsidiaries of foreign investment banks, who have found it difficult to raise funds in the Australian market. They have been forced to have greater recourse to parent funding that is subject to interest withholding tax (of 10%). Removal of the withholding tax financial institutions' related party borrowing would strengthen Australia's hand in attracting international business to Australia.

² See section 160ZZZA(1)(c) of the Income Tax Assessment Act 1936.

Recommendation 6: Introduce an 'Investment Manager Exemption' to ensure foreign source income flowing through to non-residents is not taken to be Australian source income under Australian tax law and therefore not subject to Australian tax.

Australia is out of step with most sophisticated international financial centres in terms of the treatment of foreign investors in Australian managed funds. Consequently, significant flows of capital, particularly from Asia, will continue to remain outside Australia, with a detrimental impact on employment and economic growth.

This is especially frustrating where Australian fund managers are technically considered some of the best in the world yet often end up having to go overseas to apply their expertise. Clearly this issue has become even more important given the current economic crisis.

As such, it is important that Australia provide exemptions that are at least equivalent to those offered overseas.

In this regard, the United Kingdom has an 'investment management exemption' which allows a manager acting for a non-resident to be exempt from assessment on behalf of its non-resident client, including offshore funds. The exemption was introduced to encourage non-residents to invest through British institutions.

In the US, the exemption for foreign investors trading in US stocks even where a local agent / manager is present in the US has been in place for many years.

Hong Kong has also implemented such an exemption clarifying that offshore funds with Hong Kong fund managers and investment advisors may now confidently state that they are not subject to tax in Hong Kong on profits derived in Hong Kong.

A similar exemption could be used in Australia, to address situations in which Australian and foreign source income flowing through to non-residents is taken to be Australian source income under Australian tax law because the management and control function is performed by an Australian fund manager. So doing would provide a significant boost to the export activities of the funds management industry.

Recommendation 7: Conduct a review of the Offshore Banking Unit (OBU) tax measures to modernise the system and possibly expand the range of eligible activities.

The Offshore Banking Unit (OBU) measures enacted from 1991 were part of a package of legislative reforms, introduced in stages over a number of years, which were designed to improve the competitiveness of Australian financial institutions and promote them on the world stage. With that objective in mind, the OBU measures sought to encourage financial institutions to generate larger revenues from such operations.

The financial service landscape has however undergone vast changes over the last two decades and the OBU measures have not kept pace. There are rigidities and limitations in application, and complexities in design and drafting which increase the risk of very adverse outcomes for taxpayers who err in implementing OBU structures.

Recommendation 8:

Managed funds should be exempt from the application of the FIF rules where:

- (a) Registered Managed Investment Schemes or a unit trust, all of the units of which are held by Managed Investment Schemes and/or complying superannuation funds;
- (b) Such funds would be required to satisfy a widely held test (as per s 12-395 of the Taxation Administration Act 1953);
- (c) For investments in entities resident in jurisdictions with which Australia has entered into a Double Tax Agreement; or
- (d) The offshore vehicle distributes a large proportion of its income.

Additionally:

- (e) The current exemptions available to AFI subsidiaries undertaking financial intermediary business must be retained. Further, the current treatment in respect of listed country CFCs should also be maintained;
- (f) Investments in legitimate offshore business activities should not be penalised;
- (g) The definition of "financial intermediary business" should be updated to take into account activities ordinarily carried on by financial intermediaries including banking, equity financing, and leasing activities and hedging of these activities.
- (h) There should be an exemption for public companies (and their subsidiaries) from the measures provided that the exemption can be developed in a manner which is not overly onerous for taxpayers.

We understand that the Board of Tax has finalised its Report into the Foreign Source Income Anti-Tax-Deferral Regimes and that it is currently being considered by Government.

As you will be aware, a number of FICA members lodged submissions with the Board of Taxation, including the ABA and IFSA. These submissions proposed a series of amendments which, if implemented, would considerably reduce the compliance burden on the industry without giving rise to significant risks to the Revenue.

These are longstanding issues which have been identified by industry over many years.

FICA believes that the above changes to Anti-Tax-Deferral measures are capable of being implemented in the short term. Importantly, implementing the suggested amendments would provide a significant impetus to the AFCF agenda.

Recommendation 9: Introduce GST-free treatment of B2B financial supplies.

The GST treatment of financial services has always presented a challenge, but when introduced in 2000 Australia's approach was equal to or better than comparable GST/VAT jurisdictions. Since that time, there has been much debate, and the general consensus is that zero-rating of B2B financial services is the most effective approach to address the inefficiencies of input taxation.

The Australian approach is now inferior, particularly compared to approaches taken by GST jurisdictions in our local region. If Australia's financial system is to remain competitive in our region, close consideration needs to be given to the introduction of zero-rating of financial services. Zero-rating eliminates the comparative advantage that offshore providers of financial services have because their services do not contain embedded GST costs.

