Further Opening-Up China's Financial Sector: Strengthening Market Reform and Regulation

Roy Gori

President and CEO, Manulife Financial

Executive Summary

Over the past several decades, China has worked to strengthen financial regulation and liberalize financial markets. More recently, the Chinese government has wisely undertaken a policy campaign to deleverage the financial sector, which focused on reducing risks related to shadow banking activity and begun to address the challenges associated with an aging population. In doing so, the Chinese government made important progress toward mitigating future potential risks.

This paper suggests some further areas where the Chinese government might consider utilizing effective and progressive regulation to reduce risk and implement further reform and opening-up. Progressive regulation refers to regulatory efforts that balance regulatory control and industry growth. Progressive regulations could be used to further level the playing field for the Chinese financial industry, encouraging investment by foreign companies such as Manulife and contributing to the prosperity of the Chinese nation.

Manulife makes two key recommendations to support the further opening-up of China's financial sector:

1. Lowering entry barriers, both formal and informal, for foreign firms in all finance and financial services.

Competition will provide more capital for underserved sections of the economy, driving these activities into the regulated areas of the financial system. The resulting increased competition will help foster innovation, both in China and abroad. Innovation in the areas of pension-tech and financial education would help pave the way for foreign players so that they could join an already thriving Chinese financial ecosystem.

2. Pursuing progressive regulation to facilitate the engagement of diverse companies in the financial services sector.

Regulation should provide a level playing field with well-understood requirements for success without overdue restriction. Compared to a unified approach, a differentiated regulation approach has been always more successful in driving the opening-up of the market and efficiency.

These recommendations are explored in three sections, 1) an assessment of recent financial regulatory changes in China; 2) a discussion of effective regulation to address shadow banking activity; and 3) an assessment of challenges facing China's pensions system and a discussion of possible solutions with recommendations from Manulife.

Through fostering further opening-up in a way that supports both companies and the Chinese consumers, China can build a truly unique set of forward-thinking regulations that strengthen its position as a global financial leader.

Introduction

China worked to strengthen financial regulation and reform and liberalize financial markets over the past year, reflecting a commitment to liberalization at home and to opening its markets wider to the outside world. This included a policy campaign to deleverage the financial sector, which focused on reducing risks related to shadow banking activity and unregulated credit intermediation. In doing so, the Chinese government made important progress towards mitigating future potential risks.

Manulife recognizes and applauds China's important successes in strengthening financial regulations over the past year. This paper suggests some further areas where the Chinese government might consider utilizing effective and progressive regulation to reduce risk and implement further reform and opening-up. Progressive regulations could be used to level the playing field for the Chinese financial industry, encouraging investment by foreign companies such as Manulife and contributing to the prosperity of the Chinese nation. Progressive regulation refers to regulatory efforts that are flexible and principles based, which provide a solid underpinning for companies and consumers while giving industries room to grow and to try new ideas. Simply put, progressive regulation is regulation that balances regulatory control and industry growth. Subjects including shadow banking and pensions regulation are explored, with an emphasis on risk prevention and win-win opportunities for China and foreign firms.

Manulife makes two key recommendations to support the further opening-up of China's financial sector:

- Lowering entry barriers, both formal and informal, for foreign firms in all finance and financial services.
- Pursuing progressive regulation to facilitate the engagement of diverse companies in the financial services sector.

These recommendations are explored in three sections, 1) an assessment of recent financial regulatory changes in China; 2) a discussion of effective regulation to address shadow banking activity; and 3) an assessment of challenges facing China's pensions system and a discussion of possible solutions with recommendations from Manulife.

