Opening up and Risk Prevention & Control of the Financial Services Industry

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Opening up is the only way for a country to achieve prosperity and development. The opening up of the financial industry is an important part of China's overall opening up to the outside world. Expanding the opening up of the financial industry is not only an inherent requirement for its development, but also an objective need to improve the financial services for the real economy. Since the reform and opening up, China's financial development has gained great progress, and the financial industry has made historic achievements. In particular, the opening up of the financial services industry has accelerated and significant progress has been made since 2018. In the next step, we should continue to promote the opening up of the financial industry by adhering to the "three principles", namely: adhering to the principle of pre-establishment national treatment and negative list; adhering to the coordination and joint promotion of the financial industry's opening up and exchange rate formation mechanism reform and the capital account convertibility process; paying attention to the prevention of financial risks during the opening up of the financial services industry, so that financial regulation capability can match financial openness.

I. Significant progress has been made in the opening up of China's financial services industry since 2018

In April 2018, General Secretary Xi Jinping announced at the "Boao Forum for

Asia Annual Conference 2018" that "the market access will be greatly relaxed... In the service industry, especially the financial industry, the implementation of major measures of loosening the restrictions on ratio of foreign shares in the banking, securities and insurance industries announced at the end of last year should be ensured; at the same time, it is necessary to further opening up, speed up the opening process of the insurance industry, relax the restrictions on the establishment of foreign-funded financial institutions, expand the business scope of these institutions in China, and broaden the scope of cooperation between Chinese and foreign financial markets"; "we will implement relevant measures as quick as possible, and it should be sooner rather than later". Since 2018, China's financial industry has made important progress in its opening up, which is mainly reflected in the following aspects.

i. The restrictions on foreign ownership in banks and financial asset management companies have been removed, so that domestic and foreign investors can be treated equally; and foreign banks are allowed to set up branches and subsidiaries in Chinese Mainland at the same time.

On August 23, 2018, the China Banking and Insurance Regulatory Commission (CBIRC) issued the *Decision of China Banking and Insurance Regulatory Commission on the Abolition and Amendment of Some Regulations*. First, the *Administrative Measures for Investment in Chinese Financial Institutions by Foreign Financial Institutions* was abolished. In accordance with the principle of national treatment, unified licensing measures are applied to Chinese and foreign investors for the investment in Chinese financial institutions. Second, the restrictions on the ratio of foreign shares in Chinese banks and financial asset management companies have been removed, including those in the *Implementation Measures for Administrative Licensing Issues concerning Chinese Commercial Banks*, *Implementation Measures for Administrative Licensing Issues concerning Rural Small and Medium-sized Financial Institutions* and *Implementation Measures for Administrative Licensing Issues concerning Non-Banking Financial Institutions*. Relevant provisions in the above three licensing measures are deleted, that is, the ratio of investment of a single overseas financial institution and its related party as the sponsor or strategic investor in a single Chinese commercial bank or rural commercial bank and the ratio their investment in a single financial asset management company as the strategic investor should not exceed 20%, and the total ratio of investment of several overseas financial institutions and their related parties in the above-mentioned institutions should not exceed 25%. Third, according to the principle of equal treatment of Chinese and foreign investors, if a foreign financial institution invests in a Chinese commercial bank or rural small and medium-sized financial institutions, supervisory management should be applied pursuant to the institutional type at the time of investment, and the institutional type of bank will not be adjusted due to foreign investment. Fourth, it is made clear, when an overseas financial institution invests in a Chinese bank, they should also abide by relevant regulations of the state regarding investment of foreign investors in China.

In 2018, CBIRC approved Arab Bank headquartered in Jordan to establish a branch in Shanghai, Bank of East Asia (China) Limited to upgrade its Shenzhen Qianhai Sub-branch to a branch, Chang Hwa Bank Limited to restructure its branch in Chinese Mainland into Chang Hwa Bank (China) Limited, and Cathay

United Bank to restructure its domestic branch into Cathay United Bank (China) Limited.

ii. The upper limit of foreign ownership for securities companies, fund management companies, futures companies and life insurance companies has been raised to 51%, and no restrictions will be imposed after three years.