3.3 Principle: Access to offshore market opportunities

FICA: Offshore expansion

FICA: Integration with region

Recommendation 10: As part of responding to the Mortimer Review and the Tax Treaties Review, the Government to announce that it will attempt to deal with tax treaty negotiations concurrently with regulatory recognition and trade negotiations, and ensure that financial services chapters are inserted or reviewed in all treaties.

Industry believes that there would be clear benefits in tax treaty and regulatory recognition negotiations forming part of broader trade negotiations. This approach would facilitate improved trade outcomes through more closely aligning trade priorities with tax treaty and regulatory recognition negotiation outcomes.

Such an approach would also allow for tax treaties to be reviewed at the same time an FTA is being reviewed.

It is important to recognise that even the most successful trade negotiations which liberalise financial services trade between two countries can turn out to be ineffectual as a result of undesirable tax outcomes that act as a barrier to the liberalisation otherwise achieved.

Recommendation 11: Schedule Prime Minister's road show to Asia for 2009, complete the necessary planning and implement.

Industry will work with Austrade and other agencies on analysis of key barriers and opportunities in Asia, by target market. Industry's submission to the AFCF in March will seek to highlight the key barriers and opportunities in the region.

This work will inform the planning of the road show by the Prime Minister mooted earlier this year.

Recommendation 12: Government to contact the Japanese Prime Minister and offer to host the first 'Financial Services Dialogue', to be held in 2009, between financial regulatory authorities and industry participants from both countries.

Implementation of this recommendation will deliver on the two Prime Ministers' commitments as announced in June 2008 and will also serve to promote and build on recent outcomes from the G20 meeting.

3.4 Principle: A best practice regulatory framework ...(and) A consistent, predictable policy framework

FICA: Industry regulation and structure

Recommendation 13: As part of responding to the ASIC/Treasury consultation paper 'Cross border recognition: Facilitating access to overseas markets and financial services', the Government to announce:

(a) Mutual recognition arrangements with jurisdictions who have previously been granted unilateral regulatory relief by ASIC will be pursued as a priority.

(b) That it will develop a forward program covering priority jurisdictions, as agreed with industry, with which regulatory recognition agreements will be pursued.

(c) That the Council of Financial Regulators charter is expanded to include review of any new market access regulation to ensure competitive neutrality.

Recommendation 14: Streamline the takeover requirements of the Corporations Act & Foreign Acquisitions and Takeover Act

The current volatility in financial markets highlights the importance of attracting stable, long term investment capital into domestic equity markets. FICA wishes to ensure that Australia's regulatory regime does not impose inappropriate barriers to domestic or foreign equity investment from such investors.

The current regulatory arrangements that affect foreign and domestic acquisitions of Australian equities need to be reviewed to address any inefficiencies that arise, particularly for managers of collective investment pools.

At present, neither the Corporations Act nor the FATA allow for the disaggregation of interests held in a fiduciary capacity on behalf of passive investors.

As a result, the current provisions in the Corporations Act, coupled with the growth in the Australian managed funds market, have made it increasingly difficult for Australian entities to stay below the existing 20% takeover threshold, and unduly limit investment opportunities in Australian companies.

Australia, with a takeover threshold of 20%, is already out of step with jurisdictions such as the USA, United Kingdom, Canada, Hong Kong and Singapore where the threshold is 30%. Additionally, while there are differences in the takeover laws of the respective jurisdictions, each of these also permit disaggregation of holdings in specified circumstances.

As a result of our lower takeover threshold and lack of aggregation relief, fund managers and others investing in the Australian market face investment restrictions which do not apply in other jurisdictions. This issue is compounded in the case of foreign institutional investors seeking to invest in Australian listed equities where the limit is effectively 15% under the FATA.

Recommendation 15: In relation to financial services, that the Commonwealth government continue its work to eliminate unnecessary regulation and ensure that efficiency is given appropriate emphasis by financial regulators.

FICA appreciates the Government's ongoing efforts to eliminate unnecessary regulation and to make the regulatory burden commensurate with the public benefit to be gained. In this regard, the large effort being made to achieve a national consumer credit regime under Commonwealth responsibility is welcome. FICA would draw attention that significant benefits would be gained from rationalisation of other areas of dual Commonwealth/State jurisdiction. An example is general insurance where only recently an opportunity was missed to establish a national Financial Claims Scheme covering State-mandated insurance products.

FICA acknowledges that in fulfilling their responsibilities financial regulators must give due attention to stability of the Australian financial system and the welfare of Australian consumers. However, the current turmoil in international financial markets, should not lead regulators to neglect the importance of efficiency as a factor in how they undertake their regulatory role. Unnecessarily onerous regulation increases the cost of financial services in Australia to the detriment of the economy as a whole and in particular, puts Australian financial services providers at a competitive disadvantage to their foreign competitors.

3.5 Principle: An open, competitive financial system

FICA: Enhanced foreign presence

Recommendation 16: Industry to prepare a submission on key barriers to entry by foreign institutions (whose presence would assist in building Australia as an international financial services centre).

