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ADDRESS TO THE IFSA ANNUAL CONFERENCE

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***Remaining Competitive in a global environment –  
reducing tax and regulatory friction***

Good afternoon and thank you for the opportunity to meet with you, and speak to you on this important topic.

There's no doubt that the Australian financial sector has emerged as an industry that performs well above its weight in the global market. There are some very good reasons for this, not the least of which being highly advantageous geographic positioning, a stable political environment, a sophisticated investment community and a first world regulatory regime.

Lateral Economics has estimated that funds management may account for as much as 40 per cent of the contribution the finance and insurance industry as a whole makes to the Australian economy, putting its share of gross domestic product at around 3.4 per cent of the value added in the economy – a contribution not to be sneezed at.

When I first received the information about this session, I misread the title – I thought it was "Remaining Competitive in a Global Environment – Reducing Tax and Regulatory Fiction" – and I thought to myself – that's actually very clever!

As the organisation that represents the retail and wholesale funds management, superannuation and life insurance industries, responsible for investing over \$950 billion on behalf of more than nine million Australian, yours is a very important industry for Australia.

I have a very high regard for both your industry and your industry association. Just last month, IFSA provided a thoughtful submission to the Senate Standing Committee's Inquiry into the Influence of Private Equity Investment on the Australian Economy. The submission reflected on the 'continuing benign global economic conditions, including low interest rates and low inflation, savings gluts in major oil export countries and certain Asian economies, increasing sophistication of pension/superannuation funds and conservative

levels of gearing in listed public companies'- conditions that have also been driving international equity markets to current record levels.

IFSA provides regular submissions about key pieces of legislation before the Parliament, and invariably, the commentary and often suggested amendments make that legislation more workable – rarely, can I say, do you get it wrong.

I was reading your response to the Exposure Draft of the Taxation Of Financial Arrangements (TOFA) Bill in relation to Elections for a Tax Consolidated Group, appreciative of the fact that the level of scrutiny given to the bill identified a range of unintended consequences, caused in large part by poor drafting. This has so often been the case, especially since the Government took control of the Senate last July and has used it to push through legislation with much reduced scrutiny through the public inquiry process.

Which is why of course, this afternoon's topic is so important.

There is no argument that we need appropriate and good quality regulation in the finance and investment sector. That regulation needs to be fairly enforced so that it can improve our economic performance and quality of life. We can't promote a competitive, efficient financial services industry without an appropriate framework of regulation and the necessary commitment and resources to enforce it.

However, I believe it is lazy policy and poor politics to have a default position of responding to a critical incident or anticipating a risk with new regulation. Yet that is so often what happens.

If we consider 'regulation' in its widest form – from legislation to regulation, to professional codes – the purpose remains the same: to alter the behaviour of others according to pre-specified standards.

In this regard, there are some recurring themes in the literature about regulatory reform. These include:

- A commitment to good regulatory practice and a recognition that conceptions of best practice are changing;
- Consensus that most businesses are subject to too much red tape;
- The aim is better regulation, not just reduced regulation
- A key cause of increased regulatory burden is hyper-sensitivity to risk and high levels of risk mitigation

Kevin Rudd has committed to an intention in government of adopting a simple principle: no new regulation imposed on business unless an existing regulation is withdrawn. This will allow businesses to do what

they do best – spending most of their time developing new products, services and markets – rather than acting as compliance agents for national and state governments.

Labor's position on this issue is that a better regulatory agenda will tackle the spiralling levels of regulation that we have seen in the finance sector, prompted by an erosion of trust, and an aversion to risk.

We recognise that this escalation of regulation comes at a significant financial cost to the industry and that these costs eat into future savings.

From our perspective, the investment and financial services industry has an important role to play in helping to address Australia's trade imbalance, as long as it can remain globally competitive.

We see that the sector operates in a highly competitive environment, that you are investing in very professional, skilled and well paid jobs, and that the industry as a whole has massive potential to take a greater share of the global financial activity.

In his budget reply speech this year, Kevin Rudd expressed his concern about the regulatory burden being experienced by industry in this country. He believes, as do our economic spokesmen (both men) that we have to streamline regulatory arrangements to unleash the full potential of our businesses.

Kevin specifically affirmed his commitment to the Australian financial services and funds management industry in his speech, because he recognises not just its contribution, but also its potential for growth in dealing with retirement incomes across East Asia.

IFSA 's Executive Director Richard Gilbert argued strenuously for a review of Australia's withholding tax regime and its impact on foreign investment in real estate investment trusts at the Senate Economics Committee into the Tax Laws Amendment Bill in June.

It is significant but hardly surprising that Richard was supported in his arguments by the Property Council of Australia (PCA). He said bluntly that if Australia does not get the tax settings right, there is a possibility that the Real Estate Investment Trust industry will move offshore.

The Government, which has a majority on this Committee, did not accept these arguments, suggesting that the solution should be that when negotiating double taxation treaties, the Government considers reciprocal withholding tax treatment for distributions to foreign residents from managed investment trusts. Labor and the Democrats

saw this to be a fall-back position that will be very slow to implement. It is not a practical solution in a fast moving capital market.

We agree that the current regime for foreign investor withholding taxes IS a significant impediment to that growth. An improved tax rate would boost our local investment industry and help Australia develop its ability to compete globally for inward investment.

