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CHINA FINANCIAL MARKETS: TRENDS TO WATCH IN 2022

– THOUGHT LEADERSHIP

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This will be a crucial year for China as it is determined to move centre stage globally. It plans to tackle a range of issues from climate change to dealing with increasingly powerful tech companies, while President XI is likely to further increase his grip on power by asking the Party Congress for a third term in office. Here, Clifford Chance experts look at what lies ahead.

1

DATA AND PRIVACY

PRC regulators continue to enhance supervision of data security and protection of individual rights relating to personal information (PI). The issuance of the PRC Data Security Law (DSL) and the PRC Personal Information Protection Law (PIPL) in 2021, demonstrate the regulators' determination to safeguard data sovereignty and establish a more granular data regulatory regime.

What's next?

- **Growth of regulation.** International institutions which operate a business in China need to be prepared for upgraded data and PI regulatory requirements applicable to: internal governance structure; management of data subject rights and consent management; data flows – particularly when exporting; external contractual arrangement; and IT infrastructure. In addition to the mechanism set out under national legislation, international institutions will also need to keep track of upcoming industry-specific and regional guidance on PRC data matters.
- **Extraterritorial issues.** We expect that regulators will issue further guidance on the extraterritorial effect of the PIPL. This is the key issue for international institutions to consider when navigating regulatory requirements across different jurisdictions globally.
- **National security concerns.** Regulators may further clarify the security review mechanism. The DSL puts national security and public interest as its top priority – regulators are empowered to initiate national security reviews, carry out security reviews for exporting important data and impose export controls on certain items. Security reviews may also apply to exporting large amounts of PI under the PIPL.
- **Regulators may also issue specific guidance for small-size PI processors and sensitive PI processing rules.** We expect that designated guidance for new technologies including facial recognition and artificial intelligence will also be issued.
- **Great caution should be taken when providing PRC sourced data to non-PRC judicial/enforcement institutions.** To mitigate any potential non-compliance risk, non-PRC institutions need to consider whether the relevant data/PI is transferred outside the PRC in a manner that is compliant under PRC law, and if additional PRC regulatory procedures would apply, whether the responsible party has completed/obtained the security review / security assessment / governmental approval.

2

CHINA'S AMBITIONS FOR RENEWABLE ENERGY

China has pledged that it will reach peak emissions before 2030 and carbon neutrality, but that will require enormous effort and an estimated US$163 billion will have to be spent each year on renewable energy and other decarbonisation technologies.

What's next?

- **Moving away from coal investments.** President Xi Jinping announced at the UN General Assembly in September 2021 that China will stop building new coal-fired power projects abroad and will provide support for green and low-carbon energy in other developing countries. Although details of China's policy to end overseas coal projects have yet to announced, we are seeing market players following this trend already; for example, Bank of China said that it would no longer provide financing for new coal mining and coal-fired power projects overseas from October 2021.

- **Rapid growth and ambitions in renewable energy.** China is already one of the biggest global markets for wind and solar power. By 2030, it plans to have enough solar and wind capacity to generate 1,200 gigawatts – equivalent to all of the power needs of the United States. To connect that to the grid, it is investing in a national network of power lines that is estimated to take 30 years and cost US$300 billion, compared with the recent 10-year, US$65 billion allocation to grid infrastructure by the U.S. China is encouraging both inbound and outbound investments in clean energy and renewables (including infrastructure and technologies). However, overseas investments in renewable energy will be subject to the economic conditions and relevant policy frameworks in the host countries.
- **China's Emissions Trading System.** After three years of preparation, China's nationwide ETS was launched in July 2021 with more than 2,000 companies from the power sector as its first batch of traders. With its expansion from single sector to multiple industries, China's ETS market (already the biggest globally) will further grow and is expected to be one of the key instruments to enable China to achieve its target of carbon neutrality by 2060.
- **Environmental standards in overseas developments.** In July 2021, the Chinese government published significantly stronger guidance which shifted towards promoting green development, including reducing carbon emissions and setting higher environmental standards than those used in host countries. Some of the most powerful financial institutions in China are now trying to interpret the guidance and work out what kind of standards they shall apply to overseas green development.

CHINA'S GREEN BOND MARKET

3

China is expected to continue to focus on its domestic green-related financing and green bond market in 2022, following a series of reforms last year. These included updating the Green Bond Catalogue (the country's domestic green bond standards), by the People's Bank of China (PBoC), the National Development and Reform Commission (NDRC) and the China Securities Regulatory Commission (CSRC), and the implementation of mandatory and voluntary ESG reporting requirements by the CSRC for listed companies.

What's next?