I . Section 1– Current Context: Progress and Room for Improvement

China's government worked diligently to deleverage financial institutions, strengthen financial regulation, and mitigate systemic risk over the past two years. Concerted efforts reduced some key risks related to shadow banking and corporate debt and slowed the overall pace of credit growth in the economy. The deleveraging campaign was meant to bring down debt risk and rectify gaps in China's financial regulatory framework which had resulted in credit being put to inefficient use, and malpractice by some private financial actors. The deleveraging campaign initially focused on shadow banking and now focuses more on state-owned enterprises and local governments. China has unique economic strengths that can be leveraged to combat regulatory gaps and financial risks, including strong capacity to refine financial regulations, and a resilient and diverse economy.[1]

---

[1] Banking Industry Country Risk Assessment: China, S&P, 1&2.

i. Regulatory Changes

The deleveraging campaign resulted in a wide array of financial regulatory changes in China over the past two years. Most prominently the government made great strides to limit risks related to implicit guarantees and the shadow banking market, including imposing a new set of rules for the asset management industry which regulate how banks fund themselves and what types of financial products they can offer. Released in July 2018, the rules prevent banks from selling wealth management products (WMPs) which offer guaranteed returns. Similar rules were enacted to restrict the sale of riskier-types of universal life insurance products. In addition, the government also rolled out new liquidity risk management requirements to ensure banks have sufficient capital on hand; and undertook a nationwide audit of implicit debt on the balance sheets of local governments.

Late in 2018, the Chinese government indicated that it might expand its list of domestic financial institutions deemed Domestic Systemically Important Financial Institutions (D-SIFIs), which have been referred to as "too big to fail." Once officially designated as a SIFI, a financial institution is then subject to additional regulatory scrutiny, higher capital requirements and other rules in areas like leverage limits and transparency. S&P notes that "unlike the norm in other countries, China will include not just banks and insurers for the assessment [of too big to fail institutions], but also brokers and financial holding companies." It also appears probable that powerful financial technology (fintech) firms will be covered under D-SIFI. This is of note because it shows a willingness on the part

of the Chinese government to expand regulation in directions that other nations have not, and thus reduce future regulatory issues.[2]

Another example of shifts in the regulatory framework is the removal of previous restrictions that prevented insurance firms from purchasing tier-2 and perpetual capital bonds issued by banks.[3] Regulations relating to the stock market have also shifted. In February 2019 the China Securities Regulatory Commission (CSRC) introduced a new board for technology startups, and the Shanghai Stock Exchange issued a new set of rules that allowed companies that are not yet profitable to list for the first time while also removing a partial limit on daily share-price movements.[4]

ii. Opening-Up

In November 2017 the Chinese government made an important decision to further open its domestic financial services market to foreign competition, including in banking, insurance, and asset management. In April 2018, President Xi Jinping gave an important speech at the Bo'Ao Forum in Hainan Province reinforcing these promises. Subsequently, the China Banking and Insurance Regulatory Commission (CBIRC) issued *Measures on Facilitating the Further Opening-Up of Banking and Insurance Sectors (the Measures),* an important document which codified a reduction in regulatory restrictions on foreign investment. Under

---

[2] Too Big To Fail? China Strengthens FI Risk Buffers With New Framework, S&P, 1.
[3] China's Regulators Pave New Path For Bank Recapitalization, And Encourage Insurer Participation, S&P Ratings Direct, 2.
[4] Xie Yu and Daniel Ren, "'Not impressive': China's ambitious stock market reform meets with lukewarm reaction," South China Morning Post, February 1, 2019, https://www.scmp.com/business/banking-finance/article/2184520/not-impressive-chinas-ambitious-stock-market-reform-meets

CBIRC Notice 16 in 2018: Further Opening Up Market Access by Foreign-Investment Banks, the permitted scope of foreign investment in banks was expanded, allowing the requirements on the minimum working capital which a foreign bank can allocate to its branches in China to be reviewed on a consolidated basis. CBIRC Notice 19 in 2018 removed business-scope limitations placed upon foreign-invested insurance brokerages. The CBIRC also formally raised the mandatory equity cap for foreign ownership in a domestic life insurance venture from 50% to 51%, with an understanding that equity caps would eventually be abolished entirely. Manulife applauds these efforts to open the financial industry.

