Chapter 1

The context for the delegation's discussions

Throughout history, financial depth has been a crucial element of industrialisation and sustained high-growth periods for all economies, western and eastern … It is somewhat unusual that China's period of high economic growth hasn't occurred with an accompanying financial "revolution".[1]

Australia and China enjoy a very strong trade relationship … [A] strong trading relationship provides the basis for a strong financial relationship. As history shows, finance follows trade. As trade linkages increase, firms require an increasing array of financial services. And a strong trading relationship helps businesses in both countries identify and develop investment opportunities in the other.[2]

Introduction

1.1 This report details the visit of the Parliamentary Joint Committee on Corporations and Financial Services ('the committee') to Beijing and Shanghai from 5 May to 11 May 2013. The purpose of the visit was to improve the committee's understanding of the Australia–China relationship in financial services and, in particular, the opportunities that exist to strengthen these ties and to address areas of bilateral concern.

1.2 The committee's visit was part of the annual parliamentary committee visit to the People's Republic of China. The visit operates on an annual rotational basis between standing and joint parliamentary committees. Nominations were accepted from standing committees in 2012 and from joint committees in 2013. The visit is awarded through a competitive nomination process, with a decision made by the President of the Senate and the Speaker of the House of Representatives.

1.3 The committee was notified on 4 March 2013 that its nomination was successful. Committee members lodged expressions of interest to travel, and arrangements for the visit were made through the International and Community Relations Office (ICRO). The Department of Finance and Deregulation funded the visit.

---

1 Mr Mike Smith OBE, Chief Executive Office, ANZ Banking Group, 'Seizing Asian opportunity up to us', *Weekend Australian*, 13 April 2013, p. 31.

2 Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia, *The Journey of Financial Reform*, Address to the Australian Chamber of Commerce in Shanghai, Shanghai, 24 April 2013. http://www.rba.gov.au/speeches/2013/sp-dg-240413.html (accessed 17 May 2013).

Delegation members

1.4 The delegation was comprised of the following committee members:

- the Hon. Alan Griffin MP (Delegation Leader);
- Senator Sue Boyce (Deputy Chair of the Committee);
- Ms Laura Smyth MP; and
- Senator Anne Urquhart.

1.5 This was the Delegation Chair's fourth visit to China, having made two recent visits in August 2012 and March 2013. This was the first visit to China for the other three delegation members.

Acknowledgements

1.6 Overseas visits by official parliamentary delegations are made possible through the efforts of many dedicated and capable people. The delegation extends its sincere thanks to the following people who organised the visit to China:

- the Australian Ambassador in Beijing, Her Excellency Ms Frances Adamson;
- the Australian Consul-General in Shanghai, Ms Alice Cawte;
- the Visit Support Staff at the Australian Embassy in Beijing;
- Mr Justin Hayhurst, Deputy Head of Mission at the Australian Embassy in Beijing;
- Mr Brent Stewart, the Trade Commissioner in Austrade Shanghai;
- Dr Kylie Brown, the Post-Visit Coordinator at the Australian Embassy;
- Ms Ariane Sainsbury, the Visits and Events Manager at the Consulate in Shanghai;
- Mr Rex Chen, the delegation's interpreter in Beijing;
- Mr John Wu, the delegation's interpreter in Shanghai;
- Mr Li Hongwei from the Australian Consulate in Shanghai;
- Mr Bing Guo Xu, the delegation's driver in Shanghai; and
- officers of ICRO, particularly Ms Fiona Way.

The context for the visit

1.7 The committee's visit to China in May 2013 followed several significant developments in the process of Chinese economic reform, and opportunities to develop the Australia–China bilateral relationship in financial services. Three developments in particular were important to the context of the committee's discussions in China.