- **Enhancing ESG reporting and transparency obligations.** The Chinese Ministry of Ecology and Environment launched an overarching ESG disclosure reform plan in May 2021 and plans to introduce further amendments to the existing suite of disclosure rules for listed companies and bond issuers this year. It will also establish a mandatory ESG information disclosure system by 2025. Listed companies and bond-issuing enterprises that are regarded as key pollutant discharging entities are expected to be subject to compulsory cleaner production audits and be required to disclose environmental information in their annual reports. The Ministry will work with the NDRC, PBoC and CSRC on the implementation of the reform plan once the applicable rules are promulgated. Any key changes arising from the reform plan relating to enhanced reporting and transparency requirements are expected to apply to bond issuers in the domestic green bond market.
- **Harmonising with international standards.** The removal of fossil fuel projects from China's Green Bond Catalogue is viewed as a material step in aligning with equivalent international green standards, such as the International Capital Markets Association's (ICMA) Green Bond Principles.
- **Increasing joint efforts and international co-operation.** We are likely to see more international co-operation, following joint declarations made by the US and China late last year, to address the climate crisis. China has also announced that it is working with the European Union to converge green finance and investment taxonomies across the two markets. However, given the high level of consensus that

will be required, there may be many challenges before any of these broad declarations and co-operations turn into concrete action.

- **Greater diversification.** Domestic financial institutions and state-owned enterprise issuers currently dominate the green bond market, but with more policy direction and increased focus for green and sustainable financing, we may see greater interest in the green bond market from more diverse enterprises. We may also see greater diversification of the products available to market participants – for example, carbon neutrality bonds, green bonds and green ABS – and, with more streamlined procedures and clearer rules, there may be the maturation of related third-party services.

4

CBDC AND CRYPTO

Chinese financial regulators are determined to crack down on cryptocurrencies and have issued various circulars to further tighten the regulatory regime.

What's next?

- **Chinese regulators say cryptocurrencies and private digital tokens are not fiat money.** In tandem with stricter regulations on anti-money laundering, illegal fundraising and financial fraud, China will probably witness increasing supervisory and enforcement actions taken against crypto-related activities.
- **Issues for international institutions.** Although existing PRC regulations are not designed to capture cryptocurrency-related business operations outside the PRC, it is important for international institutions to receive assurances that a Chinese customer's funding source does not contravene applicable PRC laws and regulations. Enhancing due diligence measures against Chinese clients for crypto-related activities that are in breach of PRC laws and regulations may also be necessary.
- **Cryptocurrency mining.** Regulators take a negative view of cryptocurrency mining activities because of the vast amounts of energy it consumes, which is inconsistent with China's goal of carbon neutrality by 2060.
- **Central Bank Digital Currency.** The People's Bank of China is focusing on the promotion of its CBDC, conducting trials of the Digital Currency Electronic Payment (also known as e-CNY) system in several cities including Beijing, Shanghai and Shenzhen. The use of e-CNY is expected to be expanded to a wider range of daily-life uses and gradually opened to wholesale scenarios.

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DERIVATIVES DEVELOPMENTS IN CHINA

Market participants are very hopeful that 2022 will be the year when enforceability of close-out netting under PRC law will be broadly recognised and supported based on legal developments such as the ongoing passage of the Futures and Derivatives Law (the FDL) and recent pronouncements by the PRC Banking Regulator (CBIRC). The FDL, which has gone through its second public consultation is expected to come into force in 2022, marks the first time that close-out netting has been recognised in the PRC at a statutory level. Further, the CBIRC has published a "Final Notice" confirming support from the Supreme People's Court that PRC insolvency laws should not interfere with the operation of close-out netting. With the expected resolution of this critical issue for the PRC derivatives market, we look forward to further market development and innovation that many outside China are looking for such as the use of PRC securities as collateral, the development of carbon trading markets, the evolution of credit derivatives and much more.

C L I F F O R D

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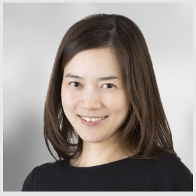
CONTACTS

David Tsai
Partner
Hong Kong
T: +852 2826 2466
E: david.tsai@
cliffordchance.com

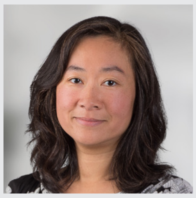


Vicky Ma
Partner
Hong Kong
T: +852 2825 8995
E: vicky.ma@
cliffordchance.com

Terry Yang
Partner
Hong Kong
T: +852 2825 8863
E: terry.yang@
cliffordchance.com

Kimi Liu
Counsel
Beijing
T: +86 10 6535 2263
E: kimi.liu@
cliffordchance.com

Jane Chen
Associate
Beijing
T: +86 10 6535 2216
E: jane.chen@
cliffordchance.com



Maggie Zhao
Partner
London
T: +44 207006 2939
E: maggie.zhao@
cliffordchance.com

Paget Dare Bryan
Partner
London
T: +44 207006 2461
E: paget.darebryan@
cliffordchance.com

Matt Fairclough
Partner
London
T: +44 207006 1717
E: matt.fairclough@
cliffordchance.com

Jeroen Ouwehand
Global Senior Partner
Amsterdam
T: +31 20 711 9130
E: jeroen.ouwehand@
cliffordchance.com

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

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Registered office: 10 Upper Bank Street, London, E14 5JJ

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