Financial Services Industry Committee
AustCham Shanghai

Australian Financial Services Business in China

AustCham Shanghai
2016 White Paper

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About
AustCham Shanghai

The Australian Chamber of Commerce in Shanghai (AustCham Shanghai) was founded in 1994 and works on behalf of more than 400 businesses. The Chamber strengthens Australia-China business, government and community relationships and promotes Australia as a creative and reliable provider of innovative, high quality business solutions.

About
AustCham Shanghai Financial Services Industry Committee

AustCham Shanghai Financial Services Industry Committee is at the forefront in developing agreed positions on China's financial sector regulatory framework. It uses this as the basis for lobbying regulators to effect improvements and works to promote the strengths of Australia's financial services sector and regulatory system.

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Welcome Message

Welcome to the 2016 White Paper on Australian financial services business in China, the third report prepared by the Australian Chamber of Commerce in China. Preparing a whitepaper is a good analogy for China in general. Some parts of the financial industry in China are progressing at blistering speed like the Shanghai Maglev whilst other elements and systems seem not to notice the effects of time. There is a big challenge in keeping this whitepaper up to date with the rapid changes taking place. This does not however mitigate its purpose of pointing out the elements that remain unchanging and unreformed and the large benefits that can be achieved for China and it its citizens by making change.

Since the publication of AustCham's previous White Paper relating to Australian Financial Services Business in China in 2012, we have seen significant development in China's financial markets and the associated regulatory environment. In the last year or so, China is continuing on the path of financial sector reform and 'opening up' as part of the broader macroeconomic agenda of a shift away from investment-led growth, to a more sustainable domestic consumption-led growth. These changes will have significant implications for Australia, the Asian region and indeed globally.

Establishment of the Shanghai pilot free trade zone in 2013 and the subsequent establishment of similar zones in Guangdong, Tianjin and Fujian in 2015 and expansion of the Shanghai pilot free trade zone to encompass three additional districts - significantly including Shanghai's established 'financial district' Lujiazui, has seen heightened focus from financial services providers and investors alike, with the heralded reforms some of the most significant financial reforms in China's history: liberalisation of deposit interest rates; liberalisation of China's currency, the renminbi and liberalisation of China's capital account. Much has been achieved and the pace of change and progress made has been quite extraordinary, but of course opportunity for further enhancements remains.

Australian investment and participation in Chinese financial markets continues to grow, with a number of new entrants across a range of different segments of the market. AustCham member feedback has continued to highlight a positive bias to continued investment in China and a desire to participate in a well regulated, transparent, open and efficient financial services sector.

It is in that context that AustCham has produced this paper, with a number of suggested recommendations for further enhancement of the system.

Since 1978 China has achieved vast strides in its economy and in securing an improved standard of living for its people. China has achieved this through an open-door policy and by allowing the private sector to innovate better and through the development of more efficient products and solutions for its citizens. This whitepaper hopes, in its own small way, to help China along this path. The paper has been prepared with the intention of informing discussion between Chinese and Australian policy makers and regulators and market participants, with a view to improving and streamlining the system for the benefit of customers and participants.

We look forward to continuing to support these developments through an active dialogue with relevant authorities and regulatory bodies about the topics raised over the course of the coming months.

Danny Armstrong
Chairman
Financial Services Industry Committee
AustCham Shanghai

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A.China's Remarkable Progress and Change

AustCham last produced a White Paper on the Chinese Financial Services Sector in 2012. Much has happened since then, with very significant changes in the development of Chinese financial markets, regulations and, of course, the China-Australia Free Trade Agreement (ChAFTA).

Many countries have gone through periods of financial market reform, but no country has ever done or attempted it on the scale which China is now doing. So far, the results have been impressive.

This White Paper has been produced with the aim of encouraging, and assisting where possible, the continuation of the positive changes that we all have recently witnessed. It is in this spirit that AustCham Shanghai puts forward a number of general and specific suggestions and recommendations.

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B. High Level Suggestions and Recommendations

(1) Liberalization and Regulation

China has used a wide array of market instruments and direct administrative measures over recent years to prevent any financial market volatility impacting on the wider economy. And, it has used the Shanghai FTZ to test various financial liberalization measures.