China's economic and financial sector reform plans

1.8 The first of these developments relates to China's plans to reform its economy and financial system. China's 12th Five-Year Plan, signed in October 2012, commits to rebalancing the economy to focus less on fixed asset investment and exports and more on domestic consumption. A less export-focused economy will reduce the current account surplus and the need to maintain an artificially weak currency. As has been well documented, claims that the renminbi (RMB) has been artificially devalued are a continuing point of tension in China's trade relationship with the United States. The plans to increase consumption rest on increasing household disposable income through higher minimum wages and transfer payments.[3]

1.9 Financial sector reform will assist the Chinese economy to make this economic adjustment.[4] The 12th Five-Year Plan commits to pursuing financial system reform, including:

- establishing a deposit insurance system;
- developing an 'over-the-counter' market and asset securitisation;
- improving the managed floating exchange rate regime;
- expanding cross-border yuan trade; and
- continuing RMB capital account convertibility.[5]

1.10 In 2012, the Chinese leadership made three significant moves to liberalise the capital account.[6] In February 2012, the People's Bank of China (PBOC) released a proposal signalling its intent to liberalise the capital account, the exchange rate and bank interest rates simultaneously. On 14 April 2012, the PBOC announced that it would widen the RMB's daily trading band (based on the US/RMB midrate) from 0.5 per cent to 1 per cent. In June 2012, the PBOC raised the cap on bank deposit rates from 100 per cent to 110 per cent of the corresponding benchmark rates.[7] It also

3 See 'China's 12th Five Year Plan: How it actually works and what's in store for the next five years', *APCO Worldwide*, 10 December 2012, http://apcoworldwide.com/content/PDFs/Chinas_12th_Five-Year_Plan.pdf (accessed 17 May 2013).

4 See the comments of Mr Mike Smith OBE, 'Seizing Asian opportunity up to us', *Weekend Australian*, 13 April 2013, p. 31.

5 China's 12th Five Year Plan, Chapter 48, http://www.cbichina.org.cn/cbichina/upload/fckeditor/Full%20Translation%20of%20the%2012th%20Five-Year%20Plan.pdf (accessed 17 May 2013).

6 The capital account consists mainly of foreign direct investment, investment in equities and bank borrowing. Liberalising the capital account would enable foreigners to more readily invest in China's assets.

7 The benchmark rate is set by the PBOC.

lowered its bank lending rate floors from 90 per cent to 80 per cent and then, in July 2012, to 70 per cent.[8]

1.11 There has been considerable interest internationally in these plans and actions to ease restrictions on bank interest rates and to reform the exchange rate and China's state-owned enterprises (SOEs). There has also been considerable academic, financial sector and media commentary on China's plans to fully internationalise the RMB.

Agreements to strengthen Australia–China financial ties

1.12 The second key development that framed the committee's discussions in China was the series of agreements between Australia and China to strengthen the interdependence of the two nations' currencies and financial markets. In March 2012, the Reserve Bank of Australia (RBA) and the PBOC signed a currency swap agreement; in April 2013, a direct currency convertibility agreement was signed; the same month, Sydney hosted the inaugural Australia–Hong Kong Renminbi Trade and Investment Dialogue; and in May 2013, the RBA made a decision to invest some of Australia's foreign currency reserves in China.

The currency swap agreement and Australia's investment of currency reserves in China

1.13 The currency swap agreement allows for the exchange of local currencies between the two central banks of up to A$30 billion, or RMB 200 billion. This represents the fourth largest RMB swap agreement. Dr Lowe, the Deputy Governor of the RBA, told the Australian Chamber of Commerce in Shanghai in April 2013:

> We see this swap agreement as another important piece of the financial infrastructure supporting trade and investment between China and Australia. Its existence provides market participants with greater confidence regarding the availability of RMB liquidity in Australia, particularly during times of stressed market conditions. In turn, this greater confidence should help build a solid platform for the growth in the RMB market in Australia.[9]

Direct currency convertibility and the Australian Prime Minister's April 2013 visit

1.14 On 7 April 2013, the Australian Prime Minister, the Hon. Julia Gillard MP, met with China's new President, Xi Jinping, and Premier, Li Keqiang.[10] The visit was

---

8 See Takeshi Jingu, 'China resumes interest rate liberalization', Nomura Research Institute, 2012, volume 148.

9 Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia, *The Journey of Financial Reform*, Address to the Australian Chamber of Commerce in Shanghai, Shanghai, 24 April 2013.

