7 March 2017

FSC FOREIGN POLICY WHITE PAPER SUBMISSION

Public Consultations Team
White Paper Task Force
Department of Foreign Affairs and Trade
Barton ACT 0221
Australia

BY EMAIL: whitepaper@dfat.gov.au

Dear White Paper Team,

The Financial Services Council welcomes the opportunity to make a submission to the Foreign Policy White Paper to assist the Government in setting out Australia's international engagement, trade and foreign policy over the next decade.

The Financial Services Council (FSC) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 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 fourth 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.

The FSC is a strong supporter of Australia's foreign and trade policy and we believe in open markets for a prosperous economy. Please find our detailed submission below.

Should you wish to discuss this submission further please do not hesitate to contact me on (02) 9299 3022.

Yours sincerely,

Sara Dix
Policy Manager, Investment and Global Markets

FOREIGN POLICY WHITE PAPER SUBMISSION

INTRODUCTION

The international focus for the financial services industry over the next decade is undoubtedly centred in Asia. As our nearest neighbours, and also a region of rapidly increasing middle class as well as an ageing population, this is where our opportunity lies. It is estimated by 2030 there will be 3 billion people in the middle class in Asia.

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

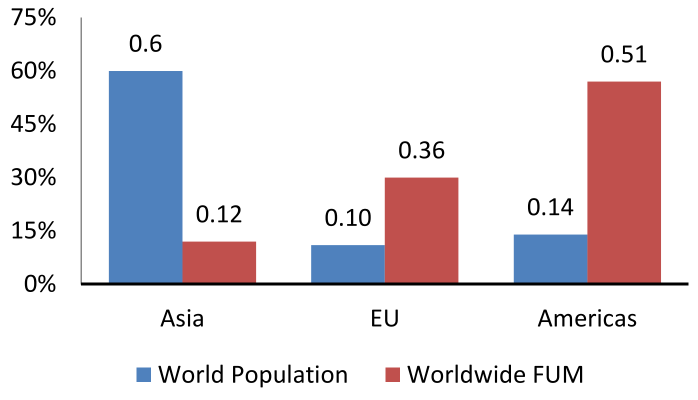
- Asia's middle class is growing quickly – this will drive demand for funds management as investors look for opportunities to invest and grow wealth;
- Asia's population is ageing rapidly – hence a need for pension and retirement savings products; and
- many countries in the region do not yet have compulsory 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 worldwide FUM, despite Asia's population sitting at 4.165 billion or 60 per cent of world's population.

By comparison, the US manages 51 per cent of worldwide FUM but only accounts for 14 per cent of the world's population. Thirty six per cent of the world's FUM is managed out of Europe yet it accounts for only 10 per cent of world population (Chart 1).[1]

As such, the Asia region provides a significant opportunity for Australian fund managers.

Chart 1: Population and Funds under Management – Asia, Europe and the Americas[2]



The September2015 APEC Finance Ministers' meeting in the Philippines was a key milestone in developing both Australia as an exporter of financial services and moving towards liberalised trade of investment funds in the Asian region.

[1] Population source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: The 2012 Revision, http://esa.un.org/unpd/wpp/Excel-Data/population.htm FUM source: ICI worldwide Mutual Fund Market Data Q1 2013: http://www.iciglobal.org/iciglobal/stats/worldwide

[2] Source as per footnote 6

We believe that having the Asia Region Funds Passport in place is the beginning of an important journey towards integration for Australia and our region.

The $2.6 trillion Australian investment management industry stands to strongly benefit from the Asian regional financial architecture. We have the third largest investment management sector globally, but have been unable to export our expertise in this vital sector of the services economy.

The economic benefits of increasing funds management exports are large. According to Deloitte Access Economics[3], if Australia increased funds management exports to the level of Hong Kong (i.e. 60% of funds under management is exported), this would:

- Increase GDP by $4.22 billion;
- Increase tax revenue by $1.25 billion; and
- Create almost 10,000 jobs (FTE).

This is a lost opportunity for Australia

The FSC strongly supports Australia's free trade agreements with our Asian neighbour countries, as well as important multilateral and regional agreements such as RCEP. These will position us for the massive economic growth expected in Asia over the next decade. We also need to be able to capitalise on these agreements through mutual recognition agreements and tax treaties, which we will outline further below.

