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Briefing note

April 2016

China releases Five-Year Plan for financial reform

On 17 March 2016, China officially released its economic and social development blueprint for the five-year period from 2016 to 2020. This is China's 13th Five-Year Plan (**Plan**) which, upon approval by the Two Sessions meeting in March 2016, is now the guiding principles for China's development in the next five years. The Plan illustrates the direction China will take in all aspects of its social, economic and political development. This briefing specifically highlights China's initiative under the Plan to accelerate its financial reform in the next five years.

Facilitating financial system reform

The volatility of the stock market and RMB depreciation during the past months that attracted worldwide attention have made it imperative for China to embark on serious financial reform. According to the speech made by Zhou Xiaochuan, the governor of People's Bank of China (**PBoC**), at the Chinese Development Forum following the Two Sessions, China is destined to improve the operation of its capital market.

The Plan envisages to accelerate China's financial reform through:

- implementing a registration-based stock listing system;
- developing a multi-tier equity financing market;
- encouraging direct financing and reducing leveraged financing;
- improving the registration system of bond issuance and bond market infrastructure and facilitating the nexus within the bond market;
- promoting the innovation of bond products, high-yield bonds and the combination of shares and bonds;
- promoting the development of repo, notes, foreign exchange and gold market;
- promoting actively and prudently the innovation of the derivatives market such as futures;
- exploring to establish the insurance assets trading system;
- improving internet financing and fintech industry as well as inclusive finance and micro-financial organization; and

- establishing a multi-tier, diverse and complementary financial market which could support a real economy.

In the midst of the volatility of the stock market, Liu Shiyu, the new chairman of the China Securities Regulatory Commission (CSRC), took office last month and re-emphasised the need to tighten and strengthen the securities market. It is expected that CSRC will enhance supervision, risk prevention and legal enforcement in order to protect investors.

Further opening up of the financial sector

The inclusion of RMB into the Special Drawing Rights basket in November 2015 indicates China's determination to proceed with RMB internalization. Yet, the recent RMB depreciation has casted doubt on the market as to whether China would proceed with RMB internationalization as planned. The PBoC has continuously assured the public that the goal of RMB internationalization is market-driven and hence would be pursued.

The Plan sets out the measures China would undertake to proceed with RMB internationalization:

- gradual convertibility of capital account transactions;
- increasing the extent and amount of freely convertible and usable RMB in an orderly manner;
- promoting RMB internationalization and the offshore remittance of RMB capital prudently;
- relaxing foreign exchange control on overseas investment;
- expanding the overseas investment scope of insurance capital;
- promoting the reform of foreign debt registration;
- increasing the pace of opening-up the stock and bond markets;
- relaxing the administration of cross-border bond;
- upgrading the standard of financial institutions to an international level and improving the global service network; and
- liberalizing the exchange rate and interest rate.

China has taken effort to push forward RMB internationalization in the past months. These include relaxing the QFII quota, opening up the Chinese inter-bank bond market to more foreign investors, developing Panda Bonds and the proposed Shenzhen-Hong Kong stock connect scheme and the London-Shanghai connect scheme (both of which are planned to be launched in the future). These measures will make the Chinese market more accessible to foreign investors, though many implementation details still await to be clarified.

The PBoC has reaffirmed that China will continue to encourage and support mid-term and long-term inbound and outbound investment activities, as opposed to ultra-short or speculative capital flow (on which China may impose restrictions).

Reshaping the financial regulatory framework

As a result of the recent market turmoil and global financial crisis, and in light of RMB depreciation and the growing importance of China's internet finance and financial innovation, the Plan emphasises the need to promote financial risk regulation through:

- strengthening the financial macro-prudential administration system;
- improving the financial regulatory framework so that it adapts to modern financial market development, such that China's monetary policy is consistent with her prudent financial management methods;
- strengthening comprehensive supervision and functional supervision;
- achieving full coverage of financial risk supervision;
- effective use and development of financial risk management tools;
- strengthening of financial consumers' protection system, including class action and financial sanctions; and
- establishing financial safety inspection and anti-financial sanction system.

The term "financial macro-prudential administration system" has been repeatedly emphasized under recent PRC regulations. The most remarkable instance was that PBoC issued a notice on Expanding Macro-prudential Management Pilot Program on the Overall Status of Cross-border Financing in January 2016. The notice states that a new regime of cross-border financing will be implemented as of 25 January 2016 to establish a comprehensive macro monitoring system and achieve an integrated management of RMB and foreign currencies. It awaits to be seen how this system would work in detail and how it would affect specific financial activities.

Others relevant highlights

The Plan also evidences China's intention to participate more actively in the global economy, including the affairs for the cooperation for global economic governance mechanism, the reform of the international monetary system and internal financial regulatory reform, and the international coordination of macro-economic policies. The convening of the G20 Finance Ministers and Central Bank Governors Meeting in Shanghai in March 2016 is a good example of China's commitment. Such initiative would facilitate China's domestic market to become more market-oriented and elevate its operation akin to international standard.

In addition, the Plan points out that through the "One-Belt-and-One-Road Initiative" which was launched to focus on connectivity and cooperation among countries primarily in Eurasia, China would enhance capital connection, strengthen cooperation among international organizations and financial institutions, and attract global capital to develop the platform for open and diverse financial cooperation.

Prospect

The Plan envisages that China would pursue more market-driven growth and further open up her financial market. This accords with China's continued commitment to liberalize the market and to further integrate with the global economy.

Among others, the Plan is applauded by IMF managing director Christine Lagarde as she believes that it would genuinely help China achieve more inclusive and sustainable growth.

As the Plan implements, we expect China's regulators to introduce more initiatives and changes to the financial regulatory framework. We will watch out on the developments closely and keep you informed of the latest changes in the Chinese financial market and regulatory system.

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