10 President Xi commenced office on 14 March 2013, while Premier Li commenced as Premier the following day.

the most senior Australian political delegation to visit China.[11] The Prime Minister was joined by the Minister for Foreign Affairs, Senator the Hon. Bob Carr, the Minister for Trade and Competitiveness, the Hon. Dr Craig Emerson MP, and the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP.

1.15 During this visit, the leaders announced the start of direct trading between the Australian dollar and the Chinese RMB. On 10 April 2013, Australia became only the third currency (joining the US dollar and Japanese yen) to have a direct currency exchange agreement with China. In simple terms, this means that Australian exporters dealing with their Chinese counterparts will be able to convert yuan directly into Australian dollars, without having first to convert into US dollars. The ANZ and Westpac have been given the rights to trade Australian dollars and Chinese yuan directly.

1.16 Dr Lowe of the RBA noted that the currency convertibility agreement 'should promote trade invoicing in RMB and facilitate bilateral trade and investment'.[12] Mr Mike Smith, Chief Executive Officer of the ANZ, welcomed the removal of current costs of intermediary conversions, indicating that the likely savings on transaction costs would be a few basis points.[13] There is a question, however, as to whether Chinese importers prefer to trade in US dollars.

Australia–Hong Kong Renminbi Trade and Investment Dialogue

1.17 In July 2012, the Australian Deputy Prime Minister, the Hon. Wayne Swan MP, and the Hong Kong Financial Secretary, Mr John Tsang, launched the Australia–Hong Kong Renminbi Trade and Investment Dialogue. The aim of the Dialogue is partly to raise awareness in the Australian private sector of RMB-denominated business opportunities.

1.18 On 12 April 2013, Sydney hosted the inaugural Australia–Hong Kong Renminbi Trade and Investment Dialogue. A paper presented at the Dialogue by the Australian Financial Centre Task Force concluded:

> The size of the Chinese economy and of its trading links with the rest of the world mean that, if it continues down the path of RMB internationalisation, the implications over time for global financial markets will be enormous.

---

11 The Hon. Julia Gillard MP, Prime Minister of Australia, 'Prime Minister and Senior Ministers to visit China', *Media Release*, 31 March 2013, http://www.pm.gov.au/press-office/prime-minister-and-senior-minister-visit-china (accessed 24 June 2013).

12 Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia, *The Journey of Financial Reform*, Address to the Australian Chamber of Commerce in Shanghai, Shanghai, 24 April 2013.

13 Clancy Yeates, 'Currency deal to hasten $120 billion worth of trade', *Sydney Morning Herald*, 8 May 2013.

> Countries that have built up RMB liquidity and RMB related financial products and services early in this process, and have the right financial architecture in place, will be well positioned to benefit from these changes in financial markets. Through increased trade invoicing in RMB and — at an appropriate time, and with the agreement and encouragement of the Chinese authorities — some further policy changes, Australia has the opportunity to both participate in and benefit from the seismic changes in global financial markets that have just begun.[14]

1.19 However, another paper presented at the Dialogue reporting on corporate attitudes to RMB-denominated trade settlement and investment found that firms have a number of concerns.[15] These include uncertainty around the ability to hedge associated currency flows, the complexity and time delays in the settlement process, and the administrative burden from unclear procedures.

Investment of foreign currency reserves

1.20 Also in April 2013, the RBA announced that it will invest some of Australia's foreign currency reserves in China. The Bank's intention is to hold around five per cent of Australia's foreign currency assets in China. Dr Lowe explained that the decision:

> ... reflects the broader economic relationship between China and Australia and our increasing financial ties. It provides greater diversification of our investments and will help with our understanding of the Chinese financial markets. Over the long run, and particularly as capital account liberalisation occurs in China, the RMB is likely to become one of the major reserve currencies of the region.[16]

The free trade agreement and the Foreign Investment Review Board

1.21 The third context for the committee's visit relates to the Australia–China trade relationship more generally. In April 2013, Australia and China abandoned efforts to broker a full free trade agreement (FTA). After eight years and 18 rounds of trade

---

14 Australian Financial Centre Task Force, 'RMB invoicing in a longer-run context: opportunities and opportunities for Australia ' http://www.treasury.gov.au/PublicationsAndMedia/Events/~/media/Treasury/Publications%20and%20Media/Events/RMB%20Dialogue/Documents/RMB_Internationalisation_Opportunities_and_Challenges_pdf.ashx (accessed 24 May 2013).