However, AustCham Shanghai believes that the present system of gradual reform has now, in part, itself become a source of financial instability.

The present system is very complex and in places quite contradictory – and not all regulators fully understand what other regulators are doing or even can do. Even the most talented and experienced Chinese financial market regulators will have difficulty comprehending in advance the wider system impact of changes in individual measures and these impacts may well be negative.

AustCham also suggests that the present complex system has itself resulted in very significant misallocation of resources, which has been particularly costly for China.

For example, controls over bank interest rates and the returns that depositors obtain contributed to the growth of other less regulated financial intermediary organizations and instruments. Some undesirable consequences of this include excess investment in real-estate, and the encouragement of undesirable speculation in the share market. At the same time, the large banks which dominate the market have had little incentive to lend to the SME sector.

At the very least the present complex system should be simplified by eliminating unnecessary regulations and administration. Examples of such unnecessary "red-tape" are given later in this report.

Ideally, the basis of the system should be changed by making it more broadly principles orientated. That is, the regulatory system should be based on a system of market orientated principles backed-up in certain areas – where necessary -- by direct administrative measures. Examples of this as it relates to particular financial sectors (such as banking, insurance etc.) are given later part in this White Paper.

In making this suggestion, we are not advocating that the Chinese financial system should be a mirror image of that in any other country. As the GFC illustrated, no financial system is perfect or immune from crisis. And the Chinese system, given its huge scale and speed of development, is very likely to need specific aspects not found in other countries.

Nevertheless, any large financial system (and, indeed any large economic system) based on controls can only achieve so much before the sheer weight of its complexity makes direct administration counter-productive.

Finally, we suggest that the reform process would in the future run more smoothly if the various financial regulatory bodies engage more fully with foreign entities (which have enormous international experience) when designing new laws and regulations and setting time frames for their introduction. For example, the confusion surrounding the introduction of VAT on financial services could have been avoided with a more consultative approach.

(2) The Australian Experience with Liberalization

Australia has developed a perhaps surprisingly good financial system for an economy of its size and distance from major world markets and international trade routes.

While debate and disagreements about liberalization and the nature of regulation in Australia over the last few decades have often been quite strong, these debates and disagreements have been related to a consultation process that has generally led to good outcomes. That is, while there have been some unexpected and unwelcome results, the often time and energy consuming consultation processes have had a net positive effect.

This, together with the combination of generally competent regulators and a well-structured regulatory system (see next section) which suits Australian circumstances, has enabled the financial system to avoid the shocks recently evident in many other countries.

Some commentators have argued that the Chinese use of a civil-law system rather than a common-law system (such as in English speaking countries where most major international financial centers are located) will impede the international competitiveness of the Chinese financial services sector.

In general, civil-law tends to be more prescriptive (with specific established "rules") than common-law which allows more room for judges to effectively define legal details during cases before them (based on broader "principles" established in the laws passed by legislatures).

A "rule" based" system in markets aims to improve the predictability by stating in advance and in detail what can and what cannot be done, whereas a "principle" based system aims to give greater freedom to market participants by laying down key principles and demanding that those principles be observed. The "principle" based system, it is sometimes claimed, gives greater scope for market participants to innovate and introduce new products because what "can" be done has not been already specified in specific "rules".

While AustCham believes that there is some truth to the above observations, it also notes that when it comes to business and financial issues (rather than more general issues of life), many of the laws in common-law countries (such as Australia) are written in a prescriptive detailed way much like those in civil-law countries. However, even when this occurs, the focus is generally on preventing bad outcomes than in promoting highly defined good outcomes which leave little or no scope for financial market innovation.

The real issue for China, as in other civil-law countries, is to write and apply, where possible, financial sector laws in a way that seeks principles-based outcomes rather than strict adherence to specific regulatory inputs.

Such laws and regulations should also be written in a way to ensure they are not excessively inwardly-focussed, so making it difficult for foreigners to compete and tending to stifle innovation.

(3) Regulatory Bodies: the Australian Approach

Very few analysts doubt that competent regulatory officials working in well-structured regulatory bodies are necessary for an effective financial system in an advanced economy.