The Foreign Policy White Paper will be an important policy document for Australia's trade, international relations and engagement over the next ten years and provides a real opportunity for us to capitalise on the opportunities at our doorstep. We support regional financial integration and the continuation of Australia's work on trade negotiations. We need to take this a step further with implementation of the financial services commitments of these agreements to ensure Australia's industries are able to capitalise on the opportunities.

TRADE POLICY

The FSC supports open markets, globalisation and regional integration. We are often a voice on financial services trade policy and support DFATs work in this space. Australia's market is largely open – for both goods and services. For financial services, this means our legislation and regulation allow foreign firms to compete in our market with low barriers to entry. This can only be a good thing for consumers and the competitiveness of our market. Unfortunately, we do not experience the same level of openness in our trading partners.

We would encourage Australia's foreign and trade policy to include frequent discussions on openness, equivalency and mutual recognition with our neighbour countries. For financial services, it is imperative that ASIC and Treasury have a mandate for international competitiveness issues and are actively working on implementing Australia's trade policy.

Our regulatory and tax settings must also take into account international competitiveness issues in order for Australian firms to be able to compete. This is included in the 'beyond the barrier' issues, once market access has been achieved.

Another element to this is following the model in the United States, whereby the financial services industry is involved in confidential discussions during the trade negotiation process. This would

---

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

ensure Australia's commitments, negotiations and language included in the FTA are all beneficial to the industry.

Barriers to trade

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.

As Australia's largest industry, financial services should be the top priority. There is much to gain from increased trade – the North Asian FTAs provide a great opportunity to capitalise on our comparative advantage.

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.*[4]

This reform agenda includes:

1. Competitive taxation rates (including withholding tax for foreign investors);
2. Introduction of a Collective Investment Vehicle (CIV) regime consisting of a broader range of CIVs (which the Government has now committed to);
3. Tax certainty for offshore investors including introduction of an Investment Manager Regime (IMR), implemented by government in 2015; and
4. The correct architecture in place (through the Asia Region Funds Passport, Free Trade Agreements or Mutual Recognition).

Despite these reviews and recommendations, the reform agenda has not yet been fully 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. As discussed above, we strongly encourage ASIC and Treasury to be involved in Australia's trade policy and implementation following agreement of free-trade agreements. This includes negotiating mutual recognition agreements with regulators in our region and develop or update tax treaties with our major trading partners.

We commend DFAT for opening a mutual recognition unit – this will go a long way in allowing financial services to capitalise on Australia's free trade agreements.

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

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

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. Proposed agreements with the EU and UK.
- 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 – despite its future now remaining uncertain.

The FTAs 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, as discussed above.

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.

We recommend that future FTAs include a commitment on regulators pursuing mutual recognition arrangements (ChAFTA), including a 'most-favoured nation' clause where possible, committing to more frequent and binding financial services committees and commitment or adjacent negotiation of a tax treaty.

Key principles and negotiating goals are outlined below.

Negotiating goals

Future FTAs should improve on outcomes in existing FTAs and reduce barriers to financial services, and in particular 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 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.

Regulatory harmonisation – financial services committees

We support the architecture under free trade agreements to develop a financial services committee. The purpose of this committee is twofold.

The first is to discuss interpretation and practicalities of enacting the FTA in the market.

This would be able to settle disputes, improve the agreement over time (e.g. with an MFN clause) and iron out practical issues for businesses wanting to utilise the agreements.

Two, the architecture is needed to be able to implement the agreement for financial services. The FTA will get Australian firms access to the market but the beyond the border constraints often hold them back. The largest of these is licencing approvals.

We are primarily interested in the second point.

In theory, the FTA gives Australia preferential access and non-discrimination for the foreign regulator to approve a licence as would be given to a domestic firm ('national treatment'). As we know, this doesn't always work in practice.

In fact we would like to go beyond this to licencing equivalency whereby an Australian firm with an approved Australian Financial Services Licence (AFSL) does not need to seek further approvals from the foreign regulator. The Asia Region Funds Passport forms a basis for determining a mechanism by which to create such regulatory equivalence.