15 'Corporate attitudes toward renminbi trade settlement and investment', Document supplied by the Reserve Bank of Australia http://www.treasury.gov.au/PublicationsAndMedia/Events/~/media/Treasury/Publications%20and%20Media/Events/RMB%20Dialogue/Documents/Corporate_Attitudes_towards_Renminbi_Trade_Settlement_and_Investment.ashx (accessed 24 June 2013).

16 Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia, *The Journey of Financial Reform*, Address to the Australian Chamber of Commerce in Shanghai, Shanghai, 24 April 2013.

negotiations, the Australian Government announced that its focus would be on securing agreements with China on a regional and industry level.[17]

1.22 On 4–6 June 2013, the 19th round of FTA negotiations was held in Beijing, focusing on agricultural trade. The Department of Foreign Affairs and Trade summarised these negotiations in the following terms:

> Good progress was made on Sanitary and Phytosanitary (SPS), Technical Barriers to Trade (TBT), and Trade in Services chapters. Constructive discussions were also held on Trade in Goods, Rules of Origin, Customs Procedures, Investment, Dispute Settlement chapters and other issues. With strong commercial interests on both sides across a broad range of sectors, negotiators continued to define the scope of market access opportunities to be included in the agreement.[18]

1.23 Chinese foreign direct investment (FDI) in Australia has been an issue of some contention in both Australia and China in recent years. Australia's Foreign Investment Review Board (FIRB) is responsible for reviewing all proposed investment from foreign state-owned companies.[19] Chinese authorities have questioned the transparency of the FIRB process and, in particular, the components and application of the 'national interest' test.[20] Some Australian parliamentarians have raised concerns as to whether Australian agricultural and mining land should be sold to companies that are essentially controlled by the Chinese state. For the past two years, a Senate committee has examined FIRB's national interest test with particular reference to how the test is applied to purchases of Australian agri-businesses by foreign companies and foreign sovereign wealth funds.[21]

---

17 *ABC News Business Today*, Transcript, 26 April 2013, http://www.trademinister.gov.au/transcripts/2013/ce_tr_130426.html (accessed 18 May 2013).

18 Department of Foreign Affairs and Trade, 'Australia–China Free Trade Agreement negotiations', June 2013, http://www.dfat.gov.au/fta/acfta/130606_subscriber_update.html (accessed 24 June 2013).

19 All foreign *government* investors must notify the Australian Government and get prior approval before making a direct investment in Australia, regardless of the value of the investment.

Foreign *persons* should notify the Government and get prior approval before acquiring a substantial interest in a corporation or control of an Australian business that is valued above A$248 million. This threshold does not apply to investors from New Zealand and the United States, except where the investment is in 'prescribed sensitive sectors'. Treasury, *Australia's Foreign Investment Policy*, 2013, pp 2–3.

20 Treasury, *Australia's Foreign Investment Policy*, 2013, http://www.firb.gov.au/content/_downloads/AFIP_2013.pdf (accessed 17 May 2013).

21 Senate Rural and Regional Affairs and Transport References Committee, *Examination of the Foreign Investment Review Board National Interest Test*, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=rrat_ctte/firb_2011/tor.htm (accessed 18 May 2013).

1.24 The Trade Minister noted that as part of a more focused Australia–China FTA, China had originally wanted its SOEs to be allowed to invest up to A$1 billion in Australia without needing approval from FIRB.[22] This proposal was not accepted. Currently, only investors from the United States and New Zealand have this exemption. As the Trade Minister told *ABC News Business* on 26 April 2013:

> The Chinese side at this point is requiring of Australia that we lift the threshold for the Foreign Investment Review Board's screening for state-owned enterprises from zero to $1 billion. The Australian community won't accept that. That's not Government policy.[23]