Competent regulatory officials may be the single most important criteria for a well-functioning financial system. Regulatory bodies need to pay remuneration that attracts appropriate talent. While bearing in mind that the personal qualities that make a good regular are not always the same qualities that make people adept at working in the private sector, it is essential that people in any regulatory body be able to communicate with people in other regulatory bodies (to avoid a silo effect) and with people in the markets.

But what are "well-structured regulatory bodies"?

Over the last few decades some countries (such as the UK) have experimented with a number of regulatory frameworks, while others (such as Australia) have had relatively few changes.

AustCham believes that there is no regulatory system that will work best in all circumstances, but notes the general success of the Australian approach which is that each regulatory agency has a clear separate mission and a policy tool to achieve that goal. The result is maximum regulatory focus.

In Australia, there are four distinct regulatory tasks allocated to the Reserve Bank of Australia or RBA (monetary policy, systemic stability), the Australian Prudential and Regulatory Authority or APRA (prudential regulation of deposit taking institutions, life and general insurance companies, superannuation/pension funds), the Australian Securities and Investment Commission or ASIC (market integrity, consumer protection, corporations law), and the Australian Competition and Consumer Commission or ACCC (which has a general responsibility for overall competition and significant mergers etc in the whole Australian economy, including financial organizations).

There is also a Council of Financial Regulators (CFR) which is the coordinating body for Australia's main financial regulatory agencies. The CFR is chaired by the RBA, and also includes APRA, ASIC and "The Treasury" (broadly, the Australian equivalent of the Chinese Ministry of Finance with some aspects of the National Development Reform Commission). Generally, there is no need for ACCC involvement in this body.

The CFR generally meets quarterly, and operates as a high-level forum for cooperation and collaboration among its members. It is non-statutory and has no legal functions or powers separate from those of its individual member agencies.

The role of the CFR is to contribute to the efficiency and effectiveness of financial regulation and to promote stability of the Australian financial system. This is achieved by the members sharing information and views on financial sector conditions and risks, discussing regulatory reforms and, if the need arises, coordinating responses to potential threats to financial stability.

China is on a steep learning-curve when it comes to good public administration in the financial sector, but AustCham believes that it had made remarkable progress in many areas. Some areas of financial regulation in China are better than others, and this is no surprise in a country of this size and complexity.

While China needs to keep working to improve general national regulation standards, AustCham believes that this will be facilitated by a concerted effort to reduce the sheer amount of detailed regulation and allow the regulators to focus their attentions on the most important issues.

(4) Information

There are three main areas where AustCham Shanghai believes better information would greatly assist the development and international competitiveness of the Chinese financial services sector – and the economy as a whole.

China's data on the level and composition of economic activity is not regarded by the outside world as highly

reliable. The more accurate the economic data and the more timely its release, the less likely it is to cause surprise and consequently volatility in financial markets and the more effectively the markets can engage in efficient resource allocation in the economy. The National Bureau of Statistics should continue its welcome efforts to improve the accuracy of Chinese economic data.

Central banks, budgetary authorities (as well as other authorities) in advanced economies do not always find it easy to communicate with financial markets in a way that is beneficial. Financial markets are not always rational and have a tendency to overshoot not only when economic data springs a surprise, but also when economic policy makers surprise with unexpected statements. Of course, macro-economic policy making is as much an art as a science and policy makers also need to respond to unexpected events (in economic data or otherwise), but clear enunciation of medium-term policy intent is on balance considered a positive in financial markets. This is particularly the case with monetary policy.

The internet is the gateway to international finance. Without secure and quick access to foreign markets and information many financial service providers, such as foreign fund (asset/wealth) managers, take unusually large risks if they set up operations in China. This issue here is not so much about the range of internet sites, but the speed and reliability of the internet that is generally available. Fund managers report that on occasion many overseas online trading platforms accessed from China via the internet are so slow as to be unusable. If market conditions suddenly change and transactions cannot be executed to protect the value of the fund, then large losses may result and this then results in client departures. These risks do not exist in other trading centers in Hong Kong, Singapore, Sydney, London or New York. If China wants Shanghai to be a global financial center then it needs to be more open to the world.

(5) RMB Internationalization

While economists are generally in favor of market determination of interest rates, the reality is that central banks do have views on what those rates should be and do act to influence some of these rates (generally at the very short-end of the yield curve) when setting monetary policy.

