ANZ OPPORTUNITY CHINA

THE CHAFTA AND IMPLICATIONS FOR AUSTRALIAN BUSINESSES

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ANZ

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November 2014 marked an historic day in Australia-China relations with the signing of a Free Trade Agreement (FTA) that is expected to boost trade and economic growth in both countries.

For Australian businesses the China Australia Free Trade Agreement (ChAFTA) creates significant opportunities. Many sectors of Australia's domestic economy, in particular natural resources, agriculture and services will now have access to new sources of foreign investment and the confidence to make longer term investments due to enhanced export opportunities.

In *ANZ Opportunity China: the ChAFTA and implications for Australian businesses*, we outline the importance of this agreement, key areas of opportunity and how to do business in China.

China remains one of the fastest growing countries in the world and it will continue to shift towards a consumption driven and increasingly service sector led growth model. This will provide many Australian businesses with the chance to evolve and diversify. Now is the time for businesses to make these growth opportunities a reality.

INTRODUCTION

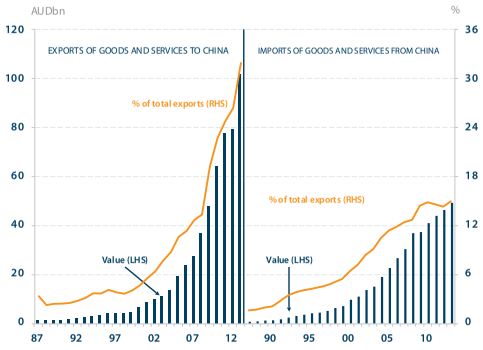
THE CHAFTA HAS THE POTENTIAL TO BE A GAME CHANGER

Why this one stands out

- The ChAFTA has the potential to be transformational over time as:
  - China is Australia's largest two-way trading partner (2013: AUD150 billion; 23% of Australia's trade) (Figure 1)
  - Australia receives a high share of China's outbound investment flows (around 10%, or USD9-10 billion for the period 2011- to 2013)
  - 800,000 Chinese visitors now come to Australia annually, up from 280,000 in 2005
  - 95,000 Chinese students are enrolled in Australia (representing 25% of all international students in Australia)
- The ChAFTA builds on the trade deals recently concluded with Japan and Korea, with the three agreements covering around two-fifths of Australia's goods exports.
- The ChAFTA includes a built-in mechanism to allow for further trade liberalisation between China and Australia and the expansion of market access over time, including a first review mechanism within three years.
- The ChAFTA promotes the significant relationship that exists between China and Australia and it plays to the many strengths of both countries.

FIGURE 1. AUSTRALIA'S TRADE WITH CHINA

Source: DFAT, ANZ Research



Australian businesses

- Coupled with other recent announcements, the ChAFTA will make it easier for Australian businesses to establish operations in China.
- In some sectors Australia has been granted "best ever access," meaning that Australian businesses can operate wholly owned subsidiaries or with less restrictions relative to companies from other countries. This is a critical advantage but one that is finite and could change at any time, as China is highly likely to provide the same level of access to other countries. Consequently, this provides a window of opportunity for Australian businesses.
- Unfortunately, only 19% of businesses have taken advantage of recent FTAs but for those that did, 75% experienced export growth. (source: EIU)
- To successfully capitalise on the ChAFTA opportunity, businesses should be aware of what the changes mean for their industry. More importantly, businesses should develop or extend relationships in China, understand Chinese business and cultural customs and be across key regulations and financial characteristics when doing business in or with China.
- From a banking perspective, businesses should understand the growing importance of RMB as a payment currency, how to effectively manage risk, liquidity and the repatriation of profits (often referred to as trapped cash).

Chinese businesses and consumers

- Domestic Chinese businesses will have the capacity to do even more business with Australia. Up to 95% of Australian goods imported into China will eventually be tariff free, providing lower costs for businesses, which should flow through to consumers in the form of lower prices across a range of product categories.
- Chinese businesses should find Australia an even more attractive market from an investment perspective. Non State Owned Enterprise (SOE) controls for Foreign Direct Investment (FDI) into Australia have been relaxed. Furthermore, while tariff reductions across various industry sectors will make exporting back to China more economical and guaranteeing supply a key investment decision.

Australian consumers

- China is Australia's largest source for electronic goods, textiles and footwear. Tariffs on a range of clothing and footwear categories fell from 10% to 5% on 1 January 2015 while the ChAFTA will result in 0% tariffs when the agreement enters into force. Businesses may seek to utilise some tariff savings to offset against unfavourable exchange rate moves, but the competitive retail market should see a mix of lower prices and better quality (i.e. higher specification) on a range of Chinese produced imports. This is a benefit that should flow through to consumers.

Timeline

- The announcement in November 2014 of the ChAFTA represented the official end to negotiations. The full text (~8,500 product categories and ~1,500 pages of text) will be released in April 2015 once it has undergone a legal scrub. It will then be translated, verified and formally signed before it goes through both parliaments to become law. All of this is expected to be concluded by the end of 2015 when tariff changes will begin to come into force.

CHAFTA OVERVIEW

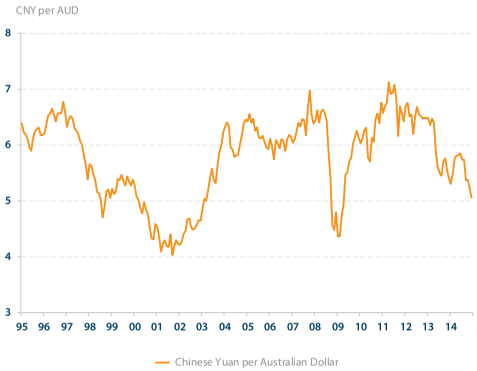
THE INCLUSION OF SERVICES PLAYS TO AUSTRALIA'S STRENGTHS

Highlights

- **Services:** Australian firms in a range of services industries will gain almost unheralded access to China's markets.
- **Foreign investment:** The ChAFTA should encourage more investment from China into Australia over time. Inbound private Chinese investment proposals below AUD1.08 billion will no longer require Foreign Investment Review Board (FIRB) approval, except in so-called sensitive sectors like agriculture where the new (lower) thresholds are AUD15m for land and AUD53m for agribusiness. The Government retains the ability to screen Chinese investments at lower thresholds in media, telecommunications and defence-related industries. State-owned enterprise investment proposals will still require FIRB approval.
- **Labour mobility:** As part of an apparent wider push by the Australian Government, the ChAFTA will reduce barriers to labour mobility and improve temporary entry access for Chinese workers. Limited details are available except that Chinese-funded infrastructure projects in Australia above AUD150m will be able to use Chinese labour under so-called Investment Facilitation Arrangements if the skills are not available locally.
- **Tariffs:** Around 85% of all Australian exports will enter China tariff-free initially, expanding to 93% within four years and 95% on full implementation. About 95% of Chinese goods imported to Australia will be tariff free after four years.
- **Currency:** The Australian dollar has depreciated by nearly 30% against the Chinese yuan in recent years, providing a further tailwind for Australia's exporters to China, particularly those outside the resource sector (Figure 2). The lower currency will help with competitiveness and support profitability for these exporters. The lower currency, however, will make imports from China more expensive.

FIGURE 2. LOWER AUSTRALIAN DOLLAR IS A TAILWIND FOR EXPORTERS

Source: Bloomberg, ANZ Research



Comparison with other FTAs

Australia has a multilateral FTA with New Zealand and ASEAN countries. Bilateral FTAs are in force with Chile, Korea, Japan, Malaysia, New Zealand, Singapore, Thailand and the United States.

Given the difficulties in getting several countries to agree on multilateral FTAs, there has been a proliferation of bilateral agreements in recent years which tend to be much easier to settle. The aim of FTAs is to reduce or remove trade barriers and provide mutual benefits to both countries by playing to their respective comparative advantages.

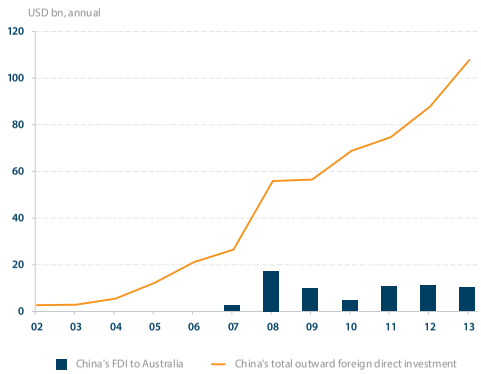
A key differentiating factor of the ChAFTA over other Australian FTAs is that it is with a country where demand, outbound investment (Figure 3) and tourism (Figure 4) are expected to continue to grow quickly. While all FTAs are broadly similar in their aims, the agreement with China potentially provides greater upside for Australia due to the strong underlying growth, increasingly for food and services, as living standards in China improve further over time.

According to the Australian Government, under the ChAFTA China commits to provide almost unmatched access for Australian services providers (only Hong Kong and Macau, special administrative regions of China, will have better access). Access will be improved in around 40 areas to levels either equivalent or better than those enjoyed by other nations. Tourism, aged care, health, finance, engineering, construction and legal firms are among the potential beneficiaries. China is seeking to develop its services sector so that it accounts for a larger share of output and growth and this transition is already happening (Figure 5). Services account for more than 70% of Australia's economy so we are well placed to help achieve that. But there will be strong competition from other countries.

For agriculture, the ChAFTA will eventually remove the advantages enjoyed by New Zealand farmers under its FTA with China (signed in 2008), including in beef and dairy. Although it will take around a decade to close the gap entirely. Australian dairy farmers, however, will have one advantage over their kiwi counterparts: an absence of 'safeguard' measures should cheese, butter, liquid milk or infant formula exports grow very fast out of Australia.

FIGURE 3. CHINA'S OUTWARD FOREIGN DIRECT INVESTMENT

Source: CEIC, KPMG/University of Sydney, ANZ Research



CHINESE INVESTMENT INTO AUSTRALIA IS SET TO INCREASE

FIGURE 4. SHORT-TERM VISITORS TO AUSTRALIA FROM CHINA

Source: ABS, ANZ Research

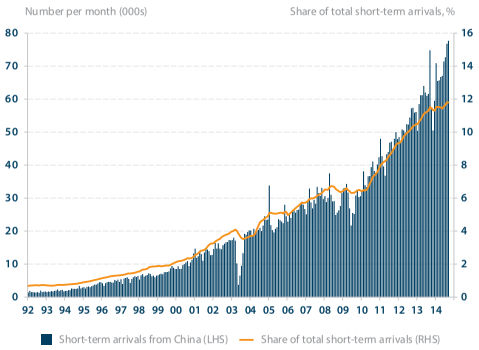
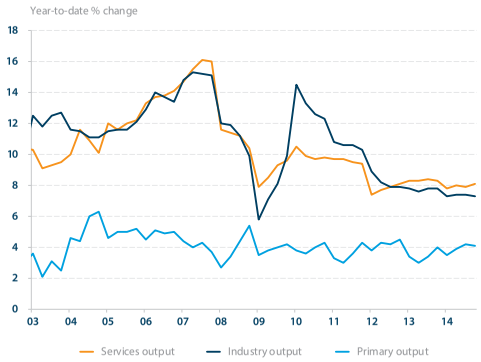


FIGURE 5. SERVICES ARE BECOMING MORE IMPORTANT IN CHINA'S GROWTH

Source: Bloomberg, NBS, ANZ Research



Benefits for China

The benefits for China are multifaceted. Tariff reductions on Chinese exports to Australia will be of some benefit to Chinese businesses. In turn, Australian consumers will ultimately benefit from lower tariffs on imports from China. The timing and extent of the pass-through of lower tariffs will depend on various factors, including: the timing and rate of tariff reductions; currency hedging strategies of importers; and the pricing power of importers. Any effect may not be immediately apparent amid changing exchange rates and the effects of other factors.

The small size of the Australian market means that tariff cuts on imports from China are the most important part of the FTA from China's perspective. Easier access for private Chinese investment in Australia outside of agriculture is also a key benefit. As shown in Figure 3, Australia already "punches above its weight" in terms of its share of China's outbound investment. Naturally, it is expected that this investment flow would continue into Australia's mining sector, but probably not at the speed of recent years during the mining investment boom. Investment into agriculture is also expected to rise given that actual FDI from China is still small despite rising interest. With China increasingly diversifying its own industrial structure to higher end manufacturing and services, its global investment is also likely to diversify.

Chinese investment in Australian property, including residential, office and other commercial assets (such as hotels), is expected to remain strong, regardless of any easing in process under the ChAFTA. The lower Australian dollar against the yuan also makes Australian assets more attractive.

Chinese appetite to investment in new and existing Australian infrastructure is also rising. Chinese companies are showing interest in the anticipated increase in government asset sales in Australia over the next few years. In fact, there has already been one high profile example of a Chinese company purchasing the construction arm of an Australian company in part to gain exposure to the anticipated pick-up in new infrastructure spending in coming years. The apparent relaxation of labour mobility between China and Australia under the ChAFTA (and more broadly) makes such investments more attractive.

As China transitions to a more services based economy, consumers will benefit from the increasing imports of quality health and aged care services and easier movement of workers between the two countries.

From a broader perspective, a FTA with an open and advanced economy like Australia will push forward China's market-oriented reforms.

BEEF, DAIRY AND WINE ARE AMONGST THE KEY AGRICULTURE BENEFICIARIES

LABOUR MOBILITY

- According to the Government, the ChAFTA will reduce barriers to labour mobility and improve temporary entry access within the context of each country's existing immigration and employment frameworks and safeguards.
- Notably, Chinese-owned companies registered in Australia undertaking large infrastructure development projects above AUD150 million will be able to negotiate, similarly to Australian business, increased labour flexibilities for specific projects. This will be assessed on a case-by-case basis under arrangements similar to the former Enterprise Migration Agreements (EMAs) introduced to assist in addressing skills needs of the resource sector. EMAs were negotiated with the project owner and set the terms by which foreign workers could be engaged on the project, as well as outlining training commitments that had to be met by the project. Workers were subject to the Worker Protection Act 2009 and were obliged to pay Australian market salary rates.
- Broadly speaking, it appears that the Australian Government is pushing ahead with several initiatives to make it easier for skilled foreign workers to come to Australia, at least temporarily. For instance, the Immigration Department has proposed a new temporary visa which would allow specialised workers to enter Australia for up to one year without the need for a 457 skilled worker visa.