1.25 Since 2001, FIRB has blocked only two investment proposals: Shell/Woodside and ASX/SGX. The Board has accepted all 380 FDI proposals from Chinese companies since October 2007. Only six of these projects have had conditions placed on them. Notably, the buyout of Cubbie Station by a Chinese–Japanese–Australian consortium in 2012 and the state-owned subsidiary Yancoal's merger with Gloucester Coal in the same year both had ownership caps placed on them. More recently, however, FIRB accepted without condition Chengdu Tianqi's takeover of Talison Lithium, and sovereign wealth fund China Investment Corporation's bid for a 35 per cent stake in Chengdu Tianqi's bid vehicle.[24]

The delegation's meetings

1.26 The committee's nomination for the visit indicated its interest in holding meetings in China with the following organisations:

- members of the Joint Financial Services Working Group of the China–Australia Chamber of Commerce in Shanghai;
- Austrade representatives in Beijing and Shanghai;
- senior representatives of Australia's four major banks and Macquarie Group to discuss their experience establishing branches in China. Several of these representatives are members of the Australian Chamber of Commerce (AustCham) Beijing and Shanghai Financial Services Working Group;
- representatives of AustralianSuper;[25]

22 The Hon. Craig Emerson MP, Minister for Trade, Interview with *ABC News Business Today*, Transcript, 26 April 2013.

23 The Hon. Craig Emerson MP, Minister for Trade, Interview with *ABC News Business Today*, Transcript, 26 April 2013.

24 Andrew Silberberg and Amelia Jamieson, 'Pessimistic outlook on FIRB Chinese decisions could prove unfounded', Arnold Bloch Liebler, http://www.abl.com.au/ablattach/ablarticle280313.pdf (accessed 17 May 2013).

25 AustralianSuper is a multi-industry employer superannuation fund.

- members of the China Banking Regulatory Commission (CBRC), the China Securities Regulatory Commission (CSRC) and the China Insurance Regulatory Commission (CIRC);
- representatives of the PBOC; and
- Chinese officials from the Ministry of Foreign Affairs and the Ministry of Commerce.

The Delegation Leader, the Hon. Alan Griffin MP, and Ms Wu Xiaoling, Vice Chair of the Financial and Economic Committee of the National People's Congress, meeting at the Macau Hall at the Great Hall of the People, Beijing, 6 May 2013.

1.27 The delegation had the opportunity to meet and have discussions with all except two of these organisations.[26] In addition, the committee met with the following people and organisations:

- the Vice-Chair and other members of the Financial and Economic Committee of the National People's Congress and the Shanghai People's Congress;
- members of the Australia–China Friendship Group of the National People's Congress;
- the President of the Shanghai branch of the China Development Bank (CDP);

26 The committee's tight schedule did not allow time to meet with AustralianSuper representatives or officials from the Ministry of Commerce (MOFCOM).

- representatives of the Shanghai Stock Exchange; and
- representatives from the Australian Treasury and the Reserve Bank of Australia.

1.28 A full list of the committee's meetings, and the names of the people with whom it met, can be found in Appendix 1.

The AustCham Beijing and Shanghai Financial Services Working Group

1.29 The committee's nomination for the visit expressed interest in the work of the AustCham Beijing and Shanghai Financial Services Working Group. As noted earlier, the committee had the opportunity to meet with several members of the Working Group on 9 May 2013 at a lunch at the Consul-General's residence in Shanghai.

1.30 The Working Group was established in 2010 with a view to:

- raising awareness of strategic and emerging issues for Australian financial services firms operating in the Chinese market; and
- leveraging the strength and reputation of Australia's financial system to facilitate a dialogue with key officials and policy makers in China.[27]

1.31 The Working Group released an Issues Paper in 2011 and a White Paper in 2012, both of which made several recommendations towards meeting these objectives.[28] The committee understands that drafting is under way for the release of a further document to be published later this year.

1.32 The second and third chapters of this report refer to several of the recommendations raised in the Working Group's reports. Several of these ideas were raised in discussions that the delegation had with Australian and Chinese representative bodies during its visit.

Australian banks in China

1.33 The delegation met with representatives from all four major Australian banks in both Beijing and Shanghai, as well as a representative from AMP Capital in Beijing and Macquarie Capital in Shanghai (see Appendix 1).