Likewise, central banks (and other authorities) do have views on what are appropriate exchange rates at any time, and do take action to at least limit excess volatility. The problem that they face is that (as with interest rates) it is difficult to exactly know what is appropriate. And, of course, both interest rates and exchange rates have an effect on each other.

AustCham understands China's cautious approach to liberalizing the capital account and allowing the market to play a greater role in determining the exchange rate, but also welcomes the recently announced moves to achieve this. However, this path is not without difficulties for China.

Firstly, some people will tend to see movements in partly-regulated exchange rates as efforts to influence international trade competitiveness and capital flow. And, indeed, this is sometimes the case with countries that in theory have a completely market determined foreign exchange rate. However, it is important that any such beliefs do not mutate into competitive devaluations in order to boost domestic economic activity.

Secondly, complete liberalization of the Chinese capital account may lead to massive international capital flows that result in very undesirable effects on the exchange rate and domestic interest rates. The Chinese authorities would be best equipped to deal with such possible events if China's debt markets (both at the short and long ends of the yield curve) were more developed.

(6) Free Trade Zones

The Shanghai Free Trade Zone (FTZ), formally established in late 2013, has proved to be a useful testing ground for financial reforms, including market setting of interest rates, cross-border RMB transactions and capital account convertibility. And the additional three FTZs more recently established may also, at least in part, play a similar role.

However, announced Shanghai FTZ reforms often failed to be implemented in a meaningful and timely way. Often, it seems, the announcement is followed by a prolonged period of finalizing details and various regulatory adjustments. AustCham understands that the process of financial reform is difficult, and involves new ideas and processes for many officials, but believes that some of these difficulties could be resolved by involving experienced foreign institutions in a more inclusive consultation process.

There is no doubt FTZs will continue to be a useful testing grounds. The remainder of this document makes recommendations that could be implemented in the FTZs – particularly in Shanghai -- without too much trouble if they are not deemed suitable for all of Mainland China. Having said this, it would be a pity if the relative ease of undertaking reforms in FTZs became an excuse for lack of reforms outside these areas.

C.Issues Concerning More Than One Type of Service Provider

(1) Head Offices

Observation:

Foreign financial institutions wishing to provide diverse financial services in China often find themselves needing multiple "head offices" to satisfy regulatory requirements. For example, an insurance company and a bank may both be 100% owned by one legal entity in their home market and controlled by one group. However, two separated "head-offices" will be needed in China (one for insurance, and one for banking). The same need for multiple "head-offices" occurs if the foreign financial institution has a mixture of banking activities in China. "Head-office" resources (people, support functions and business platforms) cannot be shared or leveraged. This significantly increases the complexity and cost of doing business in China.

Recommendation:

Foreign financial institutions operating with-in China should be able to structure their group activities in a way that minimized "head office" costs while still complying with the requirements of various financial sector regulators. The most important principle is legal and prudential separation of business activities and customer information rather than separation of "head-office" resources.

Benefit:

While this issue will be relevant to all of China, it will be particularly relevant to Shanghai with its government anointed aspirations to become a top-ranked international financial center where international companies can locate their group or regional "head-quarters".

(2) Bond Markets

Observation:

Bond markets are a necessary part of any efficient financial system. Ideally, the market should consist of both government bonds (issued by the central government and lower tiers of government) and various types of corporate bonds (both financial and non-financial) to allow the most effective market identification of the yield curve. The Chinese financial sector presently lacks such a diverse market.

Recommendation:

AustCham encourage China's policy makers to continue efforts to further develop the bond markets. As this is an area where foreign financial institutions have particular experience and expertise, foreign banks and other entities operating in China should be permitted and encouraged to issue bonds when it is seen as financially beneficial.

Benefit:

While the bond market is its basic form is not overly complex, its efficient functioning plays an important part in helping the whole financial system price risk – ie match particular interest rates and time periods to the risk involved in lending to particular companies, projects, regions etc. An efficient bond market can also be very useful – and sometimes crucial – when the People Bank of China (PBoC) conducts monetary policy.

