Banking & Finance Law

Aiming Shanghai towards International Financial Center Status

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Overview

On 14 February 2020, 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) and the Shanghai Municipal Government jointly issued the *Opinions on Further Accelerating the Building of Shanghai into an International Financial Center and Financial Support for the Integrated Development of the Yangtze River Delta* (《关于进一步加快推进上海国际金融中心建设和金融支持长三角一体化发展的意见》) (the "**Opinions**")[1]. The Opinions provide 30 initiatives to accelerate building Shanghai into a leading international financial hub. 11 of these initiatives aim to further open up Shanghai's financial sector, including expanding market access for foreign financial institutions, promoting the asset management business, facilitating the establishment of an RMB financial asset allocation and risk management center, and cultivating a high-quality financial business environment in line with international standards.

This note sets out some of the key initiatives relating to opening up the financial markets.

Supporting the set-up of wealth/asset management presence in Shanghai

The Opinions support foreign institutions to set up joint venture wealth management companies with Chinese banks and insurance asset management companies, which restates the opening-up policies in the financial sector announced in 2019, such as the *Relevant Measures for Further Opening Up the Financial Sector* issued by the Financial Stability and Development Committee of the State Council on 20 July 2019 (the "**11 Measures**"). The 11 Measures, amongst others, encourage foreign financial institutions to invest in wealth management subsidiaries of commercial banks, and allow foreign asset management companies to establish foreign-controlled wealth management companies with the wealth

[1] English translation of the Opinions is available upon request.

management subsidiaries of Chinese banks or insurers.

The Opinions also encourage the establishment of insurance asset management presences in Shanghai and provide that the approval for foreign financial institutions to set up or invest in pension fund management companies in Shanghai will be granted on a case-by-case basis.

Expediting removal of the foreign equity cap for life insurance companies

The 11 Measures stipulate the deadline for removing the foreign equity cap for life insurance and health insurance business has been brought forward to 2020, a year earlier than the previous deadline. China has further committed to remove the foreign equity cap for the life, pension, and health insurance industries no later than 1 April 2020 in its phase one economic and trade agreement with the United States. The Opinions further encourage the removal of the foreign equity cap for the life insurance and health insurance industries to be first implemented in Shanghai, which indicates the foreign equity cap may be removed in Shanghai even earlier than 1 April 2020.

Further opening up of the bond market and improving foreign exchange risk management

The Opinions restate the principle of opening-up of the Chinese bond market as provided in the 11 Measures, and further provide for promoting the gradual transformation of domestic settlement agency banks into custodian banks so as to provide diversified services to foreign investors in the China Inter-bank Bond Market (CIBM). Detailed opening-up measures still await further clarification by the competent authorities.

The 11 Measures lift the restrictions on rating agencies and underwriting licences. Foreign rating agencies can now provide ratings for all types of bonds that are traded on the CIBM and exchanges. Foreign-invested banks are eligible to apply for Type A lead underwriting licenses in the CIBM and to act as lead underwriters for domestic bonds. As of today, Standard & Poor's has been allowed to provide rating services in China, and Deutsche Bank and BNP Paribas have received Type A lead underwriting licences.

The Opinions also provide for optimizing the foreign exchange rate risk management of financial investments by foreign institutions, and facilitate the entry of foreign institutions into the China Inter-bank Foreign Exchange Market to hedge their investment positions in the CIBM. In that regard, SAFE has promulgated the *Circular on the Improvement of Foreign Exchange Risk Management by Foreign Institutional Investors in the Interbank Bond Market* on 13 January 2020, which allows foreign investors to conduct over-the-counter (OTC) foreign exchange derivatives transactions with up to three financial institutions, or to directly trade in the China Inter-bank Foreign Exchange Market as a client of a prime broker.

Developing the RMB interest rate and foreign exchange derivatives market

The Opinions provide for the development of the RMB interest rate and foreign exchange derivatives market, launching RMB interest rate options, and further expanding product types such as foreign exchange options. It is expected that the launch of various risk management products will help foreign investors to effectively hedge and manage RMB financial asset risks.

Clarifications on legal documentation for OTC derivatives transactions

The Opinions indicate that foreign institutions may freely choose and sign the following master agreements to conduct OTC derivatives transactions:

I. **NAFMII Master Agreement**: the master agreement published by the National Association of Financial Market Institutional Investors and commonly used in China. Chinese inter-bank market participants are required to sign NAFMII agreements to conduct OTC derivatives transactions in the inter-bank market, which include interest rate derivatives, exchange rate derivatives, bond derivatives, credit derivatives and gold derivatives, as well as a combination of the foregoing derivatives transactions.

II. **SAC Master Agreement**: the master agreement published by the Securities Association of China, the China Futures Association and the Asset Management Association of China. Market participants in the Inter-agency Quotation and Service System for Private Placement Products need to sign SAC agreements to engage in OTC derivatives transactions in the market, which mainly include equity and commodities derivatives transactions. These markets are currently not available to foreign investors.

III. **ISDA Master Agreement**: the most commonly used OTC derivatives agreement in the world, published by the International Swaps and Derivatives Association. Currently, only foreign central banks, monetary authorities, international financial organizations, and sovereign wealth funds are explicitly permitted to sign ISDA agreements with Chinese counterparties to conduct OTC foreign exchange derivatives transactions in the Chinese inter-bank market.

    The Opinions, for the first time, explicitly make clear that all foreign institutions may choose ISDA agreements instead of NAFMII agreements to conduct OTC derivatives transactions with Chinese counterparties in the Chinese inter-bank market. The Opinions are high level and it is unclear whether PBOC and/or NAFMII will revise the existing rules or issue new rules to implement the Opinions in this regard.

Developing a high-quality business environment for foreign investors

The Opinions focus on establishing a financial business environment in Shanghai recognized by international markets. Specifically, the Opinions provide that Shanghai will pay particular attention to rule of law in the financial sector, increase penalties for illegal financial activities, establish a system of financial rules that are in line with international standards, remove “invisible barriers” to market access, and foster a fair market environment. Shanghai will also promote the Shanghai Financial Court and the Shanghai Bankruptcy Court to improve their professional skills and increase their international credibility and influence by taking reference of high-standard practices in international markets.

Outlook

Since last year, China A-shares have been included in MSCI, FTSE and S&P Dow Jones Indices, and China bonds have been included in Bloomberg Barclays and JPMorgan indices. China has also become the second largest bond market in the world as of late 2019. China’s financial markets are set on an irreversible journey towards further internationalization and Shanghai will undoubtedly play an important role in this process. The Opinions demonstrate the national and Shanghai local authorities’ determination to give Shanghai greater support in establishing the city as an international financial and asset management center.

It is expected that the opening of the Chinese market will attract more foreign investors to share in the broadening opportunities. Implementation of the Opinions may make Shanghai a more favorable choice in terms of location while benefiting China’s overall financial industry development.

Important Announcement

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