1.34 It was explained to the delegation that Australia's banks have different objectives for their operations in China. The ANZ foresees a major presence in China

---

27 Australian Chamber of Commerce Financial Services Working Group, *Australian Financial Service Business in China*, Issues Paper 2011.

28 Australian Chamber of Commerce Financial Services Working Group, *Australian Financial Service Business in China*, 2012 White Paper, http://www.austchamshanghai.com/ftp/event/AustCham%20White%20Paper%20ENlr.pdf (accessed 14 May 2013).

with a strong retail focus. The other three banks envisage more niche roles: the National Australia Bank (NAB), for example, is focusing on the agricultural market, while the Commonwealth Bank is focused on financing for small- and medium-sized enterprises (SMEs).[29]

1.35 While some Australian banks have had a business presence in China for decades, branch openings have occurred only in the past five years. The ANZ was the first Australian bank to invest in China and currently has branches in Shanghai, Beijing, Guangzhou, Chongqing and Hangzhou. In addition, the ANZ established the Chongqing Liangping ANZ Rural Bank Co Ltd in 2011, has an operations hub in Chengdu, and has a 20 per cent stake in both the Shanghai Rural Commercial Bank and Bank of Tianjin.[30] It has been reported that the ANZ plans to increase its network in China to 20 outlets over the next 10 years, subject to regulatory approval.[31]

1.36 The NAB opened its first Chinese branch in Shanghai in November 2011. It first established a business presence in China in 1982, opening a representative office in Beijing. Westpac also established a formal presence in China in 1982. It currently has two branches in China: one established in Shanghai in 2008 and another opened in Beijing in 2011. In March 2010, the Commonwealth Bank established its first Chinese branch in Shanghai. The following year, it opened a County Bank in Jiyuan in China's Henan province.[32] The Commonwealth Bank owns a 20 per cent stake in Qilu Bank and the Bank of Hangzhou.

1.37 Macquarie Bank has had a presence in China since 1995. It has one representative office in Beijing and another in Shanghai. Its Chinese operations focus on investment banking, corporate finance and advisory services, and corporate and asset finance.[33]

---

29 Delegation's discussions with Australian bank representatives at the Australian Embassy in Beijing, 6 May 2013.

30 See 'ANZ continues China expansion with new branch in Hangzhou', AustCham, http://www.austcham.org/about-us/news/2013/jan/18/anz-continues-china-expansion-new-branch-hangzhou (accessed 19 May 2013).

31 Hannah Lynch, 'ANZ Bank investing $A300 million to expand China network', *The National Business Review*, 16 May 2012, http://www.nbr.co.nz/article/anz-bank-investing-a300m-expand-china-network-wb-118883 (accessed 20 May 2013).

32 Commonwealth Bank of Australia, 'Commonwealth Bank to open County Bank in China', 9 February 2011, http://www.commbank.com.au/about-us/news/media-releases/2011/090211-commonwealth-bank-to-open-county-bank-in-china.html (accessed 24 June 2013).

33 Australian Chamber of Commerce Financial Services Working Group, *Australian Financial Service Business in China*, 2012 White Paper, http://www.austchamshanghai.com/ftp/event/AustCham%20White%20Paper%20ENlr.pdf (accessed 14 May 2013).

China's banking system

1.38 China's financial system is dominated by its banking system and, in particular, the domestic loans and deposits of the large state-owned commercial banks. The debt securities market is comparatively undeveloped. The RBA estimates that domestic credit is equivalent to 145 per cent of gross domestic product (GDP). Debt securities and equity market capitalisation are each equivalent to around 30–40 per cent of GDP.

1.39 China's big four commercial banks are:

- the Industrial and Commercial Bank of China;
- the China Construction Bank;
- the Bank of China; and
- the Agricultural Bank of China.