ASIC should be involved in a working group or committee with foreign regulators to be able to negotiate this. The group could also discuss and move towards regulatory harmonisation.

Finally, to realise commitments for services, we rely on regulatory agreements or licensing.

For example, in financial services, it involves the foreign and Australian securities regulators creating a framework for mutual recognition, issuing class order relief and a regulatory guide for financial services licensees.

There is no point having services commitments unless they are properly implemented. Our thinking must therefore start with implementation.

Other beyond the border constraints include:

- Structure of Australian entities: e.g. the Responsible Entity model not recognised overseas;
- Australian unit trusts not widely recognized (barrier for regulators to approve);
- Foreign direct investment caps;
- Capital requirements;
- Prudential regulations and investor protection;
- Commercial presence requirements/cross border access;
- Distribution access to advisors, platforms, consumers;
- Requirement to partner with a local institution;
- Joint Venture and Branching restrictions;
- Stock market restrictions.

These types of restrictions should be discussed between regulators with a view to trade facilitation and harmonisation.

Including regulators in financial services trade policy should be a key feature going forward – with a focus on implementation.

WHOLE OF GOVERNMENT COORDINATION IN TRADE PROCESS

Australia's trade coordination process has also been a key factor as to why the financial services industry has been unable to fully utilise the excellent commitment in Australia's FTAs.

Australia's regulatory and international relations process is governed by several government bodies – Treasury (Asia Region Funds 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.

A key piece of the puzzle for the financial services industry is involvement of the regulators as discussed above. In particular, the regulators need to be more involved in the process to assist in negotiation, enable implementation and consequently the development of mutual recognition arrangements.

A key issue is that Australian regulators do not have mandates for considering international competitiveness and trade issues. They have also not been involved in the FTA process which has hampered usefulness for the financial services industry.

Australian regulators also often have different approaches to regulation than our Asian neighbours. 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'[5].

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. 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 '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.

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. We note that this should be a priority for DFAT's mutual recognition team.

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.

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

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*[6]*.*

Accordingly, we welcome the Memorandum of Understanding that ASIC signed with the Korean FSS on 11 February 2015 and the commitment for mutual recognition under ChAFTA.

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. The Asia Region Funds Passport will provide an ideal base from which this roadmap could be developed. This multilateral mutual recognition agreement will apply to fund products meeting set criteria. The eligibility of fund operators has been agreed and will be based on experience and other clearly defined parameters. A similar set of rules could be agreed between regulators on a bilateral basis using provisions of the FTA as a basis.

RECOMMENDATIONS

- Focus Australia's international and trade policy over the next decade within our region, where huge opportunities exist for the Australian financial services industry.
- Ensure cooperation between regulators occurs with the aim of promoting international competitiveness as a factor for decision making.
- ASIC should appoint a commissioner to lead international trade and competitiveness.
- ASIC and Treasury should work with DFAT in negotiations of financial services sections of free trade agreements and subsequently negotiate mutual recognition with regulators in our region.
    - A roadmap should be developed on how market access (through licensing and mutual recognition) will be facilitated by the regulators.
- DFAT should consult with industry through confidential discussions in the trade negotiation process (similar to the process in the USA).
- Support regional financial integration (including through expanding the Asia Region Funds Passport) and progress associated domestic policies and regulation.

[6] Johnson Review 2009, page 121

- Seek to harmonise and pursue competitive regulation and tax policy settings to enable Australia to compete in our region. Take a long term tax focus.
- FTA Process:
    - Ensure more frequent and binding financial services committee meetings following negotiation of an FTA – and include ASIC and Treasury in this process.
    - Negotiate or update a tax treaty with every country we have an FTA with.
    - Negotiate a commitment to pursue mutual recognition of financial services between regulators.
    - Consider FSCs template for negotiation of FTAs in Appendix A.

APPENDIX A: 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: 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 transparency	Expedite processing of licenses and related authorization/approval requirements. Improve transparency of procedures including that governing retail distribution for financial investment and advice.	Set timelines for issuing of licenses and approvals. Require information to be public, accessible and known 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.