On April 27, 2018, CBIRC issued the *Measures of China Banking and Insurance Regulatory Commission to Accelerate the Implementation of Opening up of Banking and Insurance Industries,* which raised the foreign shareholding ratio of foreign-invested life insurance companies to 51%, and no restrictions would be imposed after three years. On April 28 and August 24, China Securities Regulatory Commission (CSRC) successively issued the *Administrative Measures for Foreign-invested Securities Companies* and *Administrative Measures for Foreign-invested Futures Companies*, allowing the ratio of foreign shares in securities companies and futures companies to reach 51%. In addition, according to the *Administrative Measures for Securities Investment Fund Management Companies*, the accumulative ratio of foreign shares or equities (including direct holding and indirect holding) in Sino-foreign joint venture fund management companies should not exceed the ratio committed by China's securities industry for opening up to the outside world. Therefore, fund management companies are further open to foreign investors, and the ratio of foreign shares can reach 51%.

On December 24, 2018, UBS completed its equity acquisition transaction, and raised the shareholding ratio in UBS Securities Co., Limited to 51% from 24.99%, achieving absolute control over the latter.

iii. It is no longer required that at least one of the domestic shareholders of a joint-venture securities company should be a securities company.

On April 28, 2018, the *Administrative Measures for Foreign-invested Securities Companies* promulgated by CSRC stated that the conditions of domestic shareholders of joint-venture securities companies are consistent with those of other securities companies. It means that at least one of the domestic shareholders of a joint-venture securities company is no longer required to be a securities company.

iv. The interconnection mechanism for the stock markets in Chinese Mainland and Hong Kong has been further improved.

On May 11, 2018, China Securities Regulatory Commission and Hong Kong Securities and Futures Commission announced that they agreed to expand the daily quota for interconnection. The daily quota of Shanghai Stock Connect and Shenzhen Stock Connect were adjusted to RMB52 billion, and that of Hong Kong Stock Connect under Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect were adjusted to RMB42 billion.

v. Qualified foreign investors are allowed to operate insurance agency business and insurance assessment business in China.

On June 19, 2018, CBIRC issued the *Notice on Allowing Foreign Investors to Operate Insurance Assessment Businesses in China* and the *Notice on Allowing Foreign Investors to Operate Insurance Agency Business in China*. The above documents clearly indicate that overseas assessment agencies that have been operating for more than three years or foreign professional insurance agency institutions that have been engaged in insurance agency business for more than three years may invest to establish insurance assessors or insurance agencies in China, for the purpose of operating insurance assessment or insurance agency business. A foreign-invested insurance company that has started business for more than three years in China can invest to establish insurance assessors or insurance agencies and operate related business in China.

vi. The restriction on business scope of foreign-invested insurance brokerage companies has been loosened, which is consistent with that of Chinese institutions.

On April 27, 2018, CBIRC released the *Notice on Loosening the Business Scope of Foreign-funded Insurance Brokera*ge *Companies,* to liberalize the business scope of insurance brokerage companies in line with that of Chinese ones. Specifically, a foreign-funded insurance brokerage companies that has obtained the license for insurance brokerage business may engage in the following insurance brokerage business in China: (1) drafting an insurance plan for policyholders, selecting insurers and handling insurance formalities; (2) assisting the insured or the beneficiary to make a claim; (3) reinsurance brokerage business; (4) providing clients with disaster prevention, loss prevention, risk assessment or risk management consulting services; (5) other business approved by CBIRC.

vii. The introduction of foreign investment is encouraged in the banking financial fields such as trust, financial leasing, auto finance, currency brokerage, and consumer finance.

On April 27, 2018, CBIRC issued the *Measures on Accelerating the Opening Up* *of Banking and Insurance Industries*, proposing to encourage the introduction of professional foreign investors to various banking financial institutions such as trust, financial leasing, auto finance, currency brokerage and consumer finance.

China has made significant progress in the opening up of banking and financial fields including trust, financial leasing and auto finance. For example, in terms of consumer finance, on April 27, 2018, CBIRC officially approved Taiwan-based CTBC Bank and Xiamen Jinyuan Investment Group to establish JMX Consumer Finance Co., Ltd. With respect to auto finance, a number of auto finance companies have introduced foreign investment, and even some of them have been wholly owned by foreign companies. In respect of currency brokerage, currency brokerage companies such as Tullett Prebon (Europe), ICAP plc and Compagnie Financière Tradition have entered China and established currency brokerage companies in cooperation with domestic enterprises.

viii. No upper limit is set for the foreign ownership in the new financial asset investment companies and wealth management companies established by commercial banks.

On June 29, 2018, CBIRC issued the *Administrative Measures for Financial Assets Investment Companies (Trial)*, implementing “national treatment” for financial asset investment companies invested by foreign institutions, and imposing no restrictions on the ratio of foreign shares.

ix. The business scope of foreign-funded banks has been significantly expanded.