1.40 The Australian Treasury has noted that in 2011, these banks accounted for about 40 per cent of the estimated RMB 80 trillion in banking assets.[34] The RBA has estimated that these banks, plus China's fifth largest bank—the state-owned Bank of Communications—account for around half of Chinese banking system assets and deposits.[35] The Chinese Government has an equity stake of between 60 per cent and 90 per cent in each of the five largest commercial banks.[36]

1.41 The rest of China's banking system is mostly accounted for by other domestically owned banks, which include:

- 12 smaller listed commercial banks;
- three 'policy' banks—the China Development Bank, the Import and Export Bank of China, and the Agricultural Development Bank of China—which are solely government-owned (see chapter 2);[37]
- a postal savings bank;
- more than 100 regional banks; and
- around 3000 small credit cooperatives and rural financial institutions.[38]

---

34 Treasury briefing provided to delegation members, 'Chinese Financial System Overview', received 3 May 2013.

35 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 53.

36 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

37 The policy banks were separated from the commercial banks in the mid-1990s.

38 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

1.42 Foreign banks account for less than two per cent of total banking assets in China. At the end of 2011, there were 77 foreign banks operating under a branch licence in China, of which 37 were locally incorporated.[39] Chapter 2 of this report discusses some of the hurdles that foreign banks face in gaining entry to the market.

Government regulation of loan and deposit rates in China

1.43 The Chinese Government has considerable influence over banks' lending and deposit-taking activities.[40] While these controls have eased, they still restrict the rates that commercial banks can offer on loans and deposits. Lending rates are now bound by a floor of 30 per cent below the benchmark (official) rate; deposit rates are capped at 20 per cent above the benchmark rate. In theory, relaxing the lending floor and deposit ceiling should compress the banks' margins, enabling the banks to compete for cheaper loans and better deposit rates.

1.44 The delegation heard that government regulation of the banks' lending interest rates has created poor incentives. China's banks are constrained in how they price risk. Their exposure to investment risk is limited given their balance sheets are essentially backed by the central government, and their guaranteed interest margin discourages efficiency and product innovation.[41] Further, China's banks provide a significant and disproportionate share of credit to SOEs. The majority of banks' loans are to large- and medium-sized non-financial corporations.[42] Loans to small businesses account for around 20 per cent of loans, while loans to households account for less than one-quarter of total loans.[43]

1.45 China's banks are largely funded from domestic deposits, which account for around 70 per cent of liabilities. Half of banks' deposits are from non-financial corporations; households account for the other half.[44] The savings deposit interest rates of China's banks have often been set below the rate of inflation. Therefore, deposits are effectively a subsidy from households to banks.[45] If the Chinese

---

39 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

40 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

41 Treasury briefing provided to delegation members, 'Chinese Financial System Overview', received 3 May 2013.

42 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 57.

43 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 60.

44 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 59.

45 Treasury briefing provided to delegation members, 'Chinese Financial System Overview', received 3 May 2013.

Government's plan is to promote 'inclusive growth' and greater household wealth, it will be important to encourage greater competition in the savings deposit market.

1.46 Australian banks weathered the global financial crisis (GFC) through sound prudential regulation and limited exposure to the debt securitisation markets that affected American and European banks. China's banks remained stable during the GFC due to its largely closed capital account with limited exposure to overseas wholesale funding markets.[46]

1.47 The Chinese Government implemented a large stimulus package during the GFC. Seventy per cent of the RMB 4 trillion Chinese stimulus package was funded by local governments. By the end of 2010, local government debt in China accounted for approximately RMB 10.7 trillion, or over a quarter of total GDP.[47]

China's financial regulatory framework

1.48 The committee's visit was an opportunity for members to gain a better understanding of the regulatory framework governing China's financial system. While the following chapter examines aspects of this framework in more detail, it is useful here to outline the basic structure with reference to Australia's system of financial regulation.

1.49 The CSRC is the equivalent of the Australian Securities and Investments Commission (ASIC). Established in 1992, it was modelled on the United States Securities and Exchange Commission.

1.50 In May 1996, ASIC and the CSRC signed a Memorandum of Understanding, which created the basis for cooperation between the two authorities without creating binding international legal obligations.[48] The committee understands that during the ministerial visit to China in April 2013, ASIC Chairman Mr Greg Medcraft and CSRC Chairman Mr Xiao Gang agreed to second ASIC employees to the CSRC.[49] The committee strongly supports this initiative: it is an excellent opportunity for greater understanding of the two nations' corporate regulatory and financial systems.

---

46 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 56.