AGRICULTURE

- The ChAFTA will have a significant impact for the agriculture sector, with both winners and losers. Tariffs will be eliminated on a number of important commodities such as beef and dairy, however, the agreement missed the mark on commodities including cotton, rice, sugar and oilseeds. In fact the commodity "beneficiaries" currently account for less than 25% of agriculture related exports to China, implying that further opportunity may exist as negotiations evolve.
- **Beef:** Australia is already China's primary supplier of beef and while the eventual elimination of tariffs are positive, there will be questions on the ability of Australian producers to meet China's growing demand. Many exporters may be reluctant to switch export volumes to China and risk being shut out of the key Indonesian market. Timing on the ChAFTA is important as the staged elimination of beef tariffs will benefit Australian producers at a time when competition from US and Brazilian producers is likely to increase when they are fully allowed back into the Chinese market.
- **Dairy:** The intangible benefit of dairy's inclusion is the impact on sentiment, as producers have often viewed the advantage that New Zealand has had, care of its own FTA with China, as being highly significant. While it will take up to 11 years for tariffs to be eliminated, progress in this area is a great win for the industry. The ChAFTA is a major positive for dairy but in a globally competitive market the dairy sector needs to continue to innovate and build a brand to win market share in a growing market. These announcements are also likely to lead to further investment in the sector, particularly towards processing and production in a bid to secure supply.
- **Wine:** The ChAFTA positions Australia to regain ground over their Chilean competitors, who have lifted exports seven fold since the introduction of the China-Chile FTA. With China's major Australian wine import category being at the premium price-point, the tariff cut from 15% to zero over four years will allow the Australian industry to boost the competitiveness of its high-end products.
- *Key client considerations include working capital and supply chain management, RMB liquidity management, foreign exchange risk management, commodity risk management and asset based gearing.*
- See ANZ Live: *ANZ Research: FTA positions Agri into the Asian century (19th Nov, 2014).*

MANY AUSTRALIAN SERVICES BUSINESSES WILL ENJOY "BEST EVER ACCESS"

MANUFACTURING

- Tariffs on a range of Chinese imports will be reduced or eliminated but Australia's manufacturing industry has consolidated and evolved such that the total benefit to the industry is likely to be mixed.
- Australia will phase out tariffs on manufactured imports from China of clothes, footwear, household electronics, cars and car components by 2019.
- **Pharmaceuticals and vitamins:** Across the manufacturing sector, the biggest opportunity lies in Australia's globally integrated pharmaceutical industry, which already exports products to China worth almost AUD600m annually. China's growing middle class and demographic profile make the market attractive to both pharmaceutical exporters in addition to vitamin providers. Tariffs of up to 10% on pharmaceuticals, including vitamins and health products, will be removed either on entry into force or phased out over four years.
- *Key client considerations include working capital and supply chain management, RMB liquidity management, foreign exchange risk management, commodity risk management, target capital structuring and funding.*

CONSTRUCTION AND ENGINEERING SERVICES

- China will give Australian construction companies access to carry out construction work in Shanghai if they are established in the Shanghai Free Trade Zone (SFTZ) and partner with Chinese companies.
- Australian architectural and engineering firms will be allowed to obtain broader business licenses to carry out work on construction projects in China.
- Temporary access for Chinese workers can be negotiated to work on major projects undertaken by Chinese companies in Australia worth more than AUD150m if the skills are unavailable locally. See *Labour Mobility*.
- *Key client considerations include performance guarantees, RMB liquidity management, foreign exchange risk management, target capital structuring and funding.*

FINANCIAL SERVICES

- Unprecedented new and improved access frameworks will allow Australian providers of banking, insurance, funds management, securitisation, securities and futures services will be able to better pursue commercial opportunities in one of the world's fastest growing services markets.
- **Insurance:** An ability to fully access China's statutory third-party compulsory motor vehicle insurance market.
- *Key client considerations include RMB payments and cash management, FX risk management, investment sourcing and hedging, regulatory capital solutions, and debt funding.*
- **Funds management:** Australia was granted a RMB50 billion quota (around AUD10 billion) under RMB Qualified Foreign Institutional Investor (RQFII) program to invest offshore RMB in Chinese onshore financial instruments; Australian securities brokerage and advisory firms can provide cross-border securities trading, custody, advice and portfolio management services to Chinese institutional investors allowed to invest offshore.
- *Key client considerations include RMB liquidity management, FX risk management, deposit and yield solutions, investment sourcing and hedging, asset based gearing.*
- **Securities and futures:** Joint ventures with up to 49% Australian ownership; ability to conduct domestic securities funds management business.
- *Key client considerations include RMB payments and cash management, liquidity solutions, FX risk management, capital structure and funding.*
- **Private equity:** Further work on access to Chinese investment opportunities.
- *Key client considerations include advisory, acquisition finance, capital markets access, hedging; for investee companies - transaction banking, working capital and funding.*
- **Banking:** Removal of minimum RMB100m working capital requirements for subsidiaries; subsidiaries will be the first foreign banks eligible to engage in credit asset securitisation.
- *Key client considerations include structuring, portfolio management, funding and distribution.*

HEALTH AND AGED CARE

- Australia's healthcare industry is growing rapidly and is now the country's biggest employer. Australia's ability to successfully operate hospitals, aged care and other health related facilities will be a competitive advantage for businesses that decide to take advantage of "best ever access" to the domestic Chinese market.
- China's health sector remains very underdeveloped and its population is ageing quickly, providing a significant demand tailwind that should grow until at least 2030 when the population is expected to peak.
- *Key client considerations include RMB liquidity management, foreign exchange risk management, target capital structuring and asset based gearing.*

EDUCATION

- China is Australia's largest export market for education services (worth around AUD4 billion in 2013) and also one that is highly protected.
- The FTA provided the seemingly insignificant benefit to Australian education providers of adding their name to a government website but this site is the primary channel for students to choose an education provider for studying abroad and is highly trusted (77 institutions will be added to the existing 105 Australian institutions on the website). In fact, almost 90% of Chinese students studying in Australia used a provider listed on the Ministry's website. This is likely to provide increased exposure and ultimately student demand to Australian education providers.
- *Key client considerations include RMB liquidity management, foreign exchange risk management and funding.*

TOURISM AND HOSPITALITY

- Australian service providers will be able to construct, renovate and operate wholly Australian-owned hotels and restaurants in China. Australian travel agencies/tour operators will also be able to establish wholly Australian-owned subsidiaries in China for tours within China for both domestic and foreign travellers.
- Up to 5,000 Chinese work and holiday visas will be provided by Australia. These are visas granted to young people for up to a year who want to travel and work in Australia. This change will add modestly to the significant number of such visas already granted by Australia with about 240,000 granted to other countries in FY2014.
- Tourism Australia projects that China will contribute nearly one-quarter of the growth in the number of visitors to Australia over the decade to FY2023 and that about two-fifths of inbound tourism expenditure will be sourced from China over that period. (The Government also recently announced significant increases to allowable airline capacity between Australia and China.)
- *Key client considerations include RMB liquidity management, foreign exchange risk management and funding.*

OTHER SERVICES

- Australian law firms will be able to establish commercial associations with Chinese law firms in the SFTZ. This will allow them to offer Australian, Chinese and international legal services through a commercial presence, without restrictions on the location of clients.
- There are also benefits for Australian firms in: manufacturing and mining services; architecture and urban planning services; transport services; and telecommunications companies.

RESOURCES

- The reduction in tariffs on some of Australia's resource exports to China is a positive but ANZ Research believes that the overall benefit to Australia's resources sector will be minimal, as the tariff reduction on high volume exports will be low.
- See ANZ Live: *ANZ Research: Limited benefit for Resources from China-Australia FTA (20th Nov, 2014).*

AUSTRALIAN OPPORTUNITIES FROM THE CHAFTA

PLAYING IN NICHES CAN BE A MAJOR ADVANTAGE

A look at which areas and industries will benefit from the ChAFTA

When it comes to FTAs all products and industries are not created equal. While the ultimate aim of a FTA is to create trade and therefore create income in both countries, FTAs typically do not cover every export and import. As such, the benefits and opportunities will vary.

ANZ Opportunity China uses both quantitative and qualitative methods to identify where the major opportunities are for Australian businesses exporting or looking to export to China.

Although the full detail from the ChAFTA is not expected until April 2015, the key levers in determining the size of the opportunity can still be determined.

Some of the key factors to determine the strength of the export opportunity for Australian businesses across all product categories and industries will include:

- Australia's relative strength, size, and cost advantage relative to the Chinese domestic offering and sources from other countries
- The relative price elasticity of the good/service
- The magnitude of the tariff reduction
- Any major differences in quality of the product/service compared to what's available in China

NOT ALL AREAS WILL BENEFIT

ANZ's analysis found that Australia's opportunities are likely to be deep and narrow in some areas and largely immaterial in others. For instance, Australia's exports to China of car engines were worth over AUD102 million in 2013. However, potential realised benefits to Australian businesses will be low, as the major domestic automotive manufacturers are exiting Australia. This will have a profound impact on capacity as associated original equipment manufacturers are forced to realign their strategy given the impending impact on their future sales.

Resources are another area where there will be limited upside post the ChAFTA as existing tariffs on the major commodities are already low. Despite significant export volumes to China of resources including coking coal, non-coking coal and copper, the change in tariffs will not be a catalyst to drive material volume gains or new export opportunities for Australian businesses. The tariff elimination may result in a slight pivot towards Australian exports, leading to potential market share gains for Australia relative to other countries, however, the extent of this change is expected to be immaterial.

THE LARGEST OPPORTUNITIES

The forthcoming detail of product category tariff changes will provide extra clarity on where the opportunities for Australian businesses may be. What we know now though is that the largest aggregate opportunities are likely to be (in no order):

- Agriculture including dairy, wine and beef
- 3rd party liability motor vehicle insurance
- Funds management
- Education
- Health (aged care and hospitals)
- Vitamins

For aged care, hospitals and 3rd party liability motor vehicle insurance, there is added complexity compared with a traditional trade flow relationship as wholly owned subsidiaries need to be created and operated in China. As such, understanding local market dynamics, business structures, domestic laws and capital requirements will become a critical success factor. How to operate amidst this complexity is covered off in more detail in *Section 3 – What Australian businesses should be doing and Section 4 – Navigating the banking market.*

While the opportunity may be high, the added business and execution complexity may limit the amount of Australian businesses that have the capability and/or capital to compete in a large foreign market.

IT PAYS TO PLAY IN NICHES

Despite strong coverage on the major export opportunities for Australia, many businesses do not take advantage of FTAs, as they are either unaware or unsure how to capture the opportunity.

The objective of *ANZ Opportunity China* is to provide Australian businesses with a view on where the opportunities are, what they should know when dealing with China from a banking and capital perspective and how they can successfully execute their China strategy.

Playing in niches can be a major advantage for a number of Australian businesses. The full ChAFTA text is expected to be 1,500 pages long covering around 8,500 tariff lines. The majority of exports to China (95%) will eventually be tariff free and for some product categories that will result in a significant reduction in price and therefore, the potential attractiveness to Chinese business and consumers.

Examples of major tariff reductions in smaller categories include a 25% tariff reduction in honey related products over five years, a 21% tariff reduction on pearls within four years, a 10-25% tariff reduction on various nuts over four years, a 15% tariff reduction on rock lobster in four years and up to a 30% tariff reduction for various fruit juices.

These are not major export categories to China, however, the sharp drop in prices make these Australian products significantly more attractive to Chinese consumers and relatively more competitive compared with the same product from other countries where tariffs with China may still remain in place.

It is essential that businesses understand how their area of expertise is affected when the ChAFTA enters into force in late 2015. More detailed information will be released by the DFAT in April, but businesses should be planning now.

BENEFITS AND OPPORTUNITIES WILL VARY BY INDUSTRY SECTOR

FIGURE 6: THE CHAFTA INDUSTRY OPPORTUNITY HEATMAP

Source: DFAT, ANZ

Industry	Export Level*	Tariff Reduction	AU Relative Strength	ChAFTA Opportunity	ANZ Comment
Agriculture					
Beef	Medium	0% within 9 years from 12-25%	High	High	Attractive dynamics and material tariff reductions should be a tailwind
Sheepmeat	Medium	0% within 8 years from 12-23%	High	High	Tariff reductions and a lower AUD should favour the Australian premium wine segment especially
Dairy	Medium	0% within 4-11 years from 10-19%	High	High	China is already Australia's export market by a factor of four
Wine	Medium	0% within 4 years from 14-20%	High	High	A small but protected export market could provide a growth opportunity for some Australian producers
Hides, skins & leather	Medium	0% within 9 years from 12-25%	High	High	A very small export market to China but one that should continue to grow
Horiculture	Low	0% within 4-8 years from 10-30%	Medium	Medium	A high quality/in demand product will drive demand. The 3% tariff elimination on barley and 2% on sorghum are immaterial
Seafood	Low	0% within 4 years from 8-15%	Medium	Medium	Demand will increase in line with a Chinese domestic market that values the quality of Australia's cattle for production purposes
Barley (and other grains)	Medium	0% within 0-4 years from 2-15%	High	Medium	China is a high consumer of pork, however, domestic production covers the majority of demand
Live animal exports	Low	0% within 4 years	High	High	Demand will increase in line with a Chinese domestic market that values the quality of Australia's cattle for production purposes
Pork	Low	0% within 4 years	Low	Low	China is a high consumer of pork, however, domestic production covers the majority of demand
Resources					
Coking coal	Very high	0% immediately from 3%	High	Low	The small change in tariff is unlikely to influence demand
Non-coking coal	Very high	0% within 2 years from 6%	High	Low	The small change in tariff is unlikely to influence demand
Copper (alloy/refined)	Very high	0% immediately from 1-2%	High	Low	The small change in tariff is unlikely to influence demand
Alumina	High	0% immediately from 8%	High	Low	The small change in tariff is unlikely to influence demand
Nickel	Medium	0% immediately from 3%	Medium	Low	The small change in tariff is unlikely to influence demand
Zinc	Medium	0% immediately from 3%	Medium	Low	The small change in tariff is unlikely to influence demand
Copper (waste/scrap)	Medium	0% immediately from 1.5%	Low	Low	The small change in tariff is unlikely to influence demand

Industry	Export Level*	Tariff Reduction	AU Relative Strength	ChAFTA Opportunity	ANZ Comment
Manufacturing					
Pharmaceutical/ Vitamins	Medium	0% within 4 years from 3-10%	Medium	Medium	China is Australia's largest export market but manufacturing capacity has declined. Vitamin exports remain an opportunity
Processed food		0% within 4-5 years from 7.5-30%	Medium	Medium	Not a major export market, however a lower AUD and some fairly significant tariff reductions could provide opportunities
Car engines	Low	0% within 4 years from 10%	Low	Low	Domestic manufacturers are exiting the industry. Our capability was high but our capacity will be low
Other manufactured products	Low	0% in 0-4 years from 3-15%	Low	Low	Niche providers may prosper but the aggregate opportunity remains low
Services					
Legal	Low	Guaranteed access in the SFTZ	Medium	Medium	Improved access and coverage will benefit tier 1 and possibly tier 2 firms that have the capability to participate in the Chinese market
Education	Very High	Improved visibility and better access	HIgh	Medium	The Chinese export market is worth more than AUD$4 billion, signifying the strong appeal for Chinese students. Better access/visibility should provide further growth
Telecommunications	Unknown	Improved foreign equity limits	High	Medium	Potentially an attractive market for the right business
Tourism	Low	Access fro wholly owned AU companies	Medium	High	A large and growing segment but domestic competition is high
Aged care	Unknown	Green/brownfield for wholly owned hospitals & aged care providers	High	High	Very favourable macro/demographic conditions but local market knowledge will add complexity for Australian operators
Other services	Unknown	Increased market access & equity ownership limits	Medium	Medium	Potentially very attractive across a range of industries for businesses of all sizes
Financial Services					
Insurance	Low	Access to compulsory 3rd party liability motor vehicle insurance	Medium	High	Very low foreign insurer penetration; opportunity to leverage technical expertise
Banking	Medium	Reduced waiting period and streamlined branch access applications	Medium	Medium	An attractive opportunity for the 4-5 major Australian banks
Funds management	Low	Granted RMB quota under RMB QFII program	Medium	High	Opening for sourcing RMB funds to invest in onshore RMB securities

***Export Level** Very high > **AUD$3b** High **AUD$1b-AUD$3b** Medium **AUD$200m-AUD$1b** Low **<AUD$200m**

The opportunity heatmap covers interim information released by DFAT in November 2014. Further government information set to be released in April 2015.

AUSTRALIAN AGRICULTURE WILL BE A MAJOR WINNER FROM THE CHAFTA

ChAFTA industry spotlight

The full ChAFTA text will provide clarity at the product level, but the major opportunities from the ChAFTA are not just based on tariff changes but also demand and supply fundamentals, Australia' relative strength in a particular industry, historical trading relationships and changes with respect to competing countries to Australia for the Chinese import dollar. While the ChAFTA is relevant for every industry, we provide a spotlight on a few of the most important.

SPOTLIGHT ON AGRICULTURE

The signing of the ChAFTA in November 2014 was greeted with strong enthusiasm by the Australian agricultural sector. China's imports of food and agricultural products have continued to increase over the past decade, driven by population growth, rising incomes, urbanisation, and a trend toward Western diets. While domestic food production has continued to grow, driven by agricultural strategies as part of the Five Year Plans, China's import food dependence has doubled to almost 13% since 2001.

Particularly over the past decade, the Australian agriculture sector has in many ways felt handicapped by the lack of a FTA, in comparison to their competitors from New Zealand, whose FTA with China was finalised in 2008. With the gradual elimination of tariffs under the FTA, the Australian agriculture sector will enjoy equal footing with New Zealand.

Primarily, the impact of the implementation of the ChAFTA on Australian agricultural exports will be increased price competitiveness with their competitors. In addition, a scheduled review of the ChAFTA's outcomes after three years may allow for further liberalisation of market access.

