Progress and Challenges in the New Round of Financial Reform

May 28, 2014

Shanghai
Features of the Three Rounds of Financial Reform

First round: 1979-1997. Core: a large-scale development of financial institutions and financial market system, the establishment of a central bank regulation system and separate supervision system.

Second round: 2002-2005. Core: joint-stock reform of state-owned commercial banks, rural credit cooperatives reform, partial liberalization of foreign markets, the regulatory model closer to international norms.

Third round: 2013 – present. Core: enhance the role of the market in the allocation of financial resources, in accordance with the rules of the market.

- Highlights:
  - To build a more competitive and inclusive financial services (private capital to initiate the establishment of small and medium banks, shares in financial institutions; development of inclusive finance; improve the insurance compensation mechanism; promote policy reforms in financial institutions)
Features of the Three Rounds of Financial Reform

- Improve the financial market system, the development of multi-level capital market, abundant financial products
- Improve the market mechanism (stock issuing system reform; interest rates, exchange rate marketization; two-way open system of the capital markets; establishment of a deposit insurance system, improve financial market exit mechanism; strengthen the financial infrastructure construction)
- Improving financial regulation, guarantee the safety, efficiency and overall stability of the financial markets (implement financial regulatory reform measures and robust standard; improve regulatory coordination mechanism; define financial regulatory responsibility and risk handling responsibility of the central and local governments)
Progress Made in the New Round of Financial Reform

First, to build a more competitive and inclusive financial services

- (1) On November 14, 2013, the revised “Measures for the Administration of Pilot Consumer Finance Companies” relaxed restrictions on the conditions of the main contributor, allowing domestic non-financial enterprises whose main business is the provision for consumer loan products as the main contributor.

- (2) On March 14, 2014, the revised “Measures for the Administration of Lease Financing Companies” replaced the main contributor system with the main promoter system, ceasing to distinguish between major investors and general investors and abolishing the regulation that the funding of the main contributor need to account for 50% of the total investment.

- (3) In March 2014, the CBRC approved the first pilot program for five private banks.

- (4) On December 12, 2013, China Banking Regulatory Commission Office issued the “Notice on Related Matters of Small and Medium Commercial Banks Setting Up Community Branches and Small and Micro Branches”, simplifying the relevant administrative approval process, including the elimination of the quantitative restrictions on single application for community branches, small and micro branch, and the cancelling of the approval for senior executives to take office and the initial examining to start business.
Progress Made in the New Round of Financial Reform

- Second, to improve the multi-level capital market system

1. Intensive IPO system reform measures

1. On November 30, 2013, the CSRC issued “Advice on Further Promoting IPO Reform” to promote registration system reform, including five areas: the audit concept marketization, financing methods market, more market-oriented issuing rhythm, the issuing price, the marketization of distribution methods and restraint mechanisms.

2. On December 2, 2013, the CSRC issued “Interim Provisions for the Public Offering of Shares by the Shareholders of the Company at IPO, introducing and regulating "the transfer of the old shares" that shareholders holding the shares over 36 months can sell the old shares to the public when offering new shares in accordance with the principle of equal consultation.

3. On December 6, 2013, the CSRC issued “Guidelines on Key Financial Information and Operating Conditions Disclosure after the Audit Deadline of the IPO Prospectus and Financial Reports of Listed Companies” and “Guidelines on Disclosure of the Contents Related to Profitability in the IPO Prospectus and Financial Reports of Listed Companies” in order to improve the quality of information disclosure.

4. On December 13, 2013, the CSRC issued the revised “Administrative Measures on Securities Issuance and Underwriting”. The placement mechanism, placement ratio, the claw-back mechanism, information disclosure and disciplinary mechanisms and other aspects were revised.
Progress Made in the New Round of Financial Reform

2. Pilot program for the preferred shares. On November 30, 2013, the State Council issued the “State Council Guidance on Pilot Program for the Preferred Shares”. On March 21, 2014, the CSRC issued the “Administration Measures for the Preferred Stock Pilot Program”. On April 3, 2014, the CBRC and CSRC jointly issued "Guidance and Advice on Commercial Banks to Issue Preferred Shares to Supplement Tier 1 Capital."

3. To promote the capital market to open to the outside world

(1) On December 3, 2013, the central bank issued the “People's Bank of China’s Views on Financial Support for China (Shanghai) Free Trade Zone Construction”, stipulating that financial institutions and corporate in the region can invest and trade in the securities and futures trading venues in Shanghai according to regulations; foreign parent enterprises in the region can issue RMB bonds in the domestic capital market according to relevant national laws and regulations. According to market demand, international financial transactions can be explored in the area.


4. To promote the construction of multi-level stock market. On December 13, 2013, the State Council issued the "Decision on Related Issues about the National SME Share Transfer System”, involving the National SME share transfer system (the "new three board") of the transfer board mechanism, approval and audit system, investors appropriate management system, omni-directional supervision system.
Progress Made in the New Round of Financial Reform

- 5. local government bonds
  
  On May 19, 2014, the Ministry of Finance issued “2014 Local Government Bonds Self-issuing and Self-paying Pilot Approach”. In 2014, the local government of Shanghai, Zhejiang, Shandong, Beijing, Qingdao, Ningxia and Jiangxi can issue local government bonds, pay interest and repay principal within the scale approved by the State Council. The allocated amount is effective within the year. The bond durations are 5, 7, 10 years. The structure of the proportion is 4:3:3.

- Third, the interest rate market reform.
  
  On December 7, 2013, the central bank issued "Interim Measures for the Interbank Deposit Certificate" allowing deposit-taking financial institutions issued interbank deposit certificate within the record amount in China's interbank market according to the interest rate of the market.

  From March 17, 2014, the floating range of inter-bank foreign exchange market trading price of the RMB against the U.S. dollar expanded from 1% to 2%.

- Fourth, open RMB convertibility and capital projects
  
  The “People's Bank of China’s Views on Financial Support for China (Shanghai) Free Trade Zone Construction” abolished individual approval for foreign debt business like the offshore leasing of financial leasing companies and implemented the registration and management practice;

  On May 23, Shanghai headquarters of People's Bank of China issued rules to start Shanghai FTA. Shanghai regional financial institutions can provide financial services such as current account, direct investment and investment and financing innovative business through the FTA local body.
Progress Made in the New Round of Financial Reform

- **Fifth, to improve financial regulation**
- Banking Supervision:
  - (1) On November 18, 2013, the amended “Banking Financial Institutions Director and Senior Managerial Personnel Management Approach“ was issued.
  - (2) On January 6, 2014, the “Guidelines on the Disclosure of the Important Global Evaluation Index of Commercial Banks” was published.
  - (3) On January 17, 2014, the “Commercial Banks' Liquidity Risk Management Approach (Trial)” was issued. The implementation starts on March 1, 2014.
  - (4) On March 13, 2014, “Approaches on the Administrative Licensing Matters of the Rural Small and Medium Financial Institutions” was issued, stipulating decentralization and conditions, standards and procedures for optimizing administrative license.
Progress Made in the New Round of Financial Reform

- **Capital market regulation:**
  1. On November 30, 2013, the “Guideline No. 3 on Listed Company Supervision --- Cash Dividends of Listed Companies” was issued.
  2. On December 27, 2013, the General Office of the State Council issued the “Opinions on Further Strengthening the Capital Market to Protect the Legitimate Interests of Small Investors”

- **Insurance Market Regulation**
  2. On February 19, 2014, “Notice on Strengthening and Improving the Regulatory of the Use Ratio of Insurance Funds” was issued.
  3. On February 28, 2014, the “Notice on Norms for Bank Deposit Insurance Funds Business” was released.
  4. On March 21, 2014, the CIRC issued the “Administrative Measures for the Insurance Company Mergers and Acquisitions”.
  5. On April 4, 2014, the CIRC issued the amended “Interim Measures on Management of Insurance Funds”.
  6. On April 15, 2014, the CIRC issued the revised “Insurance Company Equity Management Approach”.
  7. On May 5, 2014, the CIRC issued “Notice on the Relevant Matter of Investing Capital Trust Scheme with Insurance Funds”.
Progress Made in the New Round of Financial Reform

- **Shadow banking supervision:**
  - (2) At the end of 2013 and the beginning of 2014, the State Council issued the “State Council’s Notice on Strengthening the Regulation of the Shadow Banking.”
  - (3) The People's Bank, the CBRC, CSRC and CIRC, SAFE jointly issued “Notice on Regulating the Financial Institutions’ Business”, including 38 normative suggestions such as regulate interbank business behavior, strengthen and improve the inter-bank business internal and external management, promote normative business innovation of assets and liabilities etc.

- **A number of other reform programs are being developed, and will be issued intensively in the second half of the year.**
Challenges in the New Round of Reforms

- First, how to deal with the relationship between government and the market
  
  The last two rounds of reforms referred to the best experience of developed countries, but (1) it was mainly executive powers under the circumstance of planned economy + bureaucracy still remain as the dominant form; (2) many partial reforms, lack of a systematic reform.

- Government:
  - Sectoral interests
  - Regulatory capacity

- Second, how to convert financial supervision model and strengthen coordination
  
  The financial regulatory model based on the current regulatory agencies and separate supervisions in different industries is facing increasing challenges: in 2012, after entering the “big information management era”, banks, brokerages, fund companies, fund subsidiaries, trust companies, insurance companies insurance asset management companies can offer information management products to the market. Regulatory rules and standards at different prices level vary greatly, resulting in market segmentation, disorderly competition, increased regulatory arbitrage.
Challenges in the New Round of Reforms

- Third, how to improve the integrity and Compatibility of the reform programs
  - 1. small loan company's system design: not to be treated as a financial company but as a commercial business, loan only, no deposit, no leverage.
  - Purpose: To support private capital to provide financing services to small and medium micro enterprises
  - Estimates: ROE  Lending rates (calculated by 5% of asset impairment loss)
    - 4%  More than 15%
    - 6%  More than 18%
    - 8%  More than 21%
    - 9.5% More than 24%
  - 2. IPO reform
    - IPO is a regulated secondary market tools. In fact, as long as the CSRC continues to maintain the secondary market price (too many private investors affect social stability) functions, as long as the institutional problems of the stock market is not resolved, the IPO market is difficult to marketised.
    - A lot of coordination, matching problem. For instance, coordination between the interest rate market and the exchange rate formation mechanism and liberalized capital account controls; between the interest rate marketization and currency regulation and control methods; between the exchange market and capital market development in the floor and OTC market.
Challenges in the New Round of Reforms

- Fourth, how to deal with the financial risks, and properly handle the relationship between the economic development, financial risk prevention, the implementation of market-oriented reforms and financial stability
- Bond defaults
- Market interest rates may bring bank failures (the United States, Taiwan)
- Bottom line: the systematic, regional financial risk does not occur
- Economists pay more attention to market principles and advocate deregulation to allow the market clearing; politicians are more concerned about economic and social stability and hold the bottom line.
- The question is, no one knows whether a single securities market default, individual financial institution exit will lead to a chain reaction; how much pressure brought by the financial crisis can China withstand?
Thank You!