Labor is mindful of the fact that government should not be in the business of handing out tax breaks to wealthy foreign corporations, but recognises that our extremely high relative withholding tax rates are starting to discourage investors who would otherwise be interested in placing money in Australia.

We are competing with regimes in Japan – where the withholding tax rate is 7 per cent, with Singapore which has 10 per cent, and with the Netherlands -15 per cent. One of the options, of course, might be that investment companies wanting to compete could move their operations overseas- which would be a disaster for Australia.

Labor's objective is to turn Australia into a funds management hub for Asia, building on the existing strengths of our funds management industry. This would generate extra income from Australia which in turn creates new jobs at home, strengthens the profession and grows our economy. That is why Labor in government will halve the withholding tax on distributions from Australian managed funds to non-residents, from 30 percent to 15 percent. Labor's advice is that this tax currently generates some \$30 million every year – but in our view halving it will provide concrete assistance to Australian funds managers competing against tax regimes applying to their competitors in Dublin, Luxembourg, New York and Singapore.

Furthermore, in our dissenting report, Labor indicated that given the complexity and compliance costs of the Government's proposed tax regime would impose, Labor will also abolish the need for overseas investors paying withholding tax to lodge a tax return and claim debt as a deduction by making the flat rate a final rate. This flat and final tax rate will remove a significant burden that has threatened to hold back Australia's funds management industry from capitalising on the growth of funds under management in the region.

As Kevin said in his speech, our intention is to enable Australian businesses to take on the world and win.

Last year, at your conference, he announced his intention to establish a Funds Management Asia Export Taskforce as part of Austrade, in a Labor Government. He still believes this to be a critically important part of a strategy in growing Australia's share of this global industry.

There are several other superfluous aspects of Taxation law that Labor is currently examining. Chris Bowen, Labor's Assistant Treasurer in waiting, will speak about these in his keynote address to the Conference lunch tomorrow.

But coming back to the issue of withholding taxes – there is also an issue of equitable treatment within the taxation system: surely foreign investors who invest in Australian managed funds should receive the same tax treatment as Australian investors would receive when they invest in those overseas countries' funds

IFSA supported the notion of regulatory impact statements when the Financial Services Reform Act 2001 (FSRA) was introduced, yet there is little evidence that they have been successful and, in fact, the requirement has been widely ignored.

So, what else can be done to address the regulatory friction – or fiction – within your industry?

Certainly we can look at some principles-based regulation – which relies on the capacity of individuals to make ethical and professional judgements consistent with broader public values and industry standards of ethical action. Principles-based regulation offers opportunities for regulation reduction and improved professional practice.

I know that your industry promotes the position of self-regulation through industry codes and self enforcement.

This approach has the merit of regulating via self-regulation, where the government embraces co-production with entities such as IFSA moving towards principles-based regulation and allowing your membership to operate within modes of 'enforced self-regulation'. This is an approach that 'speaks softly but carries big sticks', improves transparency and knowledge sharing and adopts sunset clauses for regulators.

I know you want more – and have sought greater involvement in consultative processes for proposed regulatory changes and reform proposals, and a commitment to making regulation impact assessments really work. Labor understands and respects this.

In the last decade, each of the major legislative reforms in your industry has involved significant additional compliance burdens, and with that additional compliance come increased costs and reduced competitiveness. My latest information is that the cost for IFSA member companies to comply with the financial service industry regulation is about 10 to 15 per cent of total operational costs. We

don't want this to continue, and will work closely with the industry to try to address this.

I think it's fair to say that our current repertoire of regulatory strategies is proving increasingly unable to cope with the complexity of demands being made on it, and that its continuing legitimacy and effectiveness depends on creating systems of regulation that can manage this complexity, not wish it away.

Using codes and standards is how your industry has worked to build public trust and consumer confidence. They also help to deal with the rogue players who might be tempted to behave unprofessionally. This in turn has continued to build market confidence.

We have already announced our intention to take a cleaver to the impositions created by Financial Service Regulation – where reforms to date have been very poor, and in some cases counter productive.

Disclosure documents, improved transparency of information and access to information on provider websites are just a start.

But the business sector generally is also having to deal with a messy range of regulations across jurisdictions.

To address this, Labor will use an incentive approach, similar to the national competition policy model, to encourage states to harmonise regulation where it is appropriate and possible.

In the same way that the competition policy drove national economic reform, we believe that this measure will have significant economic benefits – both for the nation and for the industry.

This initiative will provide new opportunities for reducing the administrative burden on companies – through harmonisation of, for example, payroll tax variations, stamp duty bases for insurance products.

Your industry is one that demonstrates how good commercial practice is underpinned by good regulation. Labor believes that for the Australian financial services industry to continue to grow, to be innovative and internationally competitive, we must share the goal of greater cooperation and more efficient regulation.

Labor's view is that this is a shared responsibility between government, industry and its regulators. The regulatory regime established to support the commencement of the Financial Services Regulations Act needs to be brought up to date to foster greater competitiveness in the market.

It is the industry players who are able to bring the practical advice and information needed to fine tune that regulatory regime and Labor in government will be asking for that advice.

Thank you again for inviting me to contribute to your conference, I'm happy to take questions.