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D.Specific Service Provider Recommendations

(1) Banking

(a) Reporting requirements

Observation:

Foreign banks operating in China find that they need to spend much more time and effort providing regulatory reports in China than they do when operating in their home countries. For example, one Australian bank group with over one thousand branches in Australia needs to annually provide 402 regulatory reports to the Australian authorities. That same group has a branch in Shanghai and must provide 3,162 regulatory reports per year, and the same number must be provided for its second branch in another city. Moreover, an extra 3,162 reports for the banks consolidated activities in China must be provided – to give a total of 9,486. In addition to the fact that PBoC and China Bank Regulatory Commission (CBRC) reports often overlap, there are often ad-hoc requests for information.

Recommendation:

The PBoC and CBRC should form an inter-agency Working Group tasked with eliminating the collection (and sometimes multiple collection) of data that is of little or no use. This Working Group should conduct meetings with other official users of bank data (for example, the National Development Reform Commission or NDRC) and the banking community (either individually or through their industry associations) and with the aim of rationalizing the collection of data. The Working Group should aim to develop a data collection regime that is outcomes orientated (ie useful information) rather than input orientated (ie data collected because it is possible to collect and might be of use at some time in the future).

Benefit:

Fewer regulatory reports would not only reduce the costly administrative burden for banks, but would actually improve the supervision by the Chinese authorities. Too much information (often referred to as "information overload") can easily reduce focus on those things that are most important because the human brain can comprehend only so much. Statistical analysis of the huge volumes of bank data with the help of computers could at times highlight various problems in the banking sector as a whole, but banking is best thought of as a human activity which is best supervised by competent human regulators who are given the possibility of considering important data in a human way.

(b) Foreign Debt Quotas

Observation:

In 2004, the NDRC, PBoC and CBRC jointly promulgated the "Foreign Debt Administration of Foreign-invested Banks in China Procedures". The procedures relate to funds raised off-shore for lending on-shore, and divide the debt into two types: short-term foreign debt (one year or less) which is administered by State Administration of Foreign Exchange or SAFE (being part of the PBoC); and medium/long term foreign debt (more than one year) administered by NDRC. Short-term debt can be re-lent after borrowers repay, but long-term debt can only be lent once. The methodology around the allocation of foreign debt quotas is not clear (they seem to be linked to time the bank has been operating in China) and the requirements of providing specific customer details as part of the application process are onerous and often impractical.

Recommendation:

The quotas for foreign banks should be removed. If the quotas are to remain in place, the administrative procedures should at least be simplified, and long-term debt of the foreign banks should be able to be relent after bank customers have repaid their borrowings.

Benefit:

While AustCham understands that foreign debt quotas play a role in the present exchange rate regime, the size of the foreign banking sector in China is small compared to the size of the total banking sector. This general situation may never really change as overseas experience almost always indicates that foreign banks find it difficult to get very significant market share in any country. The Australian experience, however, is that the efforts of foreign banks to build market share does play an important role in stimulating the domestic banks to become more customer orientated, innovative, and capable of evaluating risk; and this is something that China presently needs.

(c) Limits on Foreign Bank Equity Investment in Chinese Banks

Observation:

It is possible for foreign banks to take equity stakes in a maximum of two Chinese domestic banks, and there is a 20 percent upper limit of foreign equity investment in any one bank.

Recommendation:

The number of domestic banks which can be invested in should be increased, and the upper limit for investment in individual banks should be increased to 49 percent.

Benefit:

This would bring benefits for the Chinese banking system as a whole by increasing competition. Moreover, it would bring the possibility of increased investment and world-class banking services in less developed regions of China.

(d) Account Opening Procedures

Observation:

Business account opening procedures for all banks require multiple documents. This puts foreign banks at a disadvantage because potential customers will often wonder why they should go through such complicated procedures when the foreign banks have limited office (branch etc) networks. Each account openings must also be visually recorded in electronic form.

Recommendation:

Adopt a principle or outcome approach to account opening procedures, instead of a rule or form based approach. The requirement for an account opening to be visually recorded should be removed.

Benefit:

Not only foreign banks, but the Chinese banking sector as a whole would benefit from a more streamlined approach to account openings.

(e) CIPS

Observation:

PBoC has recently set up a proprietary "Cross-border Inter-bank Payments System" (CIPS) for the clearing and settlement of cross-border RMB.