3.6 Principle: A reputation for integrity and transparency

FICA: Branding and positioning

Recommendation 17: Government to announce its support for the development of a consistent brand and strategy to promote Australia's financial services industry off-shore, with appropriate resources to be provided to Austrade as the lead agency, working in conjunction with industry.

A key element of developing a consistent brand is recognising the breadth, quality, size and efficiency of the Australian financial services system - from major financial institutions and niche players through to our unique distribution system which is seen as having a high degree of professionalism versus alternative models off-shore.

Australia has been through a rigorous evolution of regulation and professionalism and has developed the necessary knowledge, skills and capacities both in terms of soft capability and systems and infrastructure to provide input to external markets and develop a strong export market in this space.

On 3 December, the Finance Industry Council of Australia (FICA) hosted a 'Branding Roundtable' that brought together industry experts, Government and

promotional agencies to focus on the development of a consistent brand and strategy to promote Australia's financial services industry off-shore.

At a high level, it was agreed that the development of a consistent brand and promotional strategy for the Australian financial services industry could result in:

- (1) Increasing the level of regional awareness of the Australian financial services industry, its strengths and capabilities.
- (2) Attracting increased capital flows into Australia.
- (3) Lowering off-shore barriers and obstacles facing the Australian financial services industry.
- (4) Attracting new entrants to the Australian market.

Recommendation 18: Appropriate additional resourcing to be provided to Austrade through the 2009 Budget process to ensure they are able to effectively assist the financial services industry, including in respect of Recommendations 16 and 17 of this submission.

Austrade is a key Agency in the further development of Australia as an international financial centre. In order to more effectively facilitate cross-border financial services activity, Austrade will require designated in-country financial services resources in key markets. The industry's previous experience with delegations and country missions has been very positive and Austrade's assistance has been essential in ensuring the success of these missions.

Going forward however, in order to build on these missions and to enable more and deeper market intelligence to be actively shared between industry and Austrade, a greater level of financial services experience and expertise will be required within Austrade. Such expertise will also be of great use in providing practical input into relevant FTA and multilateral trade negotiations.

3.7 Principle: A highly skilled and innovative workforce, supported by a world class education and training system

FICA: Quality workforce

Recommendation 19: Establish a joint industry/Government taskforce to support industry programs in the following key priority areas, and identify education and training system needs.

- (a) Maximise future potential of current workforce (**increase productivity and retain**). This will need to consider remuneration and incentives in the economic and regulatory climate anticipated over the next two years, and retention strategies for specific segments including younger employees and mature age workers.
- (b) Strengthen sector capacity to attract talent from breadth and depth of full labour market (**attract**)
- (c) Increase the capacity of the sector to measure and monitor human capital risks and opportunities (**review and adjust**)
- (d) Drive sector-wide collaboration to address risks (**collaborate**)

Government and industry should also focus on promoting the quality of professionalism in the industry in terms of competence, experience and ethics.

Australia has a number of strengths on which it can base the promotion of its financial services, not least the quality of the people, experience of markets and products and expertise in systems and infrastructure.

Recommendation 20: Expedite the issue and renewal of 457 visas for skilled foreign workers in financial services for trusted sponsors.

While the 457 visa program is generally functional, it can be slow and frustrating to navigate. The efficient streamlining of visa approval processes for finance professionals, including dedicated Immigration Department relationship managers, is needed if financial institutions are to be able to transfer staff relatively easily and quickly to Australia as part of their global operations. . More work is also needed on cross-border recognition of qualifications at the industry level

This will make it easier for Australian and overseas financial institutions to operate in the Australian financial services market and make it more likely those financial institutions will create and expand their presence here.

Appendix: Summary of Recommendations

Summary of FICA Recommendations

Recommendation 1: Complete ASIC projects initiated in relation to enhancing capital flows into and out of Australia:

"ASIC has identified three key areas within its scope that would most contribute to increasing investment both into, and out of, Australia:

(a) maximising the use of recognition arrangements (whether unilateral, bilateral or multilateral);

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³ [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_134.pdf/\\$file/REP_134.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_134.pdf/$file/REP_134.pdf)

Additionally:

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(f) Investments in legitimate offshore business activities should not be penalised;

(g) The definition of "financial intermediary business" should be updated to take into account activities ordinarily carried on by financial intermediaries including banking, equity financing, and leasing activities and hedging of these activities.

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(a) Maximise future potential of current workforce (**increase productivity and retain**). This will need to consider remuneration and incentives in the economic and regulatory climate anticipated over the next two years, and retention strategies for specific segments including younger employees and mature age workers.

(b) Strengthen sector capacity to attract talent from breadth and depth of full labour market (**attract**)

(c) Increase the capacity of the sector to measure and monitor human capital risks and opportunities (**review and adjust**)

(d) Drive sector-wide collaboration to address risks (**collaborate**)

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