II . Section 2 - Regulating the Unregulated: Debt and Shadow Banking

One of the most significant issues China currently faces is the size and nature of outstanding debt in the economy, a fact which the Chinese government recognizes. Estimates from 2017 place total debt around RMB 83 trillion, or 256 percent of GDP.[5] The IMF projects that number will reach 300 percent by 2022. Corporate debt accounts for 63 percent of total debt, with household and government debt taking up 19 percent and 18 percent respectively.[6] While China's debt ratio is similar to that of several developed countries, it is the growth rate in recent years which is of greatest concern. Between 2008 and 2017, the debt-to-GDP ratio grew 114 percent.[7] A 2016 IMF report found 38 out of 43 economies whose national

[5] United Overseas Bank, *China Debt & Shadow Banking at a Glance*, August 8, 2018, https://www.uobgroup.com/web-resources/uobgroup/pdf/research/MIR-20180808.pdf.
[6] United Overseas Bank, *China Debt & Shadow Banking at a Glance*, August 8, 2018, https://www.uobgroup.com/web-resources/uobgroup/pdf/research/MIR-20180808.pdf.
[7] United Overseas Bank, *China Debt & Shadow Banking at a Glance*, August 8, 2018, https://www.uobgroup.com/web-resources/uobgroup/pdf/research/MIR-20180808.pdf.

debt was 30 percent higher than its GDP experienced severe disruption in the form of financial crises and a decline in growth.[8,9]

The size of China's shadow banking system is particularly worrisome, both for outside observers and for the government itself. The Bank of International Settlements estimated shadow financing at the creditor stage to be at 71 percent of GDP or 46 percent of total bank deposits at the end of 2016.[10] However, in the past two years, the Chinese government has taken concerted efforts (as discussed in Section 1) to better understand the size of potential risk in its shadow banking sector, curtail the riskiest forms of shadow banking activity, and bring more of the activity with which it is comfortable into the formally regulated domain. The government has also made important strides in allowing more market-based capital allocation, which reduces the need for shadow banking activity and should facilitate increased lending to Chinese households and the private sector.

This section will outline the shadow banking system as a case study for ways in which increased competition through improved regulations and more market access for foreign institutions have the potential to make China's financial markets more efficient. Shadow banking was chosen because of the significant dangers that lurk within unregulated debt and the existence of opportunities for

---

[8] Wojciech Maliszewski et. al., "Resolving China's Corporate Debt Problem," IMF Working Paper, https://www.imf.org/external/pubs/ft/wp/2016/wp16203.pdf, 2.
[9] Tasha Wibawa, "China's looming great wall of debt may have 'major global implications'," ABC News, January 19, 2019,
https://www.abc.net.au/news/2019-01-20/chinas-looming-great-wall-of-debt/10713614
[10] Torsten Ehlers, Steven Kong and Feng Zhu, *Mapping shadow banking in China: structure and dynamics*, BIS Working Papers No. 701, February 12, 2018,
https://www.bis.org/publ/work701.htm, 29 (Table 1).

mutually beneficial improvement for both domestic and foreign financial services companies.

i. Shadow Banking: Fulfilling a Need

Shadow banking is by nature difficult to define, capture and measure. In this case, the term "shadow banking" refers to all activities related to credit intermediation, typically performed by banks, that are performed outside of normal banking regulations. These include activities undertaken by commercial banks themselves for the purposes of bypassing regulatory requirements.[11]

The size of shadow banking in China ballooned after the 2009-2010 stimulus push, which was characterized by a substantial easing of monetary policy allowing shadow financing to flourish. By 2015, shadow banking was growing faster than regulated lending.[12] Shadow banking fulfilled the needs of underserved sections of the economy that found it difficult to obtain credit through traditional channels. Typically, banks prefer the safety of lending to large state-owned enterprises (SOEs) that have higher creditworthiness or explicit government backing. Small and medium-sized enterprises (SMEs) are thus often left with little choice but to seek credit from the shadow banking system.[13]

---

[11] Torsten Ehlers, Steven Kong and Feng Zhu, *Mapping shadow banking in China: structure and dynamics*, BIS Working Papers No. 701, February 12, 2018, https://www.bis.org/publ/work701.htm.