Recommendation:

Continued development of this new financial messaging infrastructure should adhere to globally accepted standards and market practices to ensure a secure, efficient, and resilient system for cross-border transactions.

Benefit:

It is in the interests of China that this new system be of such a standard to a positive influence on Chinese international financial relations and the development of Shanghai as an international financial center.

(f) Industry Talent

Observation:

Foreign banks in China continually report problems in attracting and retaining suitably qualified staff, especially for higher-level management roles. Of course, AustCham recognizes that this situation is to some degree inevitable given the limited number of years of financial reform in China.

Recommendation:

Consideration could be given to providing tax incentives for experienced banking professionals (whether they be foreigners or Chinese ex-pats) to move to China, and for employers to invest in experienced foreign trainers who can educate local talent. In particular, Hong Kong and Singapore could be targeted for such people. "Quality of life" issues become increasingly important for talented individuals -- and their families -- as their incomes and wealth rise, and nowadays one of the major "quality of life" issues is internet access (both in terms of speed and access to popular foreign internet sites); this is an area that needs to be improved. Other important areas, especially for families, are education and health services and conditions.

Benefit:

The financial industry is very skill orientated and the best international financial markets and international financial centers have high reputations for the skill and competence of the people who work there. China, and particularly Shanghai as an international financial center, would benefit enormously from more rapid improvement in the quality of the talent pool.

(2) Funds Management by Foreign Based Entities

Observation:

"Mutual funds" (sometimes called "investment funds", in Australia known as "managed funds", in Europe UCITS) are generally publicly offered open-ended funds mainly investing in transferable securities and money markets. In China, many people would perhaps more readily understand the term "wealth management". Investors in these products usually have a longer-term horizon (for example, money for retirement) than people who prefer to speculate directly in the stock-market.

In September 2015, Finance Ministers from Australia, Japan, Korea, New Zealand, the Philippines and Thailand signed a Statement of Understanding on the Asia Region Funds Passport (ARFP) which is scheduled to commence in 2016. The statement also notes the intention of signatories to ensure that all APEC economies are able to participate in the Passport when it begins or at a time appropriate to their circumstances. Once implemented, the ARFP will provide a multilaterally agreed framework to facilitate the cross-border marketing of managed funds across participating economies in the Asia region.

Mainland China authorities and Hong Kong authorities have signed an agreement concerning "mutual recognition of publicly offered funds" (MRF) which means that "public funds operating from Hong Kong and the Mainland that meet certain eligibility requirements prescribed by the China Securities Regulatory Commission (CSRC) and Hong Kong's SFC respectively for MRF will generally be deemed to have complied in substance with the other market's registration requirements under a streamlined process for distribution in such market".

Good funds management is really the combination of a variety of skills. Foremost is the ability to choose/select the best assets to invest in. But, even after such decisions are made, putting those decisions into practice by conducting transactions (particularly if they are international) involves many diverse financial skills.

AustCham welcomes the recent reforms to the regulation of international fund managers in China. These reforms include relaxation of foreign ownership restrictions on Chinese fund managers (wholly owner foreign enterprises are now permitted to carry on funds management businesses in China) and the announcement of a new QDII2 program. However, AustCham considers that additional reforms should be implemented. For example, the timing and size of approvals of QFII and QDII quotas is not transparent and is uncertain.

Recommendation:

China should give consideration to participating in the ARFP scheme. This would allow Australian and Asian funds managers to directly provide their services to Chinese investors through a regulated framework.

In addition, more certainty and transparency should be brought to the QFII and QDII quota approval processes.

Benefit:

Chinese savers would benefit from Australia's very high quality and experienced funds management industry. This would reduce the attraction of many Chinese to shorter-term direct speculation in the share-market which should make it less volatile.

(3) International Funds Management by China Based Entities

Observation:

China based fund managers who wish to trade and manage money in a global sense require a Chinese regulator in order to gain better access to overseas trading platforms. The current system in China is geared for the domestic market only, and seems built only for large fund managers. Emerging fund managers thus need to relocate overseas. This prevents the development of Shanghai (and other regions of China) as hubs for fund managers.

Recommendation:

China should provide a clear, achievable regulatory system for foreign and domestic fund managers who are managing assets in foreign markets (Labuan's regulatory system for financial companies in Malaysia offers a potential model for China to use in a Free Trade Zone). The regulatory system should be for fund managers who trade in overseas securities markets and operate in a non-custodial way. This means that the client retains full legal title to the assets which are kept segregated on third party trading platforms. Thus the fund manager only has limited rights to buy and sell assets within the account, but not rights to control money flowing into or out of the account. The regulatory system should be graduated, and provide the ability for managers to start with minimal regulation and registered capital requirements, and rise in stages as the fund manager grows. The current system assumes that only large and well established companies can manage funds. It also has the effect of forcing small fund managers underground where they are not seen or controlled by the any regulators.

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Benefit:

This system will provide a pathway for talented China based investment managers (be they Chinese or foreign individuals who want to live in China) to manage funds (even if the fund itself is legally based overseas). This will build local talent and tax revenues and contribute to Shanghai's quest to become a top-ranked international financial center.

(4) Insurance

Observation:

AustCham welcomes the provisions of the ChAFTA which allow Australian non-life insurers to establish a presence in China in the form of a branch or wholly-owned subsidiary and expanded the range of activities they can engage in. However, Australian life insurers are only permitted 50 percent ownership in a joint-venture. Both life and non-life insurance companies operating in China find that the regulators continually request very detailed (and often ad-hoc) information on their day-to-day activities, which results in a heavy regulatory burden.

Recommendation:

Regulators should put in place a system of reporting that is more structured and more principles based. That is, insurers should be allowed to freely develop their businesses provided they comply with a basic set of insurance requirements and the broader laws of China.

Benefit:

Chinese consumers of insurance services would benefit from a broader range of products at lower cost, while the regulatory authorities would find that their own work-loads (and costs) could be reduced.

(5) Infrastructure Financing Using PPP

Observation:

Infrastructure investment and its financing is always complex, particularly when it involves "public goods" (and especially so-called "natural monopolies") such as roads, ports, water supply and electricity distribution. Apart from government general borrowing, the main international form of financing infrastructure is Public Private Partnerships (PPP) which essentially involve up-front private sector financing of the construction and provision (including on-going management) of a publicly desirable asset in return for later regular financial flows to the private investors. While international experience (including in Australia) with this relatively new and complex process has not always been positive, the end result of a fully professional approach can be very positive for society.

While a good sovereign entity should normally be able to raise funds at a lower cost than "private" entities involved in a "partnership", this is not always the case. What professional structured PPPs do very well is to bring more rigor to project evaluation (ie what are the costs verses benefits) which should, if good processes are followed, reduce the extent to which local political considerations (and sometimes corruption) take precedence over total social benefit. The history over recent years of some of the activities of China's LGFVs bears witness to this possible distortion.

Another very important advantage of PPPs is that the private investors have a very strong incentive to ensure that the completed infrastructure asset is well managed and well maintained because it is on these things that the annual financial flows and profits depend. Moreover, if the completed assets become in some way listed (ie tradable) when completed, the pressure for transparency will work to improve corporate governance.

The NDRC has recently published a list of possible PPP projects across China, with some projects prioritized.

Recommendation:

AustCham welcomes the NDRC's positive approach to PPP. Despite China's size and diversity, the official guidelines for PPP need a more nationally uniform approach. This will give provincial and local officials greater confidence in dealing with organizations with which they are not particularly familiar (personally in their locality, or by reputation).

Benefit:

Good PPP is really the competent management of a great array of skills including the use of many types of financial instrument, laws, management competence etc. Thus good PPP not only provides various (usually infrastructure) assets to the Chinese people, but also is a very useful source of skill and management development in China.

(6) International Money Remittance Services

Observation:

Increasing numbers of Chinese are working outside China (for example in Africa) and with China's increasing emphasis on such projects as the "One Belt, One Road" the numbers of such workers will increase. It is only natural that these workers will want to send money back to China without incurring the costs associated with the commercial banking

system. For this reason, many of these workers use illegal methods to make these payments.

Recommendation:

Foreign non-bank foreign exchange service providers in China be permitted to directly offer remittance services to individual Chinese.

Benefit:

This would reduce the remittance costs for many Chinese workers. Moreover, the incentive to use illegal means, which always contributes to the growth of corruption with China, would be reduced.

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