The flow-on implications from the ChAFTA clearly go beyond price competitiveness. The enhanced attractiveness of Australian agricultural products, combined with the limited rate of agricultural production globally, is likely to see increased investment in production assets, as processors, traders and distributors seek to tie up supply, and investors seek to gain a return on forecast strong consumption growth. Importantly, for Australia, while a great deal of the demand predictions are based on China, the capital inflows to the sector seeking to take advantage of this are global.

Across the supply chain the improved margins of efficient operators who are able to take advantage of the ChAFTA benefits are likely to lead to increased industry consolidation, as businesses seek scale efficiencies.

However, while tariff reductions and market access are important, they form only one of the factors which will determine market share for competing agricultural exporters to China. The issue of food safety, and its impact on the food buying choices of the Chinese public, continues to attract much coverage and debate.

Different Australian agricultural sectors have continued to emphasise the food safety merits of Australia's produce, in contrast to global competitors. This varies by sector – for beef, the absence of FMD (Foot and Mouth Disease) or BSE (Bovine Spongiform Encephalopathy or "Mad Cow Disease") has provided Australia with a clear edge over global competitors such as the US and the EU. For other sectors, the food safety concerns driving Chinese consumers to look toward imported products are driven by domestic incidents such as the 2008 Chinese milk scandal, where milk tainted with melamine, led to the deaths of six babies and the hospitalisation of over 50,000 others. Arguably food safety remains a major driver in China's dairy consumer habits seven years on.

THE HIGH CHINESE DEMAND FOR IMPORTED DAIRY PRODUCTS IS LIKELY TO BE MAINTAINED

SPOTLIGHT ON DAIRY

While Australia accounts for an estimated 2% of the world's milk production, it is a significant exporter of dairy products. Australia ranks fourth in terms of world dairy trade—with 7% share—behind New Zealand and the European Union as a bloc and the United States. Over recent years, Australia has exported around 40% of its milk production - the lowest proportion since the mid-1990s, due to the reduced availability of product from a declining milk production base.

Greater China (including China, Hong Kong and Macau) is now the single most important export market for Australia, accounting for 19% of exports by both volume and value. Australian exports are concentrated in Asia, which represented 75% of the total dairy export value of AUD3.21 billion in FY2014. Australian dairy companies have been supplying these markets over a number of decades.

This concentration of exports in Asia reflects both Australia's geographic proximity to these markets and the extent to which Australia is excluded from other major markets by direct restrictions (as in the case of the EU or the impact of the export subsidy programs of major competitor countries). Asian markets have considerable potential for consumption growth as incomes rise and diets become more "westernised". The fastest growing export market for Australia in the last five years has been Greater China.

In the opposite direction, Australia is a relatively small player, making up around 3% of China's milk powder imports and around 11% of China's liquid milk imports.

Within China, local production is adjusting to tighter regulations implemented in the wake of the melamine contamination and is becoming more concentrated. The high demand for imported dairy products is likely to be maintained in the foreseeable future with significant growth expected for imported retail products including infant formula, UHT milk, cheese, pasteurized milk and yogurt, with the use of ingredients like SMP, WMP and whey powder. Powders constitute 70% of the market by volume, 82% by value.

FIGURE 7: AUSTRALIAN DAIRY EXPORT DESTINATIONS BY VOLUME

(2014, 730,904 tonnes)
Source: Dairy Australia, FAPRI & ANZ Analysis

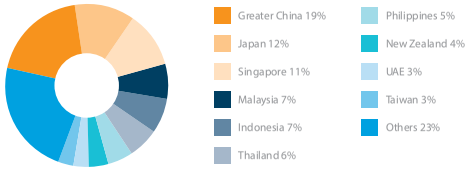


FIGURE 8: AUSTRALIAN DAIRY EXPORT DESTINATIONS BY VALUE

(2014, AUD 3,211 million)
Source: Dairy Australia, FAPRI & ANZ Analysis

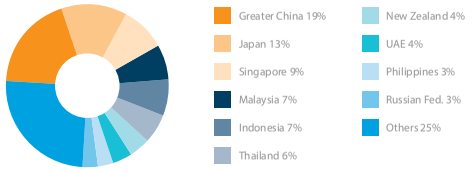
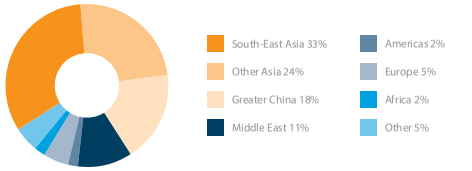


FIGURE 9: AUSTRALIAN DAIRY EXPORTS BY REGION (2014)

Source: Dairy Australia, FAPRI & ANZ Analysis



THE DAIRY DEAL

The dairy deal

It was for no small reason that Australian Trade Minister Andrew Robb described the FTA as "the dairy deal". Throughout the negotiation period, the Australian dairy sector was adamant that the dairy outcomes needed to be equal to or better than those received by New Zealand under their 2008 FTA with China. In the period since that FTA, NZ dairy exports to China have risen from AUD500 million to AUD3 billion annually.

Under the FTA, the 10% to 20% tariffs which currently apply to the dairy sector will be phased out over ten years, while the 15% tariff on infant formula will be phased out over four years.

One factor which further assists the Australian dairy sector is the lack of protective safeguards which currently apply to the New Zealand's dairy exports to China. Under the New Zealand FTA, tariffs are applied once a quota is reached, though under the Australian agreement, these safeguards only apply to whole milk powder.

The signing of the FTA is likely to see an upturn in completed transactions by Chinese investors in the Australian dairy supply chain, both at the production and processing stages. Until now, while Chinese investor interest in the sector has been widely discussed and speculated upon – rumours of options on a large number of major dairy farms abound – there have been relatively few actual transactions, with the major acquisitions coming more from European, Japanese and Canadian players such as Parmalat, Kirin and Saputo.

Wary of a repeat of the food safety issues which have rocked the Chinese dairy sector in the past, Chinese companies will be keen to secure alternative sources of supply in Australia, investing in dairy farms and dairy processing. At the same time, other major global investors are also exploring opportunities in the Australian dairy production sector, keen to take advantage of the opportunities offered by the Chinese market and enhanced by the FTA. With limited areas in Australia suitable for intensive dairy farming, this will place potential investors in competition with the established dairy processors, for whom it is vital to secure supply contracts. The result of this is likely to be ongoing upward pressure on dairy producing land, while process for dairy cattle are also likely to rise, partly influenced by growing live dairy cattle exports, with around 85% of this AUD200 million trade destined for China in FY2014.

The impact on downstream costs will also likely drive further investment by Chinese processors up the supply chain. Lower import costs are likely to drive down local raw milk prices, while increasing the price advantage of imported UHT milk over domestic products. As such, the major Chinese milk processors, such as Mengniu, Bright and Yili are all likely to seek to increase production of their branded import UHT products.

The impact of the ChAFTA for baby formula producers may be less than the other major dairy product categories. In the continuing wake of the melamine scandal, Chinese consumers remain hesitant to use domestically produced products, choosing to pay what can be a sizeable premium for imported products. As such, the impacts of marketing, innovation and distribution may continue to be the major drivers in this segment.

In the short to medium term, the impact of dairy tariff changes could be blunted by the sluggish growth. With Australia's production of both WMP and liquid milk running at low single digit figures over the past five years, the industry's challenge remains to lift productivity to meet the forecast demand.

SPOTLIGHT ON WINE

The ChAFTA comes at an important time for the Australian wine sector. In terms of wine producers, the Australian industry has continued to grow to around 2,572 in 2013. This is largely made up of boutique wineries, producing less than 100 tonnes. Interestingly, this places the Australian wine sector in contrast to almost every other agriculture sector, when overall numbers continue to decline, on the back of industry consolidation.

The Australian wine industry has been increasingly export oriented over the past twenty years, with exports rising from 55% of total volume in 1991 to 73% in 2013. In recent years, the industry had been impacted by the high AUD, as well as strong competition in the lower end of the wine market from competitors in new regions such as Chile and South Africa.

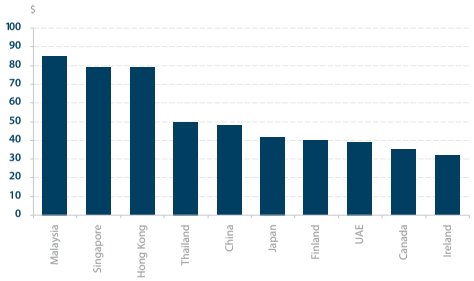
At home, the industry had also been challenged by the market power of the two major retailers, as they continued to lower margins while introducing their own private labels. Domestic consumption growth has also been sluggish, further hit by an increase in imported wine.

As an export market for Australian wine, China has continued to increase in importance, rising from the fifth largest market in 2008 to third in 2013. The growth has been driven by overall volume increases and higher price mix of exports. Chinese wine imports from Australia are almost entirely from the bottled sector (85%) rather than bulk, a ratio which is almost a direct contrast from that of Australian exports to the UK.

Australian wine producers have continued to pursue opportunities in China, while moving away from other traditional markets. In terms of pricing per case, Australia's top six markets are in Asia, and while China falls behind Malaysia, Singapore, Hong Kong and Thailand, its sheer current and forecast export volumes add to its allure.

FIGURE 10: PRICING IN EXPORT MARKETS (AUD/CASE)

Source: Morgan Stanley: Global Wine Industry Report October 2013



The attractiveness of the Chinese market lies particularly in the volumes of high priced wines. In the top price segment for Australian wine imports, above AUD10, China saw growth of 25% in 2013, and now holds around 31% of that segment. Combined with Hong Kong, the two hold almost 43%.

In China, red bottled wine dominates over other varietals, driven by cultural preferences. Red wine is considered to be "lucky", due to the connotation of "good fortune", associated with the colour red. In addition, wine is perceived to be socially and culturally sophisticated. In addition to promoting good fortune, red wine is also seen as being good for health. China's consumption of wine has continued to be driven by rising household incomes, with increasingly affluent consumers shifting to wine from beer or spirits as their alcohol of preference.

More recently, the ascension of Xi Jinping to the Chinese Presidency, and his crackdown on gift-giving and entertainment, in a bid to reduce corruption, had an initial impact on the export of Australian wines to China, declining in 2013, before rising 8% in 2014 to hit 40 million litres, valued at AUD224 million.

THE CHINESE MARKET WILL CONTINUE TO OPEN UP FOR AUSTRALIAN WINE PRODUCERS

Positioning Australian wine for growth

Tariffs on Australian wines are to be reduced to zero in four years from 14% on bottled wines and 20% on bulk wines. Just as with beef producers, the Australian wine sector will see this as allowing them to become more competitive with the Chilean and New Zealand wine sectors. New Zealand wines have had no tariffs since 2012, while Chilean wine tariffs were reduced to zero in 2015.

The growth rates of Chilean wine exports to China provide an interesting indication of the change in China's market. In 2013, a year where China's overall wine imports fell due to government austerity measures, Chilean imports rose by almost 40%. In the first nine months of 2014, Chilean imports rose a further 50% in volume, compared to an overall import decline of around 7%. Chilean wines are particularly competitive in the mid to lower end of the market, a segment which is also more relevant to younger consumers.

The impact of zero tariffs on wine, and on most retail goods for that matter is potentially more noticeable on wine purchased through e-commerce retailers, where a lack of retail associated on costs such as rent, sales staff and marketing is less likely to see tariff reductions absorbed into existing prices. This issue is likely to become of increasing relevance in China, where the e-commerce market is already larger than that of the US, and which by 2020 is forecast to be larger than the US, France, Germany and the UK combined. As e-commerce giants such as JD and Alibaba seek to enhance their infrastructure and logistics to allow overnight delivery of any good to anywhere in China, Australian wine exporters will increasingly need to build online distribution options into their marketing strategies.

The challenge for Australian wine exporters to China differs by product. For those exporting the less expensive varieties, the consumer price reductions as a result of the tariff cuts will allow them to tackle competitors not just from Chile, but from exporters such as Spain and Italy, as they seek to gain more market share from the younger, less affluent, price conscious but socially aspirational Chinese consumer.

For exporters shipping the higher priced product, the challenge will continue to be the monolith of the French industry, which continues to enjoy an almost untouchable reputation in the eyes of affluent Chinese consumers, reflected in its market share of around 50% of all wine imports. To many of these consumers, whether in retail or restaurants, the higher the price of a bottle, the greater its attractiveness. The challenge for Australian wine exporters in this market segment will continue to be to balance the volume demand for their exports with the exclusivity of their product, while positioning Australian wine as unique, but as an alternative to the French product.

Breakdown of China's import wine market 1H14

FIGURE 11: BY VALUE

Source: Wines-info.com ANZ Analysis

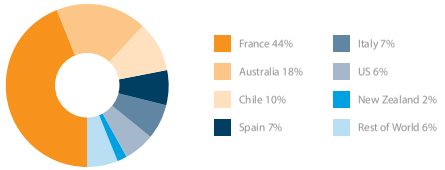
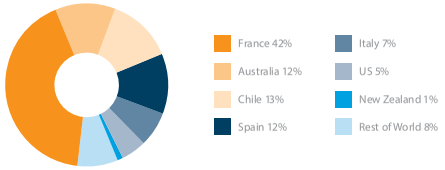


FIGURE 12: BY VOLUME

Source: Wines-info.com ANZ Analysis



The tariff cuts will see an increasing number of quality Australian wines becoming available to Chinese consumers. This is likely to be driven by Chinese wine importers who may previously have been deterred from including Australian wines in their portfolios.

In the wake of the ChAFTA, several new distribution agreements were announced. The South Australian winery Kilikanoon announced that it had signed a distribution deal with Joyvio, the agricultural division of computer maker Lenovo. This followed the announcement in August 2014 by McGuigan wines producer Australian Vintage that they had signed a distribution deal with Cofco in China.

Tellingly, the involvement by Joyvio/Lenovo provided further evidence on the trend of major Chinese companies across a range of sectors seeking to move into the wine trade.

Perhaps unsurprisingly, the trend of Chinese investors buying into Australian wineries has slowed over the past year, as Chinese investors evaluated the longer term implications of the austerity measures on their potential investments. For Chinese wine importers, the austerity measures have also left a degree of hangover stock, which will also impact investment decisions for the short to medium term. Since 2010, Chinese investments into the Australian wine sector had remained steady, though largely of a smaller scale, with the assets seen as more trophy purchases or retreats, rather than as scalable components of a supply chain strategy to provide exports of Australian wine to a wider section of the Chinese market.

FOOD SAFETY HAS BEEN THE PRIMARY DRIVER OF CHINESE BEEF IMPORT GROWTH

In addition, while Chinese investors may have anecdotally bought around 100 Bordeaux vineyards in the past five years, the investment approaches to Australian wineries are still relatively unsophisticated, in terms of factors such as varietals, locations and processing facilities – this is not overly surprising given the relatively recent introduction of international wines to the Chinese palate.

The timing of the ChAFTA, combined with a year of evaluating the implications of the austerity measures, is likely to see a return in Chinese investors to the Australian wine sector. Undoubtedly, smaller boutique Australian wineries, particularly in the sub AUD10 million range, will remain attractive assets for Chinese investors, as their output level provides enough of a volume for export and distribution through targeted outlets in China.

However, as is increasingly common in investments across different agricultural production sectors, the growing realisation by investors that individual agricultural operations require specialised and experienced management is likely to see a strong leaning toward joint venture models with vineyard and winery owners.

For investors focussing on larger operations, with the scale for wider distribution in China, attention is likely to be stronger on wineries with more advanced bottling operations, with the ability to streamline the logistics and distribution process from the vineyard, through bottling, to the distribution network itself within China.

A further factor likely to impact the wine supply chain between Australia and China is the role of the major Australian retailers, Coles and Woolworths. In the Australian domestic market, the two majors are increasingly placing pressure on individual wineries, as they increase their own basket of private label wines, and the shelf space of these labels.

In December 2014, Woolworths acquired the Australian-owned Chinese wine distributor Summergate Fine Wines and Spirits, which combines distribution rights for around 80 brands, as well as both online and retail businesses in China. It is reasonable to assume that Woolworths will seek to use its expertise to expand the Chinese retail scope of the network, increasing the volume of its private label wines onto the Chinese market, while Coles may eventually choose to replicate the strategy, as both take advantage of the tariff cuts. This scenario would intensify the competition for smaller Australian exporters, and increase the importance of creating strategic relationships with distributors who most match their needs.

SPOTLIGHT ON BEEF

The change in China's beef consumption habits over the past two decades have been one of the most marked of any agriculture sector. Chinese consumers have traditionally been low consumers of beef, deriving the vast majority of their meat requirements from pork and chicken. However, two food safety events in 2013 changed this dynamic. The detection of Avian Influenza (Bird Flu) in poultry, as well as the discovery of thousands of dead pigs in Huangpua river near Shanghai, led to an upsurge in beef consumption, as cautious Chinese consumer sought alternative varieties of meat.

As a result, China's official beef imports immediately grew fourfold, from 281,000 tonnes in 2012 to 1.3 million tonnes in 2013. China's beef import policy has been driven by domestic health and food safety issues, banning imports from those countries which do not have disease free cattle/beef industries – a move which was initially of most benefit to Australia, Uruguay and New Zealand.

For Australia, beef exports to China rose equally sharply, from around 50,000 tonnes in 2012 to 228,000 tonnes in 2013. The bulk of this was frozen beef, while the remainder was chilled. Australia's beef fortunes were aided by a ban on exports to China by its major global competitors, including the US, Brazil and India.

FIGURE 13: CHINA BEEF IMPORTS

Note: 14 - represents data until Nov-2014*
Source: US Meat Export Federation and ANZ research

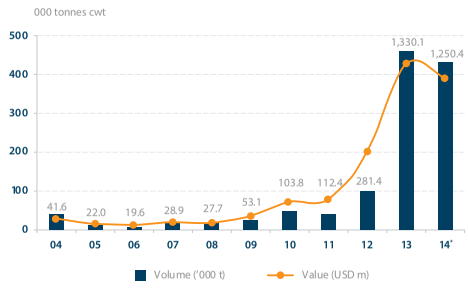
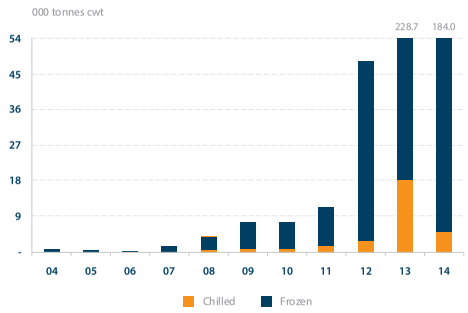


FIGURE 14: AUSTRALIAN BEEF EXPORTS TO CHINA

Source: DAFF and ANZ research



Brazil remains a key competitive threat in beef

While the ChAFTA has received a positive response from the Australian beef sector, it is important to keep the potential implications in perspective. For example, looking forward, it is highly unlikely that the commencement of the ChAFTA will have anything like the impact on beef imports as the 2013 food safety issues.

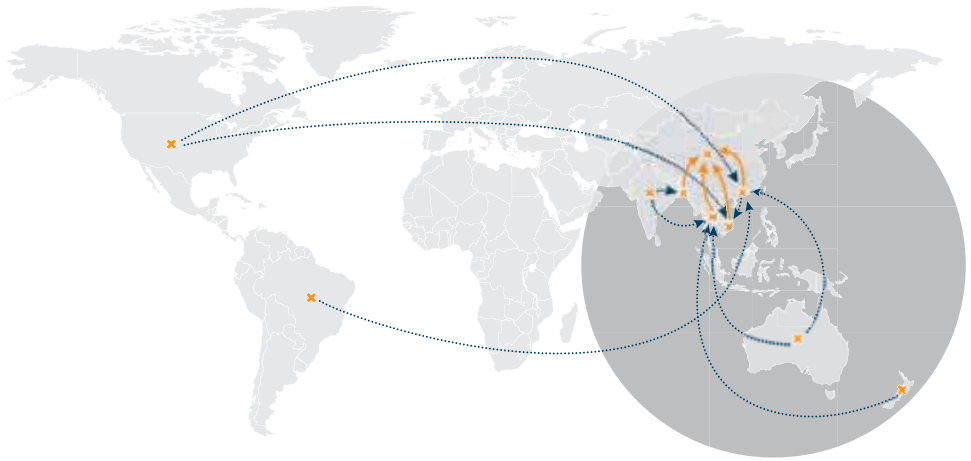
Of greater impact is likely to be China's announcement, coincidentally at the same time as the ChAFTA announcement, that it would reopen its official beef trade with Brazil, which had ceased in 2012 following the discovery of a BSE case in Brazil's Parana State. Following the re-opening, Brazil announced that it expected to sell between USD940 million and USD1.4 billion worth of beef to China in 2015.

The re-opening of trade with Brazil is also likely to see a major change in the "grey trade", the unofficial entry of beef to China from prohibited exporters. Currently, ANZ calculates that around 7% of China's beef consumption is provided by official imports, from countries such as Australia, while around 12% is supplied by unofficial imports. This has included American, Brazilian and Indian beef entering through countries such Hong Kong and Vietnam.

THE AUSTRALIAN CATTLE HERD IS CURRENTLY AT ITS LOWEST POINT FOR AROUND TWO DECADES

FIGURE 15: BEEF "GREY CHANNELS" INTO CHINA

Source: ANZ Analysis



Around 12% of China's beef consumption is provided via unofficial, grey imports.

Similarly, the Australian beef sector is unlikely to see an immediate impact on trade volumes to China, due to the current low point of the Australian herd cycle, resulting in the volume of cattle simply not being available. The Australian cattle herd is currently at its lowest point for around two decades, with numbers dramatically reduced through factors including increased slaughter, live exports and increased paddock mortality brought on by drought. In 2014, Australia saw a record cattle turn-off, of around 10.4 million – made up of 1.1 million live exports and 9.3 million head slaughtered – a figure which is unsustainable, particularly considering the female portion of the national kill was over 50%.

At the same time, the current strong beef demand from the US will continue to limit the excess beef availability. With its own herd having hit a sixty year low in 2014, US imports of Australian beef are likely to remain strong in the short to medium term, with shipments having risen by 87% in 2014, accounting for the entire additional beef export quantity from 2013.

Mindful of the looming contraction on the Australian cattle herd, and of their existing long term and fruitful relationships with customers in markets such as Indonesia and Japan, Australian beef exporters may be reluctant to shift large volumes to China in the short to medium term, preferring a gradual increased presence in that market.

Looking further ahead, the advantages for Australian beef will become clearer in the longer term. In examining the capital implications of the ChAFTA on the Australian beef sector, it is important to balance the reduced tariffs with a number of other factors.

For producers, their average relatively small scale will mean that the majority will continue to be price takers, with their revenue impacted more by the factors impacting world prices, rather than the specific Chinese market. The producers who will be in a better position are those who are of a larger scale and well integrated, with a degree of control or influence over the supply chain.

For the majority of smaller producers who are exporting directly, the tariff cuts will allow them the opportunity of becoming increasingly more competitive and profitable.

For these producers, who by their scale are likely to be in the more productive and innovative quartile of the sector, their increased margins will allow them to look at greater opportunities to enhance their operations, whether through increased scale, improved technology, or diversification of their offering.

For the majority of smaller producers, indirectly exporting, the challenge will be to see themselves as a strategic supplier within an integrated value chain instead of a supplier of a commodity. An example of this could be an abattoir in Queensland which specialises in value-added cuts for export to China and requires a certain style of animal that a producer is prepared to invest in supplying, as opposed to selling to the highest bidder, year-in-year out.

In essence, this would be about the producer doing what they are best at within their part of the value chain and positioning themselves as a strategically important supply point as opposed to one of many options from which to buy raw material. This could be achieved by understanding the strategies of the beef processors with respect to China and determining how best to complement them in order to drive a higher return for them and the producer. Many of these first and second stage processors are foreign owned and there is a heavy emphasis on appealing to Asia, less so China in isolation.

The benefits of the gradual tariff reductions are more likely to be felt by beef processors exporting to China. Like the direct exporting producers, the longer term increased margins through the tariff reductions should allow the processors to strategically examine options to upscale their operations. For many processors, the rapid rate of change in the distribution chain, particularly within China, is likely to force them to re-evaluate their processing and packaging infrastructure, and subsequent capex options. For example, as major Chinese logistics operators increasingly seek to be able to deliver any type of good to anywhere in China overnight, Australian beef processors may seek to package their beef cuts ready for direct distribution to Chinese supermarket shelves.

THE LOCAL DEMAND AND DEMOGRAPHIC CONDITIONS FOR HEALTHCARE IN CHINA ARE EXTREMELY ATTRACTIVE

SPOTLIGHT ON HEALTHCARE

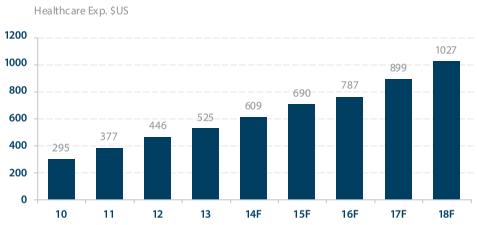
Amongst the many opportunities from the ChAFTA, one of the largest will be in health. This broad category covers everything from hospitals, aged care, pharmaceuticals, medical equipment and vitamins, all of which are included in the ChAFTA.

Total healthcare expenditure in China is expected to grow at an annualised rate of 13.4% to USD1.027 trillion by 2018 (Source: BMI). In comparison, Australia's expenditure on healthcare is around AUD150 billion and has been growing in the low single digits (Source: AIHW).

The rapid increase and expected future increase in Chinese healthcare expenditure can be linked to a growing and ageing population. This demographic tailwind for the sector should last until at least 2030 when the population is expected to peak at 1.46 billion people. Even beyond that point it's likely to be the biggest or second biggest health market in the world, which should not be difficult given that China presently has the second lowest per capital medical services expenditure amongst leading emerging markets and healthcare spending in China remains relatively low at below 6% of GDP.

FIGURE 16: HEALTHCARE EXPENDITURE IN CHINA (USD Billion)

Source: BMI. World Bank



In addition to the overall increase in demand for healthcare services, the increased wealth of the Chinese middle class has led to an increased need to provide higher quality healthcare. To that end, the Chinese Government is seeking to develop and encourage investment in private healthcare and increased foreign investment is one method of helping to close the gap and provide higher value services to China's growing middle class.

Australia has a fantastic opportunity as the ChAFTA will provide best ever access for services including hospitals, aged care, and medical service suppliers. This access allows Australian businesses to build, run or buy wholly owned subsidiaries compared with previous policy where there were equity restrictions. This will compliment a 2014 pilot program for wholly owned private hospitals in seven cities including Beijing.

While the Chinese Government has simplified and improved the FDI process there still remains a high level of complexity and ambiguity, with businesses and industries classified into three main categories: Encouraged Foreign Investment, Restricted Foreign Investment, and Prohibited Foreign Investment. Further information on FDI into China can be found in Section 4 – Navigating the banking market.

Executed correctly, improved access as a result of the ChAFTA can provide Australian businesses with a significant first-mover advantage against other foreign competitors operating or seeking to operate in China. The flipside however, is that best ever access is generally finite and in the case of the 2014 pilot program, not exclusive in all cities. This national window of opportunity will not last as China is highly likely to grant similar access to other countries to maintain a healthy level of competition in addition to increased FDI.

One of Australia's key advantages in healthcare services (i.e. hospitals, aged care etc) is the accumulated intellectual property in running these businesses effectively and efficiently. Taking these strengths to a market where the demand conditions are attractive is likely to appeal to the many businesses that have the capital to participate despite the increased complexities that accompany new market entry compared with a more typical buyer/supplier relationship.

NON-LIFE INSURANCE PENETRATION STILL REMAINS LOW DESPITE ANNUAL GROWTH OF 21% PER ANNUM BETWEEN 2005 AND 2013

SPOTLIGHT ON STATUTORY THIRD-PARTY LIABILITY MOTOR VEHICLE INSURANCE

Under the FTA, China has committed to allow Australian insurance providers access to China's statutory third-party liability motor vehicle insurance market. This access does not have restrictions on the structure of the operation or the equity capital (e.g. foreign ownership cap).

This unprecedented market opening represents a potentially substantial opportunity for interested Australian insurers to leverage their existing expertise across risk underwriting, claims management and portfolio investing into one of the fastest growing insurance markets in the world.

China's overall insurance market generated total premiums of CNY1.7 trillion (USD280 billion) in 2013, and experienced average annual growth of 17% since 2005, strongly outpacing national GDP expansion.

Motor vehicle insurance has been the largest segment within China's non-life insurance market

China's non-life insurance market had gross premiums of CNY780 billion in 2013 (USD127 billion) and has grown at substantial rates, averaging over 21% over the period 2005 - 2013, much faster than the overall insurance market. Despite the high growth rates, penetration levels are still relatively low compared to other developed markets due to various factors, including low product awareness, low penetration in rural areas and the lack of effective distribution.

In China, motor vehicle related insurance makes up the largest proportion of non-life gross premiums, representing over half of the market since 2005.

Driven by economic growth, rising income levels, urbanisation and a growing middle class which affects the demand for cars, motor vehicle insurance take-up is highly dependent on related government initiatives. Growth in gross premiums has been tremendous, averaging 21% since 2005. In 2013, the size of the motor insurance market amounted to CNY518 billion in gross premiums (USD84 billion).

FIGURE 17: CHINA NON-LIFE INSURANCE GROSS PREMIUMS AND ANNUAL GROWTH RATES

Source: BMI Q1 2015 report and ANZ analysis

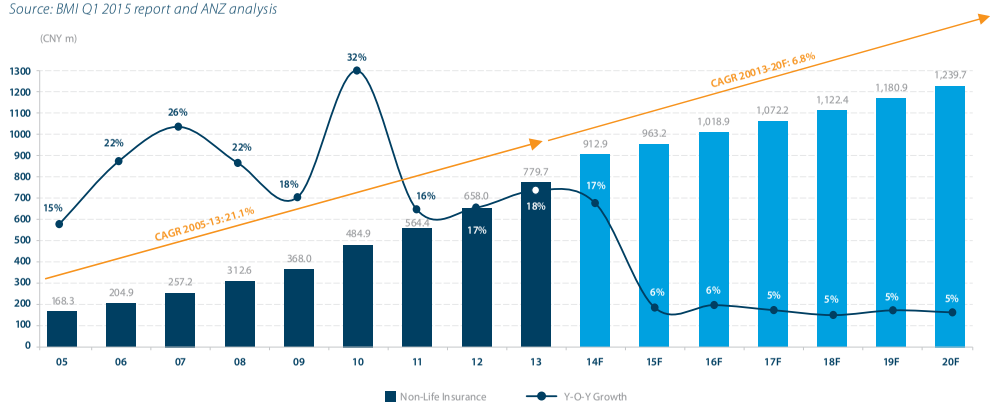
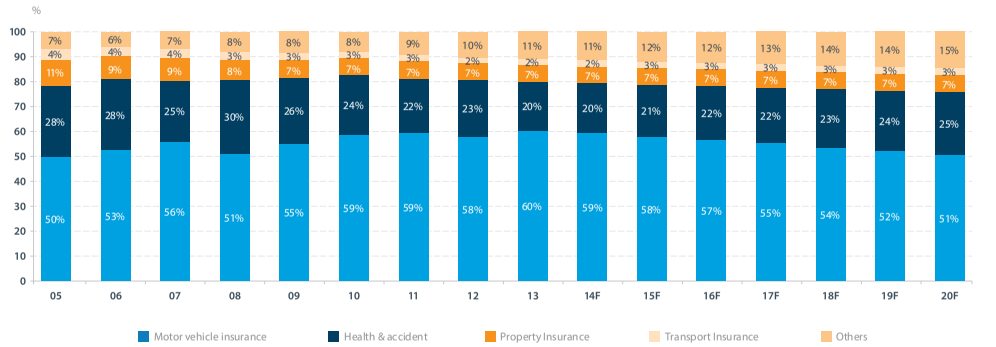


FIGURE 18: COMPOSITION OF CHINA NON-LIFE INSURANCE MARKET (BASED ON GROSS PREMIUMS)

Source: BMI Q1 2015 report and ANZ analysis

Note: percentages are different from BMI since Health & Accident insurance is considered as a part of Non-Life Insurance for the analysis – as such, the summation of the sub-segments under Non-Life is different from the Non-Life insurance premium reported by BMI; "Transport Insurance" relates to air freight, rail freight, road freight and inland waterway freight; "Others" include General liability, Credit/Financial guarantee and other insurance as defined by BMI

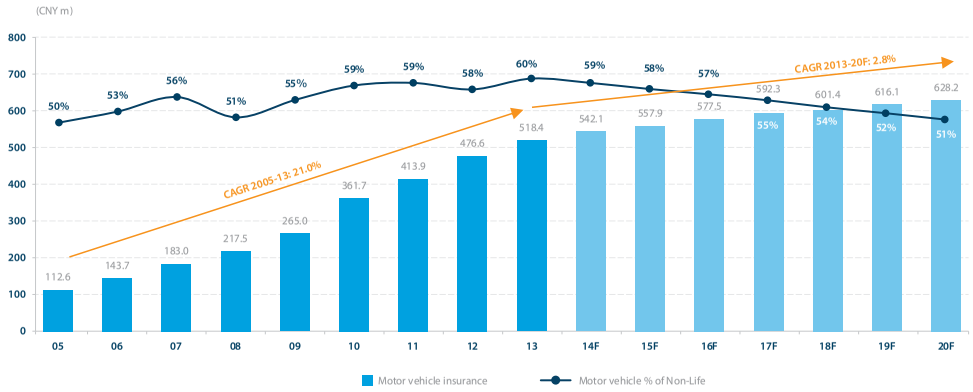


THE LARGE ABSOLUTE SIZE OF THE MOTOR INSURANCE MARKET SHOULD PROVIDE OPPORTUNITIES FOR MOTOR INSURERS, ESPECIALLY NEW ENTRANTS

FIGURE 19: MOTOR VEHICLE INSURANCE GROSS PREMIUMS AND PROPORTION OF TOTAL NON-LIFE INSURANCE MARKET

Source: BMI Q1 2015 report and ANZ analysis

Note: percentages are different from BMI since Health & Accident insurance is considered as a part of Non-Life Insurance for the analysis – as such, the summation of the sub-segments under Non-Life is different from the Non-Life insurance premium reported by BMI; "Transport Insurance" relates to air freight, rail freight, road freight and inland waterway freight; "Others" include General liability, Credit/Financial guarantee and other insurance as defined by BMI



Motor vehicle insurance in China comprises Compulsory Third-Party Liability (CTPL) and Commercial Motor Insurances (CMI), the latter consisting mainly of first party and non-compulsory third-party liability. As a result of consumers' buying behaviour (i.e. bundling), entry into the compulsory third-party market is seen as highly important for foreign insurers to access the broader motor insurance market.

The growth outlook for the number of passenger cars over the coming decade is much more restrained, due to a combination of slower economic growth, a property downturn and vehicle registration limits in some cities. As a result, the motor insurance market is expected to grow at an average rate of under 3% over 2013 to 2020.

However, the large absolute size of the motor insurance market should continue to provide opportunities for motor insurers, especially new entrants. The primary driver, the number of passenger cars, has grown at an average rate of almost 23% over 2005 to 2012, and the total number of cars is expected to surpass 200 million by 2020.

In addition, China's current car density is approximately 72 cars per 1,000 people, which is significantly lower than more mature markets such as the US, Japan, Australia and Korea. The longer term outlook is therefore attractive for both the number of motor vehicles and the associated insurance requirements.

FIGURE 20: CHINESE MOTOR VEHICLE INSURANCE MARKET – BREAKDOWN OF GROSS PREMIUMS

Source: CIRC and ANZ analysis

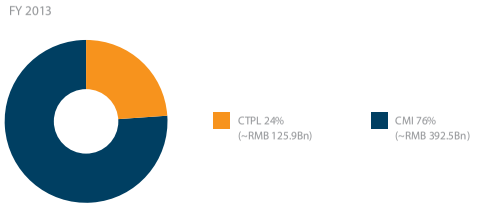
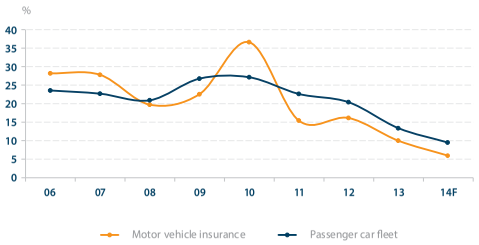


FIGURE 21: ANNUAL GROWTH IN PASSENGER CAR FLEET AND MOTOR VEHICLE INSURANCE GROSS PREMIUMS

Source: BMI Q1 2015 report and ANZ analysis



THE ENTRY OF EXPERIENCED INTERNATIONAL INSURANCE PROVIDERS WILL RESULT IN BETTER UNDERWRITING PRACTICES

FIGURE 22: PASSENGER VEHICLE DENSITY (CARS PER 1,000 PEOPLE)

Source: BMI Q12015 report and ANZ analysis

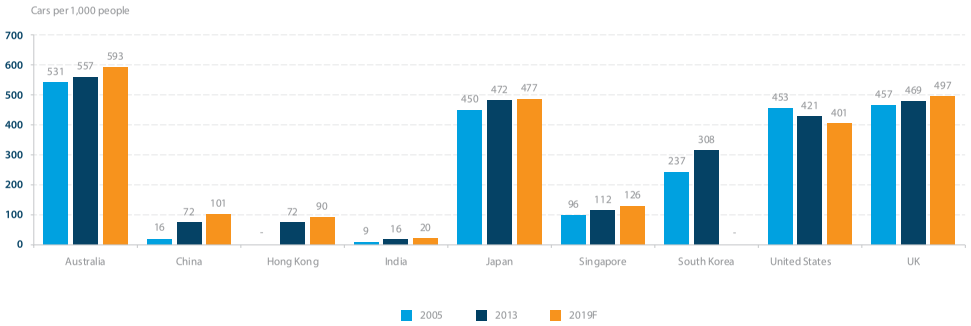
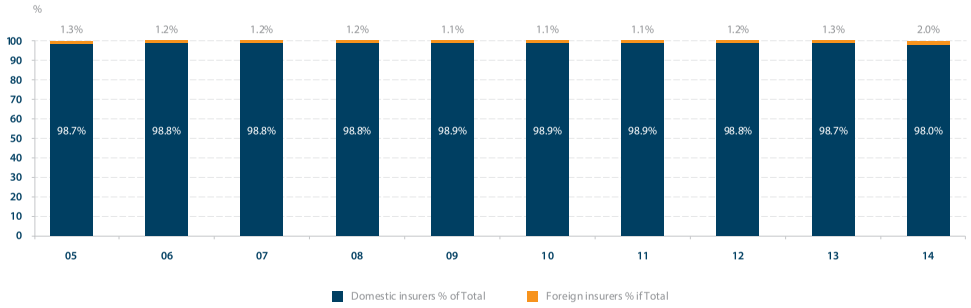


FIGURE 23: MARKET SHARE BASED ON PROPERTY AND CASUALTY GROSS PREMIUMS

Source: Bloomberg, CIRC and ANZ analysis



China's non-life insurance market is currently dominated by domestic providers, but reforms will provide foreign insurers with greater opportunity to participate.

Compulsory third-party liability motor vehicle insurance was introduced in 2006, with only domestic providers initially permitted to underwrite this business. From May 2012, foreign insurers were allowed to enter the market – Chinese authorities hope that the entry of experienced international insurance providers will result in better underwriting practices as well as promote greater competition in the local market.

At the end of 2013, there were 64 active players in the overall non-life market and the local/foreign split was 43/21. The market share of foreign players (based on gross premiums) remains small, at around 2% – as such, the potential upside for new Australian entrants is encouraging.

Despite their relatively small scale in China, foreign insurers are focused on building their customer base and expanding into other insurance lines.

Establishment requirements and considerations

Under the ChAFTA, Australian insurers will be able to access China's statutory third-party liability motor vehicle insurance market without any restrictions on the structure of the operation or the equity capital. The three forms of onshore business operation for foreign insurers are joint venture, subsidiary or branch.

THE RQFII PROGRAM SHOULD OPEN UP OPPORTUNITIES IN TERMS OF BOTH INVESTMENT ALLOCATION AND FUND SOURCING

FIGURE 24: KEY CHINA INSURANCE REGULATORY COMMISSION (CIRC) REQUIREMENTS FOR FOREIGN INSURERS SEEKING TO ESTABLISH OPERATIONS IN CHINA

Source: CIRC; Decision of the State Council on Amending <the Regulation of the People's Republic of China on the Administration of Foreign-Funded Insurance Companies (2013), lawinfochina

Minimum registered capital requirement	**Joint venture**: RMB200m or an equivalent of RMB200m in freely convertible currencies and must be paid-in monetary capital. **Subsidiaries**: RMB200m or an equivalent of RMB200m in freely convertible currencies and must be paid-in monetary capital. **Branches**: Parent company shall provide minimum working capital of RMB200m (or equivalent in other free convertible currencies). *Note: The CIRC may, according to the scope of business and business scale of the foreign-funded insurance company, raise the level of registered capital or working capital to above RMB200m.*
Experience	Engaged in insurance business for more than 30 years.
Onshore presence	More than two years since a representative office was established in China.
Size	Total assets at the end of the year prior to the application for establishment shall be no less than USD5 billion.
Home regulation	The country or region where the foreign insurance company is incorporated shall have sound insurance regulation systems; and the foreign insurance company shall have already been under the effective regulation of the relevant authority of the country or region.
Prudential capital adequacy	Shall satisfy the solvency standard of the country or region.
Home regulator approval	Shall obtain the approval from relevant authorities of the local country or region for the establishment.

For Australian financial institutions seeking to enter China's motor vehicle insurance market, these regulatory requirements, combined with operational needs, raise a number of essential financial considerations:

- **RMB FX risk management:** Currency matching and hedging needs with respect to capital deployed, dividends, capital return and reporting
- **Capitalisation of the onshore business:** Injection backed by existing capital base or new fundraising from capital markets (including RMB)
- **Investment management:** Investment strategy for premiums and shareholder equity, as well as risk hedging requirements
- **Transaction banking:** Policy premium receipts and claims payments, liquidity management

SPOTLIGHT ON FUNDS - RMB QUALIFIED FOREIGN INSTITUTIONAL INVESTOR (RQFII) PROGRAM

Under the ChAFTA, China has for the first time granted Australia a RMB quota under its RMB Qualified Foreign Institutional Investor (RQFII) program. This would permit Australian financial institutions to invest offshore RMB in Chinese onshore financial instruments, including the Chinese onshore securities market.

This is an area of significant potential growth for Australia's funds management industry. Australian fund managers' history of investment expertise and innovation, the RQFII Program should open up opportunities in terms of both investment allocation and fund sourcing.

TO DATE, 99 INSTITUTIONS HAVE RECEIVED QUOTAS TOTALLING IN EXCESS OF RMB300 BILLION

FIGURE 25: BACKGROUND TO RQFII PROGRAM – SELECTED MILESTONES

2011	• RQFII scheme established in Hong Kong • Initial investment quota of RMB20 billion • Only subsidiaries of China-based institutions could apply under the RQFII
May 2012	Additional RMB50 billion investment quota granted for the launch of RQFII A-share ETFs
January 2013	RQFII scheme was expanded to Taiwan with total quota of RMB100 billion
Mid-2013	RQFII rules revised to: • Expand the scope of eligible applicants and permitted investment • Require RQFIIs to open onshore special accounts designated for stock exchange trading, inter-bank bond market trading and stock index futures trading
July and October 2013	RQFII was expanded to Singapore and London with allocated quota of RMB50 billion and RMB80 billion respectively
March 2014	RQFII was expanded to France with quota of RMB80 billion
November 2014	ChAFTA announced; Australia was granted RMB50 billion under RQFII

Investment quota approvals

The table below shows the allocations granted to various countries so far under the RQFII Program.

Within these allocations, 99 institutions to date have received quotas totalling over RMB300 billion, mostly in Hong Kong.

FIGURE 26: RQFII ALLOCATION BY COUNTRY – AS OF 31 DEC 2014

Source: KWM Connect; Australian Government – the Treasury; ICBC Paris Branch presentation April 2014; Reserve Bank of Australia Bulletin December Quarter 2014

*Note: *Taiwan allocation is not yet open for investors*

Centre	Clearing bank	Date announced	RQFII allocation (RMB billion)
Hong Kong	Bank of China	Dec 2011	270
Taipei	Bank of China	Jan 2013	100*
Singapore	ICBC	Oct 2013	50v
London	China Construction Bank	Oct 2013	80
Paris	Bank of China	Mar 2014	80
Frankfurt	Bank of China	Jul 2014	80
Seoul	Bank of Communications	Jul 2014	80
Qatar	ICBC	Nov 2014	30
Toronto	ICBC	Nov 2014	50
Kuala Lumpur	Yet to be designated	Nov 2014	N/A
Australia	Bank of China	Nov 2014	50

FIGURE 27: RQFII QUOTAS GRANTED BY INSTITUTION – AS OF 30 JAN 2015

Source: SAFE

Centre	Number of organisations	Cumulative Approved Quota (RMB billion)
Hong Kong	79	270.0
Singapore	9	12.3
London	7	12.2
Paris	2	6.0
Seoul	2	4.0
Total	**99**	**304.5**

RQFII IN MORE DETAIL

FIGURE 28: OVERVIEW OF RQFII PROGRAM RESTRICTIONS AND CONSIDERATION

Source: The Investment Lawyer, Vol 21, No. 8 August 2014

	CSRC	SAFE	PBOC
Regulators	• Approves RQFII status • Regulates investments by RQFIIs	Monitors and regulates repatriation/remittance of RMB funds	
		Approves and allocates RQFII quota	• Regulates onshore RMB accounts • Regulates investment by RQFIIs
Eligible applicants	**Subsidiaries in Relevant Jurisdictions of:** • PRC fund management companies • PRC securities companies • PRC commercial banks • PRC insurance companies **Financial institutions with a principal place of business in that Relevant Jurisdiction that have:** • Obtained an asset management license issued by a regulator in the Relevant Jurisdiction; and • Already conducted relevant asset management business* **No strict definition of the track record is required*		
Application process	• CSRC will make decision within 60 days of receiving all required documents^ • SAFE will approve investment quota within 60 working days of receiving all required documents *^In practice, the CSRC typically takes 3-4 months to review and approve RQFII license*		
Dominant Currency	RMB (no onshore FX conversion required)		
Permitted investments	**To invest in the following RMB-denominated financial instruments within the approved investment quota:** • Stocks, bonds and warrants traded or transferred on stock exchanges; • Fixed income products traded on the interbank bond market**; • Securities investment funds; • Stock-index futures; and • Other financial instruments allowed by the CSRC (including the subscription of additional share issues, right issues, IPO of shares; and IPO of convertible bonds) *** Only prior approval of the PBOC is required*		
Shareholding restrictions	• A single foreign investor shall not hold through a QFII/RQFII more than 10% of the total shares of an individual listed company • The total A-shares of an individual listed company held by all foreign investors shall not exceed 30% of its total assets		
Investment quota restrictions	NA		
Deadline for investment proceeds to be remitted	• Open-ended funds : Not specified • 6 months after the investment quota is approved (other than open-ended funds ^^) *^^ General definition of open-ended funds applies (i.e. publicly-offered funds listed on major stock exchanges). This should be distinguished from the definition of "open-ended China fund" in QFII rules*		
Minimum investment requirement	NA		
Lock-up period	• Open-ended funds: no lock-up period • Other RQFIIs: 1 year The lock-up period is deemed to commence from the earlier of the date: (i) when the investment capital is fully remitted into the onshore designed account; and (ii) the end of six months after the investment quota is approved if the investment capital has not been fully remitted within the prescribed deadline.		
Recycling of investment quotas	• Open-ended funds: Yes, as long as the net amount of investment capital remitted into China is within the investment quota • Other RQFIIs: No		
Further quotas	Permitted to apply for further quota once 80% of the current quota has been utilised		
Repatriation	**Open-ended funds:** • May repatriate or remit on a daily basis • May reinvest within investment quota permitted **Other RQFIIs:** • May repatriate or remit on a monthly basis after the expiry of the lock-up period • SAFE pre-approval is not required • May not re-invest or recycle the remitted capital and the investment quota will be reduced accordingly		
Monthly repatriation restrictions	NA		

For Australian financial institutions seeking to participate in the RQFII program, understanding the lock-up period, permitted frequency for the repatriation of funds, and the ability to recycle the investment quota granted will be important from a liquidity management perspective in relation to the fund clients. Investment strategy and objectives will likely require deposit/yield solutions, as well as risk hedging ideas. Finally, RMB foreign exchange risk management may also be relevant for certain fund clients.

