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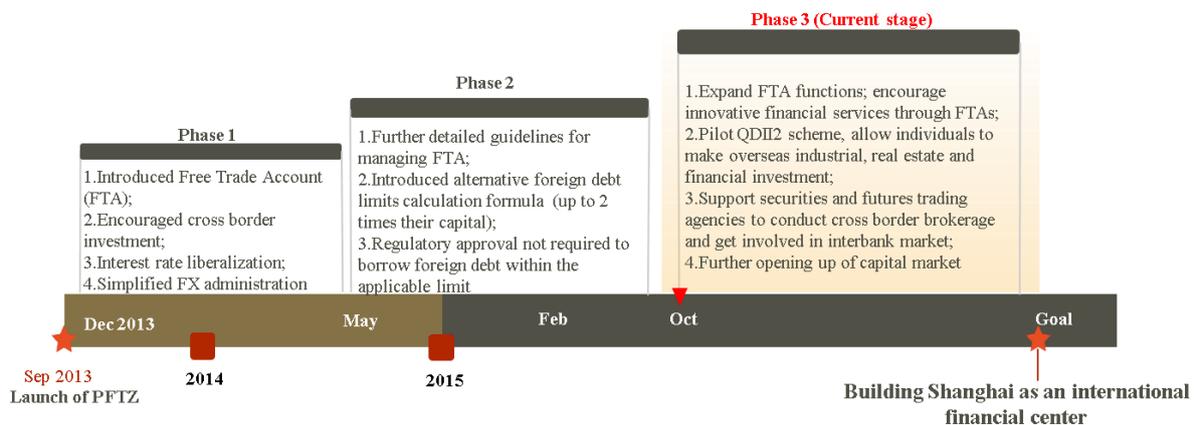
PBOC further push financial reform in China's Shanghai Pilot Free Trade Zone ("PFTZ")

On Oct 30 2015, the People's Bank of China ("PBOC"), together with six Chinese governmental bodies, jointly released "New policy on further pursuing financial innovation in PFTZ and developing Shanghai as an international financial center" (hereinafter "the policy")¹. The policy outlines 40 measures to further deepen the financial reform in PFTZ in 5 aspects including the realization of RMB capital account convertibility, expansion of cross border RMB usage, opening of the financial service sector, globalization of China's financial market, and strengthening supervisions in the financial sector. We will be introducing highlights of the plan in this report.

I Background

Launched in Sep 2013, PFTZ has been an important testing ground in China for freer trade, and a more liberal business and financial environment. PFTZ has made noticeable progress in market deregulation after over two years in operation, particularly in the financial sector. Financial reform in the area of simplifying administrative procedures were well-received by both domestic and overseas investors. Also efforts were made to push forward the market liberalization with more transparency and openness. However, PFTZ still has a way to go in living up to the high expectations many investors held at its unveiling. By the recent announcement of the policy, it indicates the government is speeding up the financial reform in PFTZ.

Please refer to below for the different stage of financial reforms in PFTZ.



¹ <http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/2970998/index.html>

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On Dec 2, 2013, PBOC issued its Opinion Concerning Financial Support for Building up PFTZ, including 30 measures to introduce the RMB and Foreign Currency Free Trade Account (FTA), relaxed restrictions over outbound investment, foreign direct investment and financing, and facilitated the cross border RMB transactions. At the same time the China Banking Regulatory Commission (CBRC) announced 8 guidelines (hereinafter “the guidelines”)² to support banking in PFTZ. According to the guidelines, Chinese-funded banks can establish branches and upgrade outlets in the PFTZ. Foreign-funded banks would be welcomed to set up branches and expand cooperation with Chinese counterparts. The guidelines supported finance companies and their subsidiaries in the PFTZ, and encouraged qualified Shanghai companies to move into the zone. With other detailed measures and handing procedures issued by governmental authorities, the framework of financial reform plan in PFTZ has been formed gradually.

On May 22, 2014, PBOC Shanghai held a conference and issued the Circular of Implementation Rules of PFTZ for Separated Accounting Business and the Rules of PFTZ for the Prudential Management of Risks Relating to Separated Accounting Business³. Both rules have fully standardized the separate account business in PFTZ and its prudential management of risks, matching and complementing each other. Releasing of both rules was very significant in promoting financial reform in the PFTZ, as well as driving ongoing investment and financing activities for the economy.

On Feb 12 2015, PBOC Shanghai issued an implementation regulation (Regulation) regarding the overseas debt financing that entities in PFTZ may raise FTAs. