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TRENDS IN GLOBAL FINANCIAL REGULATION: CHINA'S SEARCH FOR GLOBAL CAPITAL

— THOUGHT LEADERSHIP

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With protectionism and deglobalisation on the rise in Europe, the US and elsewhere, China, by contrast, is championing globalisation. Its financial system is still relatively closed to international access, but the Chinese government has recently taken steps to open up access to its financial markets to foreign investors, in order to seek global capital. Although it remains at a relatively early stage, legislative changes such as the new Foreign Investment Law and links to the global financial system including Shanghai-Hong Kong Stock Connect are already having an impact and China's influence in global financial markets may grow significantly if this trend continues.

Liberalisation of China's markets and opening up of its financial sector

At the April 2018 Bo'ao Forum of the Asia Annual Conference, President Xi Jinping delivered a speech in which he highlighted the continuing liberalisation of China's domestic economy and financial markets and announced four liberalisation measures, namely:

- lifting market entry barriers;
- creating a more attractive investment environment;
- enhancing the protection of intellectual property rights; and
- increasing imports into China by reducing the import duty on cars and other products.

As a result, PRC regulators including the People's Bank of China (PBoC), the China Banking and Insurance Regulatory Commission (CBIRC), the China Securities Regulatory Commission (CSRC), the State Administration of Foreign Exchange (SAFE), the Ministry of Commerce (MOFCOM), and the National Development and Reform Commission (NDRC) have issued or amended various regulations to implement these measures.

Encouraging foreign direct investment

On 15 March 2019, the National People's Congress (the PRC legislator) passed the long-awaited Foreign Investment Law (FIL) which will come into force on 1 January 2020. The FIL will bring China's foreign investment regime into a new era by replacing and repealing the existing laws regulating foreign-invested entities. The FIL sets out rules to further encourage, promote and protect foreign investment. It therefore sends a signal that the Chinese government will continue encouraging foreign investment into China.

In particular, the FIL confirms that foreign investors investing in sectors outside the "negative list" of sectors, for which foreign investment is prohibited or restricted, will be entitled to "national treatment" at the time of making the investment. The FIL clarifies that "national treatment" means that the market access requirements applicable to foreign investors will be no less favourable than those applied to domestic investors. The number of sectors appearing on the latest Negative List for Foreign Investment, jointly promulgated by NDRC and MOFCOM on 28 June 2018, has also been greatly reduced from 63 to 48 sectors.

Since 2012, SAFE has also conducted a thorough reform of the foreign exchange (FX) administration regime of direct investment, to further streamline and optimise relevant FX procedures. Discretionary settlement of FX into RMB under capital accounts was implemented in 2015, and further facilitation on settlement and payment under capital accounts has been carried out since then to attract foreign investment.

Macro-prudential management for cross-border financing

Foreign Debt: PBoC introduced a pilot macro-prudential management system for cross-border financing in 2016, before expanding it nationwide. For PRC borrowers (including domestic corporates) seeking international commercial loans, prior approval is no longer required and the balance ceiling has been raised, allowing them to bring more money into the country. This also implies a broadening of investment channels for non-PRC lenders, who may therefore enjoy more discretion and flexibility when entering into financing transactions with PRC counterparties.

Cross-border Guarantee: SAFE released its Regulations on the Administration on Foreign Exchange for Cross-border Guarantee in May 2014, which reduce or eliminate approval and registration requirements for most types of cross-border guarantee and relax previous restrictions on the provision of cross-border guarantees. Again, the relaxation of these regulatory requirements greatly facilitates access to financing for PRC entities.