WHAT AUSTRALIAN BUSINESSES SHOULD BE DOING

DON'T ASSUME YOU CAN OPERATE YOUR CHINA BUSINESS REMOTELY FROM AUSTRALIA

Planning is essential. ANZ highlight how to start and what to think about to execute on the benefits that the ChAFTA can bring.

The ChAFTA will not only lead to 95% of goods and services being tariff free over time, but it will prove to be a catalyst for Australian businesses to establish a buying or selling relationship with our largest trading partner. In the previous section we identified a number of industries that are likely to receive significant benefits. For some of these industries, selling into China will not only be cheaper and easier, but they will also have the capacity to set up operations or buy existing operations to develop an on the ground presence. Key considerations for doing business with or in China are highlighted below.

Key Considerations

Exporting to China

Australia has signed nine FTAs with other nations, including China, since 2005. Despite this, only 19% of exporters have taken advantage of these FTAs.

Understand the ChAFTA and what it means for you

Understand how the ChAFTA will impact your industry, both in terms of opening up market opportunities into China and/or increased competition locally in Australia.

The benefits under the ChAFTA are not automatic, so it is important to research the benefits that are available and to ensure your business is maximising the opportunities. For example, you need to register your products and obtain a Certificate of Origin in order to access tariff reductions.

ANZ advantages

Resources

FTAs are long and complex legal documents. To assist Australian businesses, ANZ has partnered with the Export Council of Australia (ECA) to develop a simple online FTA tool (www.ftatool.com.au) which displays the key points of each FTA in "plain English" and provides specific insights on how to take advantage of the relevant FTAs relating to your industry/product.

Understand the Chinese culture, customs and business etiquette

Some foreign companies are unsuccessful when expanding into China because they don't learn the basics. Businesses should develop relationships with organisations like the Australia China Business Council (ACBC) or local Australian Chinese business bodies, as they can often be your best advisors.

Some key basics include:

- Business cards are important. Create a double sided card with your details in Chinese on the reverse side – when meeting Chinese parties, always offer your card using both hands with the Chinese side face up. It's considered a sign of respect to spend a few moments examining the business cards you receive.
- Chinese naming conventions are different. In written form, surnames are placed first, followed by given names e.g. Mr Zhang Yong should be addressed as Mr Zhang.
- It is customary to exchange small and inexpensive gifts at meetings. When you are invited to a Chinese business meeting, small gifts with an Australian theme to exchange will be warmly received.
- Business slows down for almost a month around Chinese lunar New Year. Timing varies from year to year but the holiday period generally falls around late January/February and business is usually not conducted during this period.

ANZ advantages

Resources

The ANZ Asia Pacific Connect website (www.anz.com/asiapacific) is a source of information and provides insights for conducting business in 29 markets across Asia Pacific.

Key Considerations

Understand the Chinese market

China is changing at a rapid pace so you need to constantly ensure you have up to date market information.

China is not homogeneous. There are 34 provinces in China, each with their own unique characteristics, needs and consumer appetite. It is best to take a city or provincial view and enter the market via a particular province or city rather than assuming that "China" is your target market.

Consider tier 2 and 3 Chinese cities. Many businesses look to Shanghai and Beijing as their entry points given popularity and size, (populations of 24 and 20 million people respectively), however many other cities and regions across China offer substantial market opportunities. For example, the growing Western China city of Chengdu has a population of 14 million and competition can be less intense for the first time entrant.

Being successful in China is not all about the price. The tariff reductions under the ChAFTA make Australian goods and services more competitive, but China's rapidly growing middle-class consumers are seeking "clean, green" agricultural produce, and quality brand name products with ingenuity and are prepared to pay for them.

Be conscious of market nuances. What is popular in Australia may not be favoured in China, so take the time to understand the Chinese consumer and be prepared to adapt your product, packaging, advertising campaign etc. for the Chinese market.

Choose the right partners. Local in-market contacts can be more important than product and price. Share your business plan with local representative who understand market trends and economic conditions in different regions across China.

Don't assume you can operate your China business remotely from Australia. Having local employees shows your commitment to the Chinese market and is important for your brand presence and visibility.

Treat your China strategy as a long term play. Embedding your product and increasing sales takes time and commitment.

ANZ advantages

Capability and experience counts

ANZ is the only Australian bank with Client Insights and Economics teams in Asia, allowing us to provide our customers with locally produced research papers and insights into the Chinese economy and industries.

ANZ's 600 Bankers on the ground across Asia Pacific are there to assist ANZ customers locally with their banking requirements, and more.

Test the Chinese Market using e-commerce platforms

Physically selling your product/service in China can be expensive and establishing distribution channels can take time.

An easier, faster and more cost effective way to test the Chinese market and understand how to best market your product to Chinese buyers is online. Chinese consumers are technology savvy, and are avid users of Chinese social media e.g. Wechat, Weibo (Chinese version of Facebook) and online market platforms e.g. Tmall and Taobao (China's online department stores, similar to Amazon in the US).

When using electronic platforms ensure that your site is written in Chinese. Using a qualified professional translator is imperative to make sure your product is well represented.

ANZ advantages

Relationships are key

We have developed relationships with key organisations in Australia, like Vecci and Australia Post, to help our customers access the Chinese market via the electronic channels and platforms these organisations offer.

CONSIDER HIRING AUSTRALIAN EMPLOYEES WITH CHINESE HERITAGE

Key Considerations

Are you China/export ready?

Successfully entering the Chinese market requires a long term commitment, frequent travel and ability to communicate. Before expanding into China ensure you:

- Understand the Chinese regulations governing your industry or investment and familiarise yourself with relevant ChAFTA provisions. Establishing the appropriate export licenses can also be a lengthy process.
- Have a website in both English and Chinese, understand shipping times, customs procedures, establish appropriate product delivery and after sales service mechanisms to support your product.
- Have the process and equipment in place to adapt your product size, packaging, colour etc. to suit the Chinese market, if needed.
- Establish the appropriate business and tax structure and take steps to protect your intellectual property from being copied – use qualified legal and accounting firms with a presence in China to establish and review all contracts.
- Engaging a good agent/distributor in China with local knowledge of market conditions and English speaking capabilities can reduce setup costs.

It may be beneficial to have a Chinese employee/agent who can assist when language capabilities are required.

ANZ advantages

ANZ is recognised as the leading trade and supply chain bank in Australia, with trade teams on the ground across Asia Pacific to help support your initial or ongoing trade requirements. ANZ's online trade platform provides you with the ability to initiate, amend and track your trade transactions anywhere in the world.

For customers needing banking support in China, Chris Chase, ANZ's dedicated Australia/NZ desk in Shanghai, assists with the banking needs of Australian customers. He is supported by local English speaking relationship managers and in county product specialists.

Setting up a business/subsidiary in China?

Foreign companies are not permitted to do business directly in China without a business license. Although the majority of the ChAFTA focuses on opening trade relationships, it has also made it easier for a number of service industries to do business in China via wholly owned subsidiaries. Before establishing a business presence in China you should consider:

- Your own business model to decide which one of the four possible Foreign Investor Entity types of incorporation in China best suits your needs.
- Where to locate your base of operation. Different cities/provinces offer different benefits like labour pools, high tech parks, local support including tax benefits, transportation, infrastructure etc. Investigate benefits associated with operating from the SFTZ which was established in 2013.
- Establishing a good connection/relationship ("Guanxi") with local Chinese government officials and enterprises which is necessary for operating successfully in China.
- Chinese Labour Law requirements. Unlike Australia, medical insurance, pension, unemployment insurance, and housing funds are legally required when you have employees in China.
- The time, steps and cost associated with obtaining a business license in China. Depending on your industry and location, Chinese law typically requires shareholders to inject and hold cash equity. This amount can be substantial, for example foreign manufacturers operating in Shanghai are required to hold USD200,000 in registered capital. There are authorized agencies that can help foreign investors navigate the establishment requirements.

Key Considerations

Resources available to you

There are various Government bodies established to support Australian businesses. EFIC, the Export Council, TradeStart and Austrade can provide assistance and advice about exporting to China and what is required to succeed. These organisations also maintain local on the ground offices/representation across China.

Contact your State and Federal Government offices and ask about financial grants and trade missions. There are grants available to assist Australian businesses export or establish an offshore presence and the Government regularly run trade missions to China offering Australian businesses the opportunity to gain in country business experience in China.

In addition to Government assistance, it could be helpful to speak with other businesses operating in China, contacting private organisation like the Australia China Business Council may be a good place to start.

ANZ advantages

Use your networks

ANZ's long-standing presence in China means that the bank has been able to establish strong relationships with key third party market entry, sourcing, accounting, taxation, and logistics providers. We can introduce our customers to the right people in China to provide holistic support for trade and market entry.

Hiring Chinese staff

Consider hiring Australian employees with Chinese heritage and language capability to assist at business meetings, instead of relying on translators. Your employee is more likely to act in your interest.

Chinese who have lived, studied and/or worked in both countries are familiar with both markets, and can provide insight into the Chinese culture whilst appreciating how things are done in Australia.

Use Renminbi (RMB) for trade transactions

Historically trade flows with China were settled in USD, however this is changing with the internationalisation of RMB being an integral part of China's financial reform strategy.

As RMB becomes the major invoicing currency in China, you may want to consider trading with Chinese counterparties in RMB. Paying and receiving funds in RMB doesn't mean that you need to set up an account in China, as you can open and operate a RMB foreign currency account in Australia.

There are some key advantages to trading in RMB:

- Discounts of up to 5%: It is estimated that Chinese companies add up to 5% to their quotes in a foreign currency to capture the cost of bearing the exchange rate risk. If RMB is used, the additional costs can be removed.
- Extend payment terms to 210 days: Foreign currency invoices (import/export) with payment terms over 90 days involve a complex administration process requested by China's State Administration of Foreign Exchange (SAFE), however, settlements in RMB benefit from an automatic extension of payment terms up to 210 days.
- Access to wider client/supplier base: There are a large number of Chinese companies not capable of dealing with foreign currencies. Therefore, a willingness to settle in RMB can allow you to access a broader range of clients/suppliers.

More detail in **Section 4 – Navigating the banking market**

ANZ advantages

Currency

ANZ customers can open a RMB account domiciled in Australia allowing you to hold and transact in RMB (from Australia) without conversion.

Where customers want to convert, our RMB capability means we can directly convert AUD to RMB so ANZ's customers get a better exchange rate (other banks convert AUD to USD to RMB via a Chinese correspondent bank).

ANZ's trade finance products (import/export Letters of Credit, documentary collections, Standby Letters of Credit and guarantees) are also available in RMB.

TIME IS IMPORTANT, YOU SHOULD LOOK TO ACT NOW

Key Considerations

Time is important, you should look to act now

Tariff reductions are phased in over a number of years however it's best to begin developing your Chinese relationships/contracts now. In China, relationships are critical to the success of your business and these can take considerable time to establish.

Be mindful that licenses and company structures also involve lengthy establishment processes. Also if product variations are needed to suit the Chinese market you'll need time to make the necessary changes within your business.

Inbound investments

Many customers we speak to are concerned about their succession plans and ability to source funding, including equity to support their business objectives. The inflow of investment funds from Chinese investors can help solve many of the financial issues currently being faced by Australian businesses.

Due Diligence – Talk to advisors/specialists that have offices in China

If you're approached by a Chinese investor keen to invest in your business, be sure to conduct due-diligence on the background of the investor. Check with reputable advisers and institutions with a presence in China, they are often able to conduct high level background checks.

Failure to obtain the details of a potential business partner/investor's credit and professional background could lead to problems in the future.

Chinese investors usually want to have control over the business

Be aware that Chinese investors often want to have control over the business they invest in via local management. If you wish to maintain full control of your business, consider this carefully before entering into a Joint Venture agreement with Chinese investors. Seek advice from others who have successfully entered into joint venture agreements with Chinese investors.

Chinese investors are often interested in securing their supply chain or the intellectual property of the product rather than the product itself, so when trying to attract investors it is important to demonstrate how the product can make/save money and how it fits into the investor's end to end business model.

ANZ advantages

At ANZ we often receive enquiries from Chinese investors wanting to invest in Australia, this allows us to facilitate introductions where appropriate.

Key Considerations

It's important to network

Meet like-minded people by participating in reputable Asian business associations and chambers of commerce. Events run by these organisations are a good place to start building your network.

Chinese business people usually prefer to establish strong relationships before closing a deal, so expect to spend a lot of time at meetings and dinners with potential business partners over a long period of time. A great deal of business is conducted over dinner.

ANZ advantages

At ANZ we believe in the power of connecting our clients, specialists and 3rd party advisors through networking functions, both in Australia and offshore.

Opening up in Australia could be a step into china

Opening yourself to Chinese investment in Australia could open up the possibility of your future business expansion into China, especially in industries that hold a high level of intellectual property that could benefit China (e.g. health and age care) or key products and services sought by the Chinese consumer (e.g. high end agricultural products).

Increased domestic competition in Australia

Property – partnering with Chinese builders

Under the ChAFTA, the construction and building industries could see benefit from the opening of labour flows between China and Australia. With the property boom in China, there is an abundance of skilled builders capable of building high rise buildings. A number of Australian builders and developers are already exploring partnerships with reputable Chinese partners to undertake major projects in Australia.

Leveraging holiday visa workers

Working holiday visa workers are often good source of labour, especially in the Australian agriculture industry. Chinese workers are known for their work ethic, and would like the opportunity to experience the Australian way of life. Be sure to work with reputable working holiday agents to ensure you have appropriate work cover provisions to cover any working holiday visa workers.

NAVIGATING THE BANKING MARKET

DOING BUSINESS IN OR WITH CHINA CAN BE COMPLEX

Operating with or in China can be complex. We examine the key risk, liquidity, currency, capital and trapped cash considerations.

The ChAFTA represents a fantastic long term opportunity for both Australia and China. For businesses that have decided that they would like to participate in this opportunity, one of the first questions to ask will be, "will I be doing business with China" or "will I be doing business in China?"

There is an important distinction, as the regulations between having a trade relationship with a Chinese business/consumer are very different to having a locally incorporated entity.

For a trade relationship, a key consideration will include which currency to use, while for companies that have or plan to have subsidiaries in China, there are operational and capital complexities such as the FDI approval process, liquidity management and the repatriation of earnings. In the following section, we will cover these areas in detail.

TRADING WITH CHINA – WHICH CURRENCY TO USE?

RMB is becoming a global currency

The rapid development of China's economy has outpaced the liberalisation of its financial system. Heavily regulated financial markets are no longer able to service China's increasingly sophisticated and complex economy. A key agenda of China's financial reform is to internationalise RMB, to liberalise interest rates and to relax control on the capital account.

RMB internationalisation is a priority for China's financial reform. The RMB capital account has been gradually liberalised since 2009 which saw growth in RMB invoicing from zero in 2009 to over 25% of China's total cross-border trade by November 2014 (Figures 29 and 30). Consequently, the RMB's rank as the world payment currency by value has jumped from the 13th in January 2013 to 5th in December 2014 (Figure 31). Despite this rapid development, RMB trade settlement comprises a relatively small portion of the total cross-border trade but with the ChAFTA and further financial market deregulation, this is likely to materially increase.