47 Treasury briefing provided to Delegation members, 'Chinese Financial System Overview', received 3 May 2013.

48 Memorandum of Understanding regarding Securities and Futures regulatory cooperation between the Australian Securities and Investments Commission and the China Securities Regulatory Commission, May 1996, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/China_SRC_MOU_1996.pdf/$file/China_SRC_MOU_1996.pdf (accessed 18 May 2013).

49 Discussion with officials from the CSRC, 9 May 2013, Shanghai.

1.51 In Australia, banks and insurance companies are regulated by the prudential supervisor, the Australian Prudential Regulation Authority (APRA). The Chinese system has both a banking regulator—the CBRC—and an insurance regulator—the CIRC. The CIRC was established in 1998, while the CBRC was created in 2003.

1.52 The CBRC requires commercial banks to satisfy the following prudential requirements:

- a maximum loan-to-deposit ratio of 75 per cent;
- a minimum liquidity ratio of 25 per cent; and
- a minimum provision coverage ratio (provisions/non-performing loans) of 150 per cent.[50]

1.53 The CSRC, the CBRC and the CIRC report directly to the State Council. As with ASIC and APRA, they are regulatory rather than policy-making bodies. The Chairman of the CBRC, as a member of the Central Party Committee, has the highest political rank of the three regulators.

1.54 The PBOC is China's central bank. The State Administration of Foreign Exchange is an administrative agency under the PBOC tasked with drafting regulations on foreign exchange market activities, and managing the state's foreign exchange reserves. The following chapter discusses the role of both agencies in more detail.

The Financial and Economic Committee of the National People's Congress

1.55 On 6 May 2013, the delegation met with representatives from its counterpart in Beijing, the Financial and Economic Committee of the National People's Congress (NPC). This committee is one of nine special NPC committees that are each tasked with studying, examining and drafting bills related to their fields, and assisting the NPC and its Standing Committee in legislative and oversight work.[51] The Financial and Economic Committee has 17 members, including its Chairman, Mr Shi Xiushi, and five Vice Chairmen.

1.56 Chapter 2 of this report notes the Financial and Economic Committee's key interest in superannuation arrangements in Australia. The delegation draws particular attention to significant opportunities that will be presented to Australian superannuation funds to invest in the Chinese market in future years and for Chinese

---

50 Grant Turner, Nicholas Tan and Dena Sadeghian, 'The Chinese Banking System', *Reserve Bank of Australia Bulletin*, September Quarter 2012, p. 58.

51 The Standing Committee is responsible to the NPC and is the highest body of state power. Its five-year term coincides with that of the NPC and operates in a supervisory role when the NPC is not in session. See: National People's Congress, http://www.china.org.cn/english/27743.htm (accessed 18 May 2013).

fund managers to invest from the large and growing pool of Australian superannuation savings.

1.57 On 18 June 2013, members of the delegation that visited China met with several members of the Financial and Economic Committee of the NPC at Parliament House in Canberra. The delegation members were very pleased to reciprocate for these members some of the hospitality that the NPC Committee had shown the delegation during its recent visit.

1.58 The members of the NPC committee, led by Mr Wu Ritu, expressed particular interest in Australian initiatives to promote access to finance for small- and medium-sized enterprises. The Delegation Leader, Mr Griffin, directed NPC committee members' attention to the committee's 2011 report into these matters.[52] Ms Smyth noted recent government policies to increase the instant asset tax write-off threshold and loss carry-back for small businesses.[53] Moreover, the delegation members emphasised the importance of a competitive banking sector that is able to compete aggressively for credit demand in the SME market.

1.59 The delegation believes its discussions with the Financial and Economic Committee in Beijing and Canberra were extremely useful. It hopes that the Parliamentary Joint Committee on Corporations and Financial Services and the NPC's Financial and Economic Committee will have future opportunities to share ideas and concerns on these important issues of common interest.

---

52 Parliamentary Joint Committee on Corporations and Financial Services, *Access to finance for small- and medium sized businesses*, April 2011.

53 These measures enable small businesses to immediately write off the cost of asset purchases under A$6,500 and enable companies to carry back up to A$1 million worth of losses to get a refund of tax paid in the previous year.