Raising/removing foreign ownership limits

Shortly after President Xi's speech in April 2018, Governor Yi Gang (head of PBoC) announced an ambitious plan to raise foreign ownership limits for PRC financial institutions, so that foreign investors would become entitled to hold controlling stakes in such institutions from 2018. In summary:

- There is no foreign ownership limit on financial asset investment companies or wealth management companies newly established by domestic commercial banks.
- Foreign ownership limits on domestic commercial banks and financial asset management companies have been completely removed.
- The cap on foreign shareholding in domestic securities companies, mutual fund managers, futures brokers has been increased to 51% and will be completely removed in 2021.
- The cap on foreign shareholding in life insurers is increasing from 49% to 51% and will be completely removed in 2021.

Access to securities markets

China has also taken steps to open up its capital markets towards foreign investors, and to broaden the scope of international investment opportunities through different regimes over the past decades. For example:

- **QFII / RQFII Regime**

  Following their introduction in 2002 and 2011 respectively, China's qualified foreign institutional investor (QFII) and Renminbi qualified foreign institutional investor (RQFII) regimes have offered a way for overseas institutional investors to invest in China's financial markets. PRC regulators are now considering consolidating both regimes. Once finalised and agreed, the new rules would significantly alter the current regulatory landscape, and are expected to boost the domestic securities market in China.

- **Stock Connect and Bond Connect initiatives**

  June 2019 saw the launch of the Shanghai-London Stock Connect link, which allows overseas investors access to China A-shares via trading depositary receipts on the London Stock Exchange (LSE). It will also allow Chinese investors to trade in depositary receipts representing LSE-listed shares on the Shanghai Stock Exchange. Again, this can be seen as a signal that the Chinese government is keen to increase foreign access to its financial markets, and marks a significant opening up of Chinese capital markets to European investors.

  The Shanghai-London Stock Connect link follows a slightly different structure from the original Shanghai-Hong Kong Stock Connect scheme, launched in 2014, which enabled mainland Chinese resident investors to trade Hong Kong listed securities and vice versa. From 1 May 2018, the aggregate daily trading quotas on the Shanghai/Shenzhen-

Hong Kong Stock Connect were quadrupled to RMB 94 billion. Similarly, trading volumes via the China-Hong Kong Bond Connect scheme have increased significantly during 2019, a trend which is expected to continue.

The speed with which some of these regulatory changes are being introduced demonstrates the Chinese government's commitment to forge ahead with its policy of liberalising and opening up its financial markets. China is also in the process of reforming its financial regulatory system, with the aim of better serving the real economy and supporting the development of its domestic capital markets, which may also increase the attractiveness of China facilitating increased liberalisation of the financial markets.

A broader push towards economic globalisation?

More broadly, the Chinese government has indicated that it is committed to safeguarding economic globalisation and will continue to promote opening up of its markets and fostering international economic cooperation and competition. The road ahead may not always be smooth, particularly in light of the ongoing US-China trade conflict. Nevertheless, we see this outward-looking perspective in China's search for global capital and investment, particularly in the following initiatives:

The Greater Bay Area and Free Trade Zone

China's national strategy to develop the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) aims to leverage the advantages of this region, facilitate in-depth integration and promote coordinated regional economic development. The Outline Development Plan for the GBA published in February 2019 includes various measures to expedite the development of financial industries throughout the GBA. In addition, greater autonomy will be granted to a pilot free trade zone (FTZ), to encourage innovation and test reforms, with the aim of leading to wider reforms and opening up of China's financial markets.

Belt and Road Initiative

China's Belt and Road Initiative (BRI), unveiled by President XI Jinping in 2013, is an ambitious development projects that aims to boost global trade between Asia, Europe and Africa, and create vibrant economies along its route, covering 74 countries. The huge scale of the BRI vision means that its funding will need international cooperation and innovative solutions; it seems clear that China cannot fund the entire initiative alone. Whilst current BRI initiatives are mostly being led by Chinese state-owned banks, policy banks and governmental bodies, we may start to see greater interest and opportunities for international fund managers and others to invest in BRI projects. There are challenges to attracting private capital and filling the current BRI funding gap, but we expect to see more collaboration between Chinese state-owned enterprises and foreign investors or sponsors to capitalise on the potential and opportunities arising from BRI.

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