[12] Yueyao Wang, "De-Shadowisation - Taming the Chinese Shadow Banking Sector," Medium, February 8, 2018, https://medium.com/@dataramatech/de-shadowisation-taming-the-chinese-shadow-banking-sector-af369622fbb6

[13] Torsten Ehlers, Steven Kong and Feng Zhu, *Mapping shadow banking in China: structure and dynamics*, BIS Working Papers No. 701, February 12, 2018, https://www.bis.org/publ/work701.htm, 10.

Unique to China's shadow banking system is the central involvement of commercial banks. Commercial banks are the primary link between suppliers and borrowers of funds in the shadow banking system. Goldman Sachs Group has noted that asset managers in China have created almost RMB 30 trillion of shadow credit and that the formal banking system has, in recent years, funded almost 40 percent of shadow assets.[14] WMPs offered by commercial banks provide liquidity to other shadow bank entities such as trust companies. Since WMPs offer high yields, they divert household and corporate savings away from traditional, regulated bank deposits.[15] This dynamic is symptomatic of interest rate controls, which keep down deposit rates that traditional banks can offer, although Beijing is succeeding in bringing these rates up gradually over time.

ii. Obscured Financial Risks and Tight Linkages

Not only are high levels of debt unsustainable and risky, but shadow banking operating outside regulatory control obscures who is ultimately exposed to default risks.[16] Because this industry is not closely regulated, there is a risk that participating banks do not have adequate capital requirements to cover potential losses. In the event of an increased rate of defaults, there is, therefore, a risk of financial stress that might require government intervention.[17]

---

[14] Anjani Trivedi, "China Despairs of Its Dark Financial Underbelly," Bloomberg, November 29, 2018, https://www.bloomberg.com/opinion/articles/2018-11-30/china-s-p2p-purge-underscores-shadow-banking-challenge

[15] Torsten Ehlers, Steven Kong and Feng Zhu, *Mapping shadow banking in China: structure and dynamics*, BIS Working Papers No. 701, February 12, 2018, https://www.bis.org/publ/work701.htm,10.

[16] Torsten Ehlers, Steven Kong and Feng Zhu, *Mapping shadow banking in China: structure and dynamics*, BIS Working Papers No. 701, February 12, 2018, https://www.bis.org/publ/work701.htm,11.

[17] Yueyao Wang, "De-Shadowisation - Taming the Chinese Shadow Banking Sector," Medium, February 8, 2018,

Adding to the risk are tight linkages between both regulated and unregulated entities within the shadow banking system. Shadow banks have been used by local governments, often via local government financing vehicles (LGFVs), to finance infrastructure and other development projects, thereby adding to overall government debt.[18] Much of this debt is implicit, and over the past year Beijing has worked to audit these contingent liabilities and regulate how local governments manage them moving forward. S&P Global Ratings argued that off-balance-sheet borrowing by local governments as of late 2018 was as high as RMB 40 trillion.[19]

Since commercial banks are the main facilitator of shadow credit, many investors in WMPs, which channel capital into shadow banking loans, perceive there to be implicit guarantees on those investments, when in fact banks are not held to any such legal obligation.[20] Many assume that large state-owned banks would be saved by the government. Commercial bank and government involvement in shadow banking creates greater risks to the regulated financial system, however, it

---

https://medium.com/@dataramatech/de-shadowisation-taming-the-chinese-shadow-banking-sector-af369622fbb6

[18] Tasha Wibawa, "China's looming great wall of debt may have 'major global implications'," ABC News, January 19, 2019, https://www.abc.net.au/news/2019-01-20/chinas-looming-great-wall-of-debt/10713614