FIGURE 29: RMB CROSS-BORDER TRADE VOLUME OF HONG KONG AND CHINA

Source: Hong Kong Monetary Authority and The People's Bank of China
Note: Starting date is the first observation date published by the sources

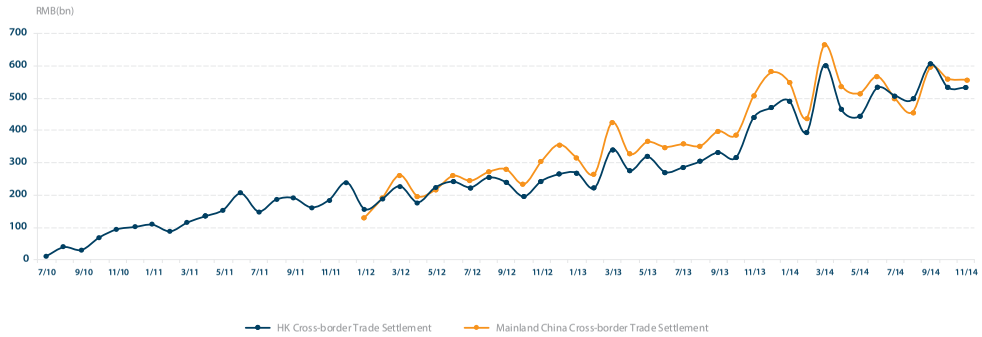
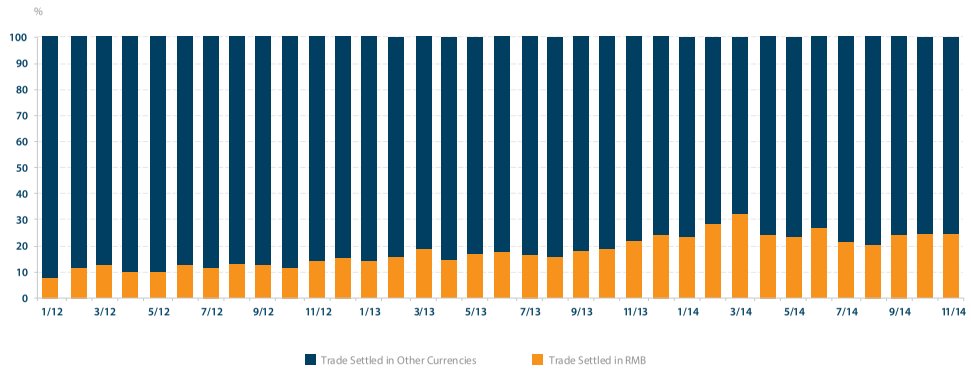


FIGURE 30: TRADE SETTLED IN RMB % OF CHINA'S CROSS-BORDER TRADE

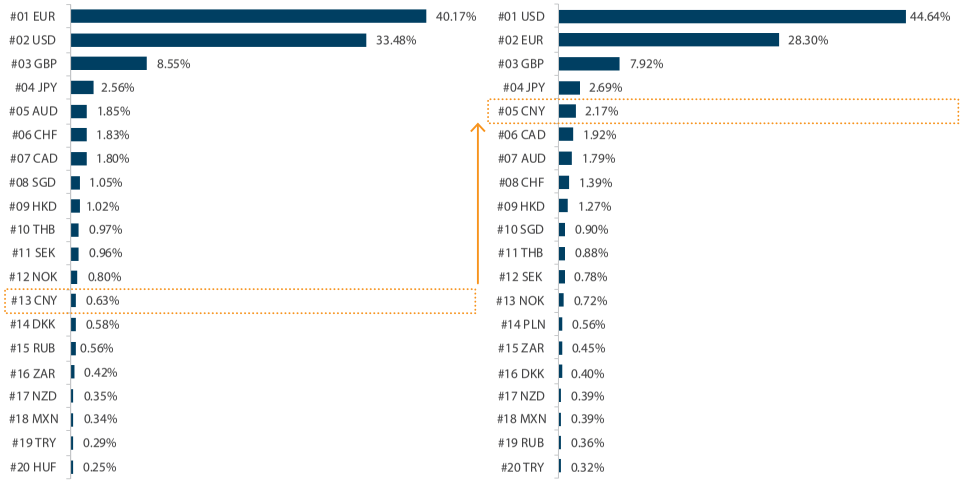
Source: General Administration of Customs



UNDERSTANDING AND UTILISING RMB AS A PAYMENT CURRENCY MAY BE BENEFICIAL

FIGURE 31: RMB AS THE WORLD PAYMENT CURRENCY

Source: SWIFT



RMB: Things to consider

- Trading in RMB can potentially lead to a lower price for imports or a higher price for exports, as Chinese businesses will no longer need to add a buffer for FX risk
- Payment terms can easily be extended past 90 days relative to a foreign currency where there are more restrictions. This can be used to improve sales or working capital
- Offering or accepting RMB can lead to an increase in potential customers and suppliers
- Trading in RMB will expose businesses to FX risk, however, this risk can be hedged at the discretion of the company

KEY ASPECTS TO CONSIDER WHEN CHOOSING RMB AS THE TRADING CURRENCY

The premise of transitioning to RMB as an invoicing currency can seem daunting. Typical client queries and potential knowledge gaps have included:

1. Understanding the process of making and receiving RMB payments
2. Accessibility, variety and the liquidity of hedging instruments relative to other currencies
3. Deviation from the dominant industry invoicing currency (i.e. USD)

The reality is that RMB is no longer as restricted as it was a number of years ago. The process of making and receiving RMB trade payment has been simplified by China's Government. Banks with experience dealing with RMB should be able to execute RMB trade settlement without delay, while offshore RMB hedging is similar to those of the major global currencies — i.e. there is no restriction on market access, ample liquidity and a variety of hedging instruments available.

For commodity related trade settlement such as gold, oil, base metals and agricultural products, the USD is still the dominant payment currency. For RMB to increase its share in international commodity trade flows, a transparent pricing mechanism will need to be developed. The launch of the international board by the Shanghai Gold Exchange in the SFTZ, which offers RMB denominated contracts to international traders, was just the first step. Three metal futures were also launched by Hong Kong Exchanges in 2014 and more commodity exchanges are being planned in the SFTZ, which demonstrate that China's Government is determination to encourage greater use of RMB.

BENEFIT 1: OVERSEAS COMPANIES CAN RECEIVE UP TO A 5% PRICE DISCOUNT

It is estimated that Chinese companies potentially add up to 5% to their quotes in foreign currencies to capture the cost of bearing the exchange rate risk. If RMB is used, the additional costs can potentially be reduced as Australian businesses will bear the exchange rate risk instead. Furthermore, given increased RMB liquidity and interbank connection offshore, Australian businesses are also able to hedge the RMB exchange rate risk at a lower cost compared to RMB hedging cost onshore. This is a benefit that both Chinese and Australian companies can share.

BENEFIT 2: PAYMENT TERMS CAN POTENTIALLY BE EXTENDED TO 210 DAYS

Currently, if an invoice (import/export) is denominated in a foreign currency and its payment terms are over 90 days, it involves a complex administration process requested by China's State Administration of Foreign Exchange (SAFE). This can limit tactical initiatives to improve working capital or improve sales by offering extended terms to customers. Settlement in RMB benefits from a potential extension of payment terms for up to 210 days without the complex administration requirement.

UNDERSTANDING CHINESE FUNDING COSTS ARE INTEGRAL TO NEGOTIATING WITH SUPPLIERS

Benefits for Australian exporters: Negotiating increased sales volumes in exchange for extended payment terms, which provide a major capital benefit to Chinese buyers. Generally speaking, interest rates in Australia are lower relative to China where many businesses need to fund via the shadow banking market. By extending terms, Australian businesses are providing liquidity to Chinese customers. This can be an effective way of growing sales and/or attracting more Chinese buyers.

Benefit to Chinese importers: By accepting the longer payment terms, Chinese customers can achieve better working capital efficiency and a lower average cost of funds. Furthermore, using RMB as the payment currency enables terms to be extended past 90 days, thereby providing larger working capital benefits to Chinese importers.

For Australian subsidiaries in China, utilising RMB to pay the Australian parent can enable payment terms for intercompany trade to be extended to 210 days from 90 days. While the parent bears the working capital burden, if Australian funding costs are lower relative to China, there is a net benefit to the Group.

BENEFIT 3: WIDER BUYER AND SUPPLIER BASE BECOME ACCESSIBLE

There are a large number of Chinese companies yet to develop foreign currency capability. Therefore, the ability to settle in RMB will allow Australian businesses to access a broader range of buyers/suppliers, reduce buyer/supplier concentration risk, while lowering credit and reputational risk. This is particularly important in the context of the ChAFTA.

FIGURE 32: UTILISING RMB TO IMPROVE WORKING CAPITAL

Illustrative example only

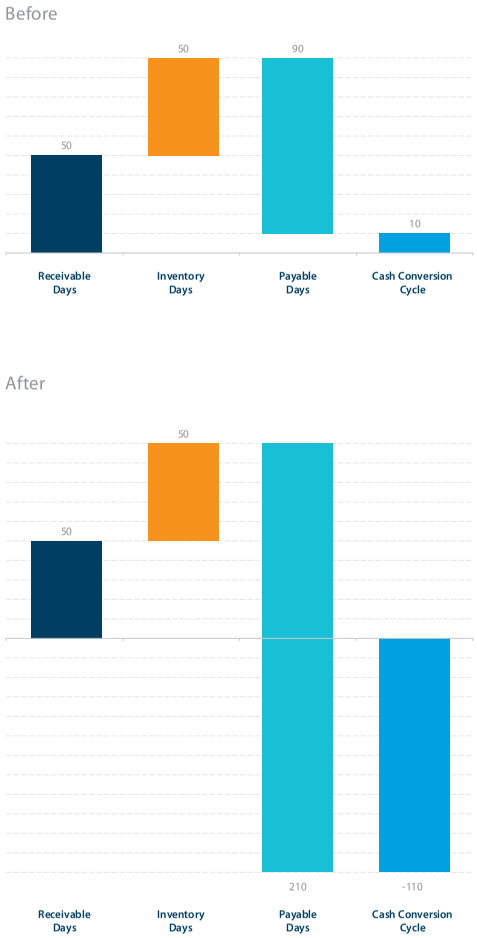


FIGURE 33: RMB COST BENEFIT ANALYSIS

Source: ANZ

	Exporters		Importers	
	Pros	Cons	Pros	Cons
Chinese Companies	• Natural hedge against domestic expenses • Reduction in hedging costs • Earn higher interest on RMB deposits • No translation gain/loss	• May need to give away profit margin • Depreciation in RMB relative to USD	• Natural hedge against domestic sales • Reduction in hedging costs	• Overseas counterparts' willingness to invoice in RMB • Appreciation in RMB
	Pros	Cons	Pros	Cons
Australian Companies	• Negotiate higher selling price • Obtain cheaper offshore RMB hedging instruments • Access to a wider client base • Increase in sales supported by payment terms extension	• RMB FX risk	• Negotiate lower buying price • Obtain cheaper offshore RMB hedging instruments • Negotiate longer trading terms • Access to a wider supplier base	• RMB FX risk

AUSTRALIAN BUSINESSES HAVE THE CAPACITY TO INVEST AND OPERATE WHOLLY OWNED SUBSIDIARIES IN CHINA

Investment in China

Across most industries, tariff reductions and improved market access to China will mean that trade considerations such as RMB invoicing are the primary consideration. However, for a number of industries such as health (aged care and hospitals), tourism (hotels and tour operators) and insurance (3rd party motor vehicle liability), Australian businesses have the capacity to invest and operate wholly owned subsidiaries in China.

This is a significant opportunity, but one that comes with increased complexity. It also highlights how China is opening up its capital account and simplifying investment procedures. As such, China will see an increasing amount of cross-border investment, both inbound (Foreign Direct Investment) and outbound (Overseas Direct Investment) (Figure 34).

With the ChAFTA, Australian companies will have a competitive advantage against many other foreign companies that are still largely restricted from operating wholly owned subsidiaries in China. However, this window of competitive advantage is unlikely to last, as China opens up its market and signs FTAs with other countries.

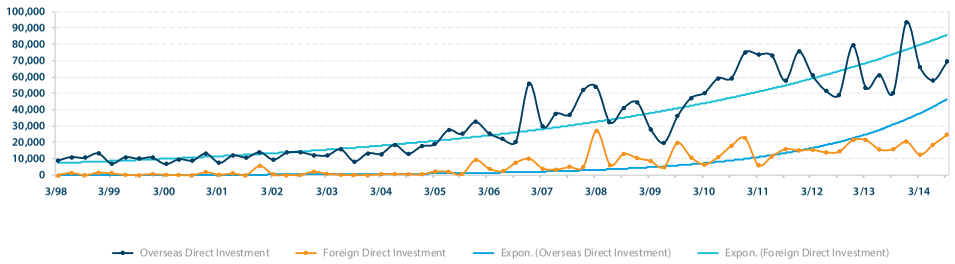
For Australian businesses looking to set up operations, many will encounter three main complexities:

- The FDI approval process (to establish subsidiaries)
- Liquidity management (having your cash in the right place and streamlining payments)
- Repatriation of earnings (avoiding trapped cash)

FIGURE 34: OVERSEAS DIRECT INVESTMENT AND FOREIGN DIRECT INVESTMENT

Source: Wind information and ANZ economics

Note: ODI: Overseas Direct Investment; FDI: Foreign Direct Investment.



UNDERSTANDING THE LEGAL IMPLICATIONS ARE CRITICAL WHEN INVESTING IN CHINA

Simplified FDI approval process

To establish a subsidiary in China, foreign companies have to go through a number of government authorities and approval/filing processes. The key departments are the National Development and Reform Commission (NDRC), the Ministry of Commerce (MOFCOM) and the State Administration of Foreign Exchange (SAFE). Recent years have seen NDRC, MOFCOM and SAFE deregulate and simplify approval processes in an effort to promote inbound investment. Coupled with the deregulation, the ChAFTA enhances the benefits for Australian businesses to invest in China in a number of sectors/industries.

The following highlights key regulations and benefits (due to the complexity of the regulations, we recommend you to seek independent legal advice on detailed investment parameters).

- NDRC governs FDI. The main regulatory documents for FDI are the Catalogue for the Guidance of Foreign Investment Industries (Foreign Investment Catalogue 2011), the Catalogue of Investment Projects subject to Governmental Verification and Approval (Investment Catalogue 2014) and Administrative Measures for Approval and Filing of Foreign Investment Projects ("Measures").
- The Foreign Investment Catalogue 2011 is the main policy to regulate FDIs. It divides FDIs into three categories: Encouraged Foreign Investment, Restricted Foreign Investment and Prohibited Foreign Investment. All others fall into Permitted Foreign Investments. To protect China's interests in a number of key industries, restrictions are imposed on investment forms and shareholdings. The ChAFTA allows some industries to have wholly Australian owned subsidiaries in China, which provides Australian businesses with a significant advantage compared to players in other countries. To keep up with China's development, the revised draft of the catalogue was published in 2014, which accordingly to King & Wood Mallesons reduced Restricted Foreign Investment industries by more than half (from 79 to 35), cut the number of industries that were limited to joint ventures and partnerships from 43 to 11 and decreased the number of industries that require a Chinese majority shareholder from 44 to 22. This is a positive step towards liberalising China's capital account and inbound foreign investment. It also suggests that Australia's present advantage will not last indefinitely.
- Investment Catalogue 2014 lists the approval body for major industries in China and the thresholds for FDIs which have been relaxed in the past two years (table opposite):

FIGURE 35: INVESTMENT CATALOGUE FDI THRESHOLD (2014 vs 2013)

**rules are for investment required to be controlled by Chinese investors*
Source: Catalogue of Investment Projects subject to Governmental Verification and Approval (2014) and (2013)

2014		
Encouraged Foreign Investment*	Over USD2 billion	NDRC Approval + State Council Filing
	Over USD1 billion	NDRC Approval
	Less than USD1 billion	Local Government Approval
Restricted Foreign Investment	Over USD100 million	NDRC Approval
	Less than USD100 million and real estate industry (regardless of the amount)	Provincial Government Approval

2013		
Encouraged Foreign Investment*	Over USD300 million	NDRC Approval
	Less than USD300 million	Local Government Approval
Restricted Foreign Investment	Over USD50m	NDRC Approval
	Less than USD50 million and real estate industry (regardless of the amount)	Provincial Government Approval

CHINESE SUBSIDIARIES OF AUSTRALIAN COMPANIES CAN BETTER MANAGE THEIR LIQUIDITY BY SWEEPING CASH TO THEIR TREASURY CENTRE

- "Measures" abolishes the approval and quota management process, replacing it with a filing system. It states that all foreign invested projects are only subject to a filing process unless it is mentioned in the Catalogue for the Guidance of Foreign Investment Industries (2011) and the Catalogue of Investment Projects subject to Governmental Verification and Approval (2014).
- MOFCOM governs registration of a company. The approval of a FDI is a key element for company registration. If the FDI is not approved, the proposed company will not be allowed to register in China.
- In the registration process, MOFCOM also determines the minimum registered capital for a company. As the name suggests, it is the funds that are required to register with the Government to use for funding of a project and it cannot be withdrawn. Unlike in Australia where people can set up a "one-dollar" company. China requires a company to have a minimum level of registered capital. The registered capital forms part of the approved project amount and the shortfall can be supported by debt or equity. To provide more flexibility upon company setup, MOFCOM released the Notice of Improvements on Foreign Investment Examination Management (the Notice) which eliminates the examination and approval of registered capital and capital contribution for most of FIEs (other than 27 sectors/industries). Despite the elimination, requirements on the ratio between the registered capital and the total investment of an FIE continue to be in effect (Minter Ellison). For further detail of the deregulation, refer to the appendices.
- Once MOFCOM approval is obtained, a company will need a foreign currency exchange certificate from SAFE to be able to transfer the funds. A SAFE certificate is the one that banks will look at to transfer a company's investment funds. See appendices for further details.