On April 27, 2018, CBIRC issued the *Notice on Relevant Issues concerning*

Further Broadening Market Access for Foreign Banks, explicitly allowing foreign banks to conduct distribution and redemption business as an agent as well as underwrite government bonds. Besides, domestic management branches of qualified foreign banks are allowed to authorize other domestic branches to operate RMB business and derivative trading business, and a consolidated calculation method is adopted for the working capital of domestic branches set up by foreign banks.

x. Restrictions are no longer imposed on the business scope of joint-venture securities companies, which is consistent with that of Chinese-funded securities companies.

The *Administrative Measures for Foreign-invested Securities Companies* promulgated by CSRC on April 28, 2018 provide that the initial business scope of a joint-venture securities company should match the experience of controlling shareholder or the largest shareholder in the operation of securities business, without separate setting of restrictions.

xi. The rule that a representative office operating for two years is required before the establishment of a foreign-invested insurance company is disabled.

On May 30, 2018, CBIRC released the *Detailed Rules for the Implementation of the Regulations on the Administration of Foreign-funded Insurance Companies of the People's Republic of China (Draft for Comment)*, and deleted the rule that "a representative office operating for two years is required before the establishment of a foreign-invested insurance company".

xii. Fields such as payment, credit rating and credit reporting opened wider.

On March 10, 2018, the People's Bank of China (PBOC) issued the *No. 7 PBOC Announcement [2018]*, removing the restrictions on the access of foreign-invested payment agencies, clarifying the access rules and regulatory requirements, and giving comprehensive national treatment to foreign-invested payment agencies. In November 2018, PBOC and CBIRC reviewed and approved the application for preparatory establishment of bank card clearing agency submitted by "Liantong (Hangzhou) Technical Service Corporation" (the "Company"). It is a joint venture established by American Express in China, which has applied as a market entity to prepare for establishing a bank clearing agency and operate the American Express brand. On January 28, 2019, the business management department of PBOC issued an announcement to record the S&P Credit Rating (China) Co., Ltd., a wholly-owned subsidiary of S&P Global in Beijing. On the same day, National Association of Financial Market Institutional Investors also announced that it would accept the registration of S&P Credit Rating (China) Co., Ltd. for development of bond rating business in the interbank bond market.

II. Correctly Understanding and Coping with the Relationship between the Opening up and Risk Prevention of Financial Services Industry

i. Opening up is not the root cause of financial risks. On the contrary, further opening can help reduce and resolve financial risks.

First, the financial services industry is essentially a competitive industry. Open competition can promote the development of the industry, improve resource allocation, and fundamentally maintain financial stability. The practice of China's reform and opening up has proved that the financial services industry needs to enhance its vitality and competitiveness in the competition, thus strengthening the soundness of financial institutions. In the process of reform of large-scale commercial banks, domestic banks have achieved significant improvements in terms of operational efficiency, asset quality and corporate governance by introducing external strategic investors and competitive stock reforms. At the same time, more and more financial institutions have begun to "go global" and participated in the international competition on the world stage. They have made substantial improvements in the risk management, product pricing, and anti-money laundering, which has facilitated their own stable operations and the healthy development of financial market.

Second, further opening of the financial services industry can introduce advanced business management concepts, technologies and rules, improve the operational efficiency of financial system and maintain financial stability. Laggard will give rise to the lack of financial stability, while an efficient financial system is the fundamental guarantee for financial stability. In the process of China's financial reform, especially the reform of large-scale commercial banks, the experience of mature market economies in the corporate governance, loan management and risk control of financial institutions has been fully absorbed through the introduction of external strategic investors, thus effectively enhancing the soundness of financial institutions.

Third, expanded opening up of the financial services industry can disperse risks and enhance risk resilience. The experience of previous financial crises in the world shows that concentrated financial risks will be more destructive, while dispersed risks will be easier to mitigate. Expansion of opening up is an important way to disperse risks. After the opening up, more entities will enter the market, leading to more adequate competition; hence the risks will not be excessively concentrated, and problems will be shared by more entities.

ii. The conditions for China to further open the financial industry are mature, with controllable risks

Some people worry that there are certain potential risks in the course of financial opening. For example, the opening up of financial industry may accelerate cross-border capital flows, amplify the potential instability of a country's financial system, and affect macroeconomic and financial stability. Meanwhile, due to the characteristics of diversified derivatives, complex product structure and frequent trading, any risk may trigger cross-institutional and cross-market risk linkage through such channels as liquidity, product connection and asset prices. It should be fully realized that with the continuous deepening of China's financial reform, constant improvement of financial regulation system and gradually mature conditions for China to expand the financial industry's opening up, the above-mentioned potential risks will be controllable to a large extent.