[19] Tasha Wibawa, "China's looming great wall of debt may have 'major global implications'," ABC News, January 19, 2019, https://www.abc.net.au/news/2019-01-20/chinas-looming-great-wall-of-debt/10713614

[20] Torsten Ehlers, Steven Kong and Feng Zhu, *Mapping shadow banking in China: structure and dynamics*, BIS Working Papers No. 701, February 12, 2018, https://www.bis.org/publ/work701.htm,10.

also means that there are opportunities to bring the unregulated segments of the system within the regulated sector. [21]

As mentioned in Section 1, the Chinese government has already taken several steps to reduce related risks. An important example are the 2018 regulations forbidding banks from selling WMPs that offer guaranteed returns on principle and new liquidity risk management requirements. [22] These regulations are an integral part of a more rigorous macro prudential assessment of financial institutions conducted by the central bank.

These rules, and associated additional regulatory efforts undertaken throughout 2018 were effective in increasing funding costs for shadow banks, which translated into higher borrowing costs for companies, reducing the private corporate incentive to turn to shadow financing channels.[23] While policy efforts had some initial successes, more recently yields for shadow bank funding have fallen in line with government efforts to ease monetary policy to boost the economy.

---

[21] "China's central bank tightens rules on asset management firms in move to reduce risks," *South China Morning Post*, July 20, 2018, https://www.scmp.com/business/banking-finance/article/2143779/chinas-central-bank-tightens-rules-asset-management-firms.

[22] "China's central bank tightens rules on asset management firms in move to reduce risks," *South China Morning Post*, July 20, 2018, https://www.scmp.com/business/banking-finance/article/2143779/chinas-central-bank-tightens-rules-asset-management-firms.

[23] Shuai Guo and Ross Spence, "A solution to a problem or a problem to a solution: The extraordinary Chinese debt problem," Leiden Law Blog, August 27, 2018, https://leidenlawblog.nl/articles/a-solution-to-a-problem-or-a-problem-to-a-solution-the-extraordinary-chines

iii. Solutions: Fulfilling the Need

The difficulties China faces with shadow banking and inadequate lending to SMEs are multi-faceted and complex. Much work remains in areas like lifting controls on interest rates, reducing implicit debt levels and allowing fairer competition in banking and capital markets. While a full exploration of these policy arenas is outside of the scope of this paper, we focus below on specific advice about improving competition in financial markets as a means to better utilize risk-based capital allocation while strengthening governance and risk management practices. In order to improve competition in the financial services industry, this paper recommends further opening up the financial services industry to foreign institutions and improving regulations to level the playing field. Additionally, Beijing should keep working to clean up local government implicit debt to reduce their reliance on shadow finance.

Beyond this broad guidance we offer a number of specific considerations:

- While Chinese private companies, particularly SMEs, have trouble accessing credit, they are more efficient than SOEs. In order to reduce risks of unregulated lending without stifling growth, well-regulated and transparent lending to SMEs should also be encouraged to flourish. To its credit, the Chinese government has already done much work to facilitate lending to SMEs. At the end of 2018, numerous senior officials, including President Xi Jinping and CBIRC Chairman Guo Shuqing, committed to facilitating credit allocation to private business.
- Accelerating interest rate liberalization to allow more competition among both domestic and foreign banks and allowing actual market pricing to

flow into credit markets would help bring shadow credit into the regulated system while better pricing risk across the board.

- Increased competition from private domestic banks and foreign institutions can incentivize banks to lend to SMEs so that SMEs would not have to turn to higher-rate loans provided by the shadow banking sector. This would eliminate unsustainable high-yield products that are the prime source of risk.
- If China wants to reduce incentives to invest in bank issued high guarantee WMPs, it should move forward with full reform of its equity markets while opening its asset management industry to wider domestic and foreign competition. Asset management companies, such as Manulife TEDA, can offer Chinese investors alternatives to the current WMP market, which mostly channels invested funds into high-yield and riskier types of corporate loans. Competition spurred by foreign firms could also help free up capital for underserved sections of the economy.
- Well-regulated competition also has secondary benefits such as breeding innovation and establishing expertise and best practices. Foreign firms can offer tremendous help in developing Chinese firms' best practices, from customer service to good governance. Both Chinese and foreign firms can take advantage of each other's expertise, freeing up capital and energy for investment in research and development. Foreign firms are not only interested in the tremendous opportunities that exist in the Chinese market but would also be able to take innovations to their home markets and learn best practices from their Chinese counterparts.

iv. Conclusion

Shadow banking is amorphous and continues to change. Regulations must be adapted to capture as much shadow credit as possible without cutting off the flow to economic growth engines in China. A well-regulated, competitive financial services market can help reduce financial systemic risks while simultaneously encouraging economic growth. China can create unique business models to address its specific social needs, such as an aging population, while also leveraging experiences from mature markets.

III. Section 3 - Financial Regulation and Innovation: A Balanced Approach

Just as debt management offers a unique opportunity to reassess regulation, pension distribution methods can provide options for opening-up the Chinese industry in new and beneficial ways. Because of its dynamic and unique financial sector, China is well placed to become a world leader in innovative regulatory practices that combine Chinese expertise and international experience. In this way, China can build a world-class, future-facing financial system with Chinese characteristics. This section explores innovations in regulation through the examination of China’s current pensions system.

Regulatory frameworks create a buffer against potential systemic distress in China’s financial sector, allowing the government to assert more control over what is going on in the sector, creating a more stable environment for business. These efforts are, in part, meant to reduce risk, close regulatory gaps, and increase discipline within China’s financial sector. Through the continuation of these efforts, China can create a more stable economic ecosystem. These efforts to

regulate should not be restrictive, but instead progressive regulations with Chinese characteristics. Progressive regulations will allow the pensions sector to expand while encouraging innovation.

The three pillars of China's pension system could be enriched by combining further opening-up and regulatory actions in complementary ways. Pillar One, the national mandatory social security pension system, will not be discussed in this paper. Pillar Two, voluntary enterprise and occupational annuities, and Pillar Three, individual voluntary retirement savings options, would benefit the most from regulatory actions that would reduce costs and encourage competition. Leveling the regulatory playing field could also mean allowing further investment and involvement on the part of foreign companies, such as Manulife. This would be mutually beneficial for China and these companies. The Third Pillar of the Chinese pensions system, which concerns private pensions for individuals, would particularly benefit from opening-up to foreign competition. Such actions would result in a greater variety of options available to China's aging population, reducing the burden placed on Pillars One and Two of China's pension system.

i. Challenges

A rapidly aging population will present a unique set of challenges to the three pillars of China's pension system. A funding gap will be chief among these; a decline in the number of working-aged people contributing to pension schemes will make the larger payouts required by an older population hard to support. The Chinese government is well-aware of these challenges and has taken some steps to address them in recent years, including strengthening enforcement of pension contribution requirements by employers and allowing pension funds to diversify

investments to secure better returns. Still, the issues caused by looming pension funding gaps could give rise to more reliance on alternative, non-state sanctioned, methods of funding retirement, tying back to the issue of shadow finance.

KPMG noted in 2017 that China's pension system would need to further develop to meet the demographic challenges facing the nation.[24] Pillar One, or the Public Pension Fund (PPF) and the National Council for Social Security Fund (NCSSF), will be particularly affected by a rapidly aging population. Pillar Two, will need to be supported to ensure that workers are paid what they are due. This support could come in the form of flexible regulation that will encourage companies to help their employees save for retirement. The Third Pillar presents a unique opportunity for development, as it is the most underdeveloped of the three.

Manulife's suggestion of further progressive regulation, with the goal of leveling the playing field within the financial industry, would be supported by such actions, as a well-regulated Third Pillar pensions system would give both foreign and national firms chances to bring in international best-practices and help limit looming funding gaps.

ii. Possible solutions

There are many ways in which the effects of this shift in population can be mitigated, including changes to workplace culture and retirement age and proactive planning for the pressures that an aging population will exert on pensions structures.

---

[24] "China Pensions Outlook," KPMG, https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2017/12/china-pension-outlook.pdf)

Increasing financial literacy is one way in which the Chinese government can further open-up their financial sector. A more aware, and thus more engaged, population would put more thought towards retirement and pensions planning, make more informed decisions when choosing financial products, resulting in better and safer financial choices. A more financially literate population may be more inclined to engage in longer-term savings behavior. China made great strides toward increasing financial literacy in the decades following reform and opening up, but Xinhua notes that "according to an annual research report of the People's Bank of China or PBOC, the central bank, Chinese consumers' average score on the financial literacy index was 63.71, a medium-high level, but there were stark regional differences."[25] Other media sources have noted that financial literacy is an important topic in China, and that there has been a push over the last several years to expand consumer financial literacy in order to support the expansion of the financial system as a whole.[26]

Some suggestions for implementing this could include incorporating financial education into school curricula and requiring banks and other financial institutions to practice more active awareness of the extent of, and gaps in, the financial knowledge that their customers possess. These measures would be meant to help the population take a more active role in their financial futures, and hopefully to create a more risk-aware society. China has already taken impressive steps toward measuring the level of financial literacy among its population with its use of macro-surveys, as these provide solid data from which to begin further efforts.[27]

---

[25] http://global.chinadaily.com.cn/a/201802/26/WS5a936691a3106e7dcc13e0aa.html
[26] http://www.rightaboutmoney.com/real-estate-to-stocks-chinas-push-for-financial-literacy/
[27] https://www.bbva.com/en/china-top-ranking-financial-literacy/

Retirement and pensions education must be considered in tandem with the products available in China's financial marketplace, as well as current and future regulatory requirements and goals. In 2018, the IMF noted that China has one of the highest national savings rates in the world, "[emanating] from the household sector, resulting from demographic changes induced by the one-child policy and the transformation of the social safety net and job security that occurred during the transition from planned to market economy."[28] The IMF further notes that "China still stands apart with one of the world's highest savings rates, compared to the global average of 20 percent, and 15 percent for emerging economies."[29] This high level of savings will be put under pressure by the demographic challenges that China is facing, leaving fewer opportunities for savings to be turned toward retirement planning. Despite these concerns, it should be noted that China's high level of savings in the household sector is a positive sign for further development of the Third Pillar; Chinese citizens have money to invest in retirement products, and a well-developed industry with well-understood products would serve as an incentive to save for retirement.

iii. Technology and Pensions: Current Trends and Opportunities

KPMG noted in 2017 that "although China dominates the Asian Fintech space with some of the world's most sophisticated mobile payments systems and highly

[28] Longmei Zhang et. al., "China's High Savings: Drivers, Prospects, and Policies," IMF Working Paper, December 11, 2018, 1. https://www.imf.org/en/Publications/WP/Issues/2018/12/11/Chinas-High-Savings-Drivers-Prospects-and-Policies-46437

[29] Longmei Zhang et. al., "China's High Savings: Drivers, Prospects, and Policies," IMF Working Paper, December 11, 2018, 1. https://www.imf.org/en/Publications/WP/Issues/2018/12/11/Chinas-High-Savings-Drivers-Prospects-and-Policies-46437

developed wealth management solutions, the impact of technology on pensions remains relatively minor."[30] China can apply the lessons learned from the development and implementation of its thriving fintech sector to the creation of a world-class pension-tech sector. China already possesses a workforce skilled in fintech, and those skills can be applied to the further implementation of pension-tech development. China has had success in implementing regulatory sandboxes in the fintech sector, and these experiences could be expanded for pension-tech.

The Chinese digital ID via Alibaba's Alipay is an excellent example of how the use of technology can improve the day-to-day lives of Chinese citizens. Through the pilot program, Chinese ID holders can, among many other things, access pension services. This is an innovative step forward, as it improves accessibility while simplifying processes relating to pensions.

Recent plans to adopt biometric pension distribution in China are also telling of a willingness to wed technology with the growing pension needs of the population. A reliable biometric distribution system would appeal to the younger generations currently saving for pensions and would be helpful for reducing pension fraud and overall risk. It could also be adapted in the Third Pillar, or private pensions sector, as it develops, allowing companies to create not only a thriving but more risk-aware industry. In their 2017 pensions report, KPMG expressed optimism in the possibility of creating new pension-tech in China; services using similar technologies have already been adopted in several programs meant to aid the elderly.

---

[30] "China Pensions Outlook," KPMG,https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2017/12/china-pension-outlook.pdf

iv. Conclusion

The implementation of a wider range of pension-tech options would call for careful and progressive regulation. It would be important to strike a balance between the needs of the private sector and the public sector so that the users of the technology would reap the maximum benefit from its use. Some key elements of this would be consumer protection, improved transparency, and ensuring that unfair competition by unregulated entities does not interfere with the development of the pension-tech sector. Openness on the part of the regulators to the ideas of non-government entities, or companies, should be encouraged, as these new ideas can lead to innovation and simplify processes. China already offers a program in which innovators in financial services are helped to understand the applicable regulations, and should continue to do so. [31] In 2018, China allowed the first tax-deferred pensions policy to be issued by China Pacific Life Insurance Co.; this means that individuals are allowed to defer tax on income used to purchase commercial pension insurance until they retire and draw money from the fund in question.[32] This marks an important step in the right direction for China, as tax-income deferred pensions will encourage consumers to prepare for retirement and promote a more balanced development of China's pension system.

IV. Section 4 - Recommendations

Manulife would like to offer two recommendations that will help China to further open up its financial system. These are lowering the entry barrier to foreign

[31] OECD (2017), Technology and Pensions: The potential for FinTech to transform the way pensions operate and how governments are supporting its development, 15. https://www.oecd.org/pensions/Technology-and-Pensions-2017.pdf

[32] http://www.chinadaily.com.cn/a/201806/07/WS5b1935a3a31001b82571ebf1.html

companies in all sectors and differentiated regulation for different types of companies rather than a uniform approach.

i. Lowering Entry Barriers

Lowering entry barriers to foreign players in all sectors will be mutually beneficial for both the government and people of China. Competition will provide more capital for underserved sections of the economy, driving these activities into the regulated side of the financial system. The resulting increased competition will also help to foster innovation, both in China and abroad.

In Section 3, we explored how progressive regulation could be beneficial to the Chinese pensions system as it opens-up further. Innovation in the areas of pension-tech and financial education would help pave the way for foreign players so that they could join an already thriving Chinese financial ecosystem.

ii. Regulatory Innovation

As expressed throughout this paper, progressive regulation will promote a balanced approach between regulation and financial innovation. Regulation should provide a level playing field with well-understood requirements for success without undue restriction. Instead of a uniform approach to regulation, differentiated regulations for different companies tend to be more successful in driving market openings and efficiencies.

Nuanced regulation would address each company within and entering the market according to its assets, size, the potential for growth and other key regulatory concerns. Regulations could then be applied in degrees, rather than in a uniform

manner, to ensure that smaller companies or companies new to the market are not overly limited because of regulations meant to protect them and the consumer.

Conclusion

China is well positioned to build a world-class financial system. China's efforts to curb shadow banking, change regulations to encourage both innovation and risk management and address the pressures put on its financial system by both internal and external factors show that this evolution is already underway. A world-class financial services sector that takes the experiences of other nations and combines them with support for progressive regulation will be key to this transformation. Through fostering further opening-up in a way that supports both companies and the Chinese consumer, China can build a truly unique set of forward-thinking regulations that strengthen its position as a global financial leader.

Manulife hopes that the above policy recommendations will be helpful and looks forward to future collaboration as China continues its efforts to further open up its financial services sector for greater prosperity.