While the opportunities of setting up a business in China are no doubt attractive, the aforementioned analysis highlights that not only do the regulations change frequently, but there is a level of ambiguity. What's most important is that businesses should seek formal legal advice early to understand what they can and cannot do in China.

LIQUIDITY MANAGEMENT

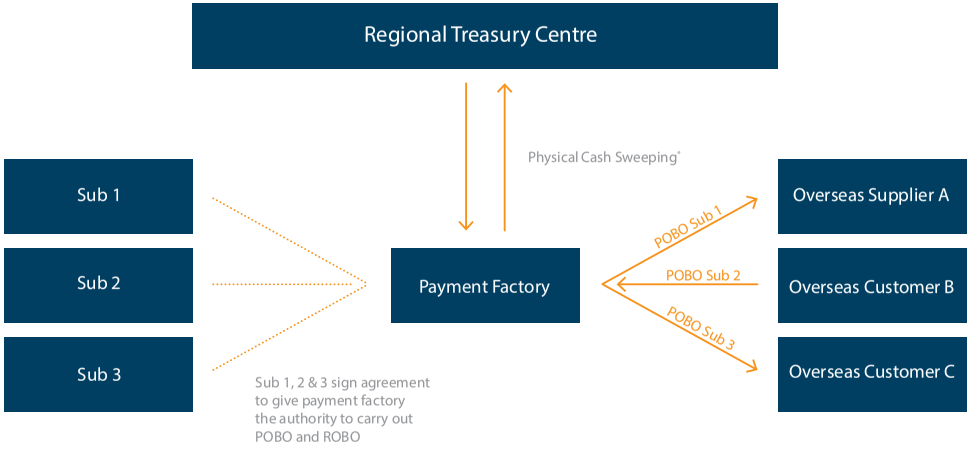
The Chinese government continue to promote inbound and outbound investment as part of further financial reform. Centralised payment (Pay On Behalf Of and Receive On Behalf Of) and netting was first introduced in the Shanghai Free Trade Zone as a pilot program. It was subsequently rolled out to pan China in 2014. By leveraging the new policy, Australian companies can better manage their liquidity by including their Chinese subsidiaries into a group payment factory. If the invoicing currency is in RMB, they can use Pay On Behalf Of ("POBO") and Receive On Behalf Of ("ROBO") solutions to centralise payments and sweep cash to the regional treasury centre. If the invoicing currency is a foreign currency, they can use POBO and ROBO to centralise its payment, FX netting to reduce FX exposure and transaction volume and FX cash sweeping to move liquidity to the regional treasury centre. See figures 36 and 37.

Centralised liquidity management provides businesses with better control, enhanced liquidity and greater visibility on funds at a Group level. It also reduces foreign exchange exposures, lowers overall transactions costs and it should also reduce the labour intensity of a finance/treasury team.

FIGURE 36: AN EFFECTIVE TREASURY MANAGEMENT EXAMPLE (RMB)

Source: PBOC, ANZ

If the payment currency is in RMB



Example: Other than using centralised payment methods to pay or receive from overseas trading counterparts, companies can also use it for intercompany transactions to reduce transaction volume and transaction costs.

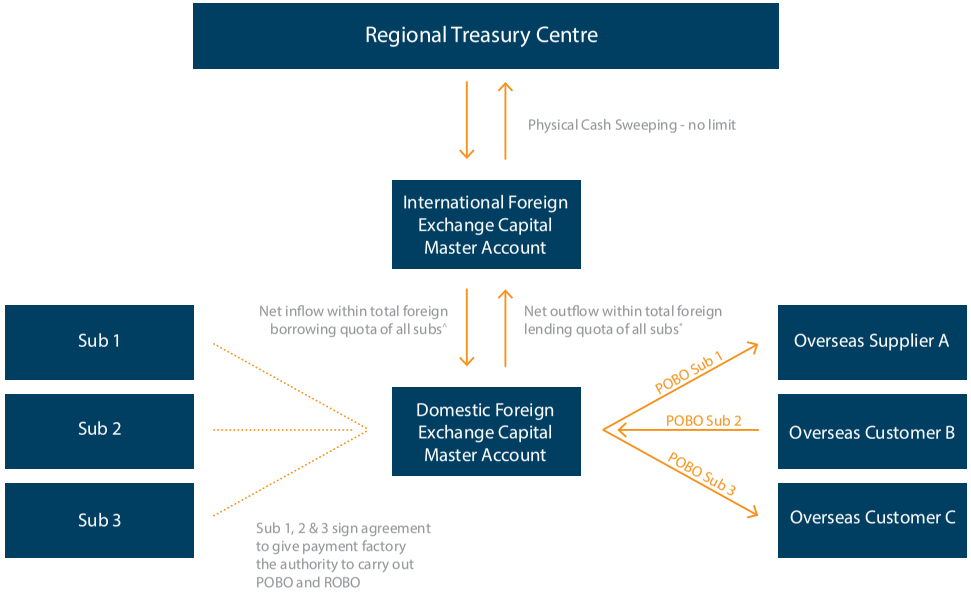
*There is no limit on cash sweeping inside the SFTZ. Though cash sweeping has been rolled out outside the SFTZ, there is a ceiling on cash inflows.

CENTRALISED LIQUIDITY MANAGEMENT PROVIDES BUSINESSES WITH BETTER CONTROL, ENHANCED LIQUIDITY AND GREATER VISIBILITY ON FUNDS AT A GROUP LEVEL

FIGURE 37: PAYMENT FLOW EXAMPLE (FOREIGN CURRENCY)

Source: PBOC, ANZ

If the payment currency is in foreign currency



Example: By using POBO and ROBO, companies can centralise all FX transactions in one account. Netting solutions enable companies to reduce the number of FX transactions and the overall FX exposure. If Sub 1, 2 & 3 transact separately and Sub 1 has AUD40 payable, Sub 2 has AUD30 receivable and Sub 3 has AUD10 payable, the total FX purchase will be AUD80 and the overall exposure will be AUD80. Instead, if Sub 1, 2 & 3 employ centralised payment and netting solutions, the total FX transaction amount will reduce to AUD20 and exposure will reduce to AUD20. This solution significantly reduces transaction costs and FX exposure.

* The net outflow is required to be within 50% of total equity of onshore members. This rule was first tested in the Shanghai Free Trade Zone and rolled out to Pan China subsequently. The quota was increased from 30% to 50%.

^The foreign borrowing quota, or borrowing gap, is the difference between the FIE's total investment and its registered capital

CROSS BORDER LENDING AND CROSS BORDER GUARANTEES CAN HELP REPATRIATE CHINESE ONSHORE EARNINGS

REPATRIATION OF EARNINGS

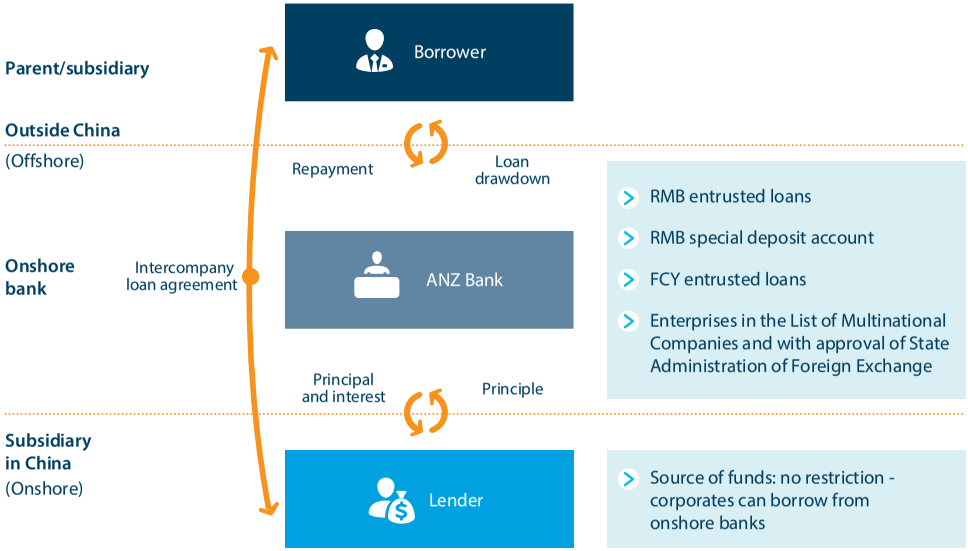
Solutions to move funds out of China (commonly known as "trapped cash") have been a top priority for treasurers. Recent deregulation could mean the end of "trapped cash". In addition to the above cash sweeping solution, there are two other solutions developed in recent years for "trapped cash".

CROSS-BORDER LENDING (ONE-WAY CASH POOLING)

Cross-border lending (also known as entrusted loans) is a one-way cash pooling solution. It is referred to as one-way because the net inflow cannot exceed the net outflow. This solution is suited for companies with one-off finance needs such as companies with an immediate need to raise funds for a project but with good working capital efficiency onshore.

FIGURE 38: CROSS BORDER LENDING

Source: PBOC, ANZ



CROSS-BORDER GUARANTEES

Cross-border guarantees were rolled out to pan China in June 2014, prior to which it was only allowed in the SFTZ as a pilot program. This solution does not include physical cash movement. Instead, the China subsidiary can use its funds in China to support its related companies' borrowing overseas.

FIGURE 39: CROSS BORDER GUARANTEES

Source: PBOC, ANZ

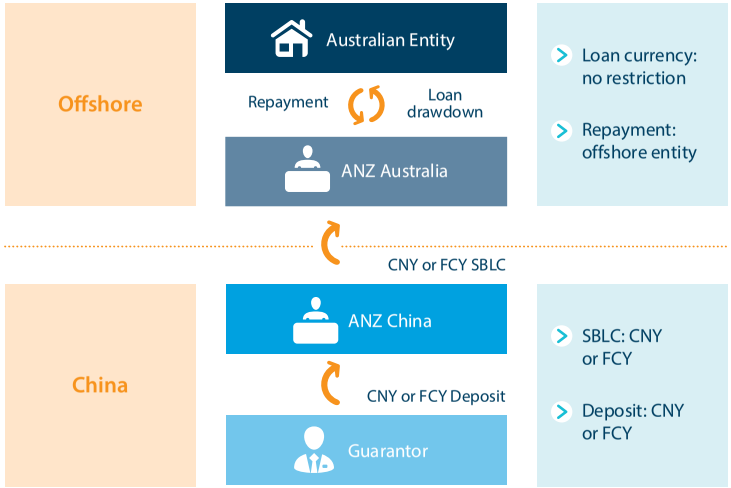


FIGURE 40: CASH SWEEPING, LOAN AND GUARANTEE PROS AND CONS

Source: PBOC, ANZ

There are pros and cons for each solution, which will be determined based on the company needs. The table below summarises the considerations of each solution. The varied regulations and unfamiliarity of doing business in China should be seen as a learning experience in the context of the significant opportunity that the ChAFTA represents.

	RMB Two-way Cash Sweeping	FCY Two-way Cash Sweeping	RMB Entrusted Loan	FCY Entrusted Loan	RMB Guarantee	FCY Guarantee
Cost	Low	Low	Low	Low	High	High
Funds Limits	No Limit (Limit) /Two way	Limit/Two way	No Limit/One way	No Limit/One way	No Limit/Two way	No Limit/Two way
Ease to Operate	Low	Low	Low	High	Low	Low
Location	SFTZ (China)	China	China	China	China	China
Source of Funds	Operating or investing cash flow	Operating or investing cash flow	No Restriction	No Restriction	No Restriction	No Restriction
FX Risk	Yes	Potentially	Yes	Potentially	No	No

Appendices

	Notice	Previous requirements
Minimum registered capital	Nil (exceptions apply)	Generally understood as RMB 100,000
Initial capital contribution	Nil	> 15% or 20%
Monetary capital contribution	Nil	> 30%
Timeframe of capital contribution	Nil	• Within 6 months, if paid in a lump sum; • Within 2 or 3 years, if paid by instalments, with the first instalment be paid within 3 months
Capital increase	Nil	First instalment shall not be less than 20% of the newly increased registered capital
Capital decrease	Nil*	After capital decrease, the registered capital must not be less than the statutory minimum

** This is not provided in the Notice but is based on ANZ's telephone consultation with MOFCOM.*

Source: Minter Ellison

Exceptions to minimum registered capital

The Notice abolishes the requirement of minimum registered capital unless it is otherwise required by laws or regulations for specific sectors. According to Minter Ellison, specific minimum registered capital requirements are still in place for foreign investment in the following selected industries:

Industries	Minimum registered capital requirement
Travel	RMB 300,000
Joint stock companies	RMB 30 million
Joint venture foreign trade company	RMB 100 million
Insurance	RMB 200 million
Banking	RMB 1 billion
Telecom	RMB 1 million, or RMB 10 million or RMB 1 billion (it may vary depending on business operation scope)
International freight forwarding	RMB 2 million for land transportation, RMB 3 million for air transportation and RMB 5 million for marine transportation
Publishing	RMB 5 million or RMB 10 million depending on specific business
Investment Company	USD 30 million

Ratio between registered capital and total investment

Although the Notice abolishes the requirement of minimum capital, the statutory requirements on the ratio between the registered capital and the total investment of an FIE continue to be in effect:

Total investment (USD)	Ratio of the registered capital
< 3 million	no less than 7/10
3 to 10 million (inclusive)	no less than 1/2
10 to 30 million (inclusive)	no less than 2/5
> 30 million	no less than 1/3

Source: Minter Ellison

Glossary of Terms

Abbreviation	Term
ACBC	Australia China Business Council
AUD	Australian Dollar
AIHW	Australian Institute of Health and Welfare
BSE	Bovine Spongiform Encephalopathy
BMI	Business Monitor International
ChAFTA	China Australia Free Trade Agreement
CIRC	China Insurance Regulatory Commission
CSRC	China Securities Regulatory Commission
CNY	Chinese Yuan
CMI	Commercial Motor Insurances
CTPL	Compulsory Third-Party Liability
DFAT	Department of Foreign Affairs and Trade
EMA	Enterprise Migration Agreements
ECA	Export Council of Australia
EFIC	Export Finance and Insurance Corporation
FMD	Foot and Mouth Disease
FCY	Foreign Currency
FDI	Foreign Direct Investment
FIRB	Foreign Investment Review Board
FIE	Foreign Investor Entity
FTA	Free Trade Agreement
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
NZD	New Zealand Dollar
the Notice	Notice of Improvements on Foreign Investment Examination Management
POBO	Pay On Behalf Of
PBOC	People's Bank of China
PRC	People's Republic of China
ROBO	Receive On Behalf Of
RMB	Renminbi
RQFII	RMB Qualified Foreign Institutional Investor
SFTZ	Shanghai Free Trade Zone
SMP	Skimmed Milk Powder
SBLC	Standby Letter of Credit
SAFE	State Administration of Foreign Exchange
SOE	State Owned Enterprise
UHT	Ultra-High Temperature
USD	United States Dollar
WMP	Whole Milk Powder

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