First, China has made great progress in strengthening financial regulation and effectively preventing risks. In recent years, China's financial regulation system, regulatory effectiveness, macro-prudential management framework and capability in withstanding financial risks have been continuously improved and enhanced. Especially, China's macro-economic leverage has been gradually stabilized recently, and potential risks such as shadow banking have been effectively controlled, hence creating favorable conditions and foundation for deepening financial opening up.

Second, in recent years, Chinese-funded financial institutions have been sounder, with relatively strong strength. In the process of reform and development, Chinese-funded financial institutions have continuously improved their competitiveness and robustness, plus a large number of intensive outlets, resulting in a high market share and a huge customer base. Owing to the favorable network effect and economies of scale, the entry of foreign-funded financial institutions will be conducive to strengthening market competition and promoting efficiency. However, they have no obvious advantages in terms of business scale, outlet setting, and customer relationship, without significant impact on the market.

Third, China has unique advantages in resisting external shocks. As the world's second largest economy, the largest exporter and the largest foreign exchange reserve country, it has a huge financial market. At the end of 2018, the balance of Chinese bond market was reported at RMB86 trillion, ranking third in the global bond market. In addition, China also has the advantage as a latecomer. During the opening up of financial industry, the experience and the lessons from developed countries and other emerging market economies can be fully absorbed.

Of course, the financial industry cannot be opened up without regulation. Taking into account the importance and particularity of the financial industry, we should insist that finance is a franchise industry, Chinese and foreign-funded financial institutions must be licensed to operate and be supervised in conducting business in China, and must not operate without license or beyond the business scope. In the process of opening up, the financial regulation system should be continuously improved, so that regulatory capacity can match financial openness. It is necessary to learn from international experience and combine with China's reality, so as to strengthen macro-prudential management and micro-behavior supervision, eliminate regulatory gaps and remedy regulatory defects.

III. Suggestions for Further Opening the Financial Services Industry

First, we should adhere to the principle of pre-establishment national treatment and negative list. The management mode of pre-approval and positive list is not conducive to fully stimulating the innovative vitality of various market players. The next step is to transition from positive list management to negative list management mode. The Central Economic Work Conference of 2018 clearly required “to relax market access and fully implement the pre-establishment national treatment and negative list management system.” Therefore, Chinese institutions and foreign-funded ones can equally enter the fields and business areas outside the negative list in accordance with the law, and achieve “equal rights, equal opportunities, and equal rules.”

Second, the opening up of financial industry should be coordinated and promoted together with the reform of exchange rate formation mechanism and the capital account convertibility process. While boosting the opening up of financial services industry, we should deepen the reform of RMB exchange rate formation mechanism, and improve the regulated and managed floating exchange rate system based on market supply and demand by referring to a basket of currencies, to enhance the flexibility of RMB exchange rate. At the same time, the convertibility of RMB capital account should be realized in an orderly manner. In recent years, significant progress has been made in the opening of China’s capital account, and channels such as QFII, RQFII, QDII, RQDII, Shanghai-Hong Kong

Stock Connect and Shenzhen-Hong Kong Stock Connect have been continuously expanded, with the constant perfection of relevant institutional arrangements. In the next step, we should speed up the amelioration of systems and rules related to financial opening up in accordance with the requirements of the 2018 Central Economic Work Conference on “promoting the transition from the flow-based opening of goods and factors to the opening of rules and regulations”.

Third, we should attach importance to the prevention of financial risks and improvement of financial regulation system, so that financial regulation capabilities can match financial openness. By adhering to the principle that finance is a franchise industry, Chinese and foreign-funded financial institutions must operate with license and accept supervision for the business development in China, and must not operate without a license or beyond their business scope. Moreover, the construction of financial market infrastructure should be accelerated, comprehensive statistics of the financial industry should be properly collected, modern technology, payment and settlement mechanisms should be utilized, and the flows of online and offline as well as domestic and overseas funds should be supervised duly and dynamically, so that all capital flows are placed under the supervision of financial regulatory authorities. In addition, a two-tier management framework including macro-prudential and micro-market regulation should be built, to improve macro-prudential management of cross-border capital flows, intensify market regulation and behavior supervision, achieve regulatory penetration, and protect the rights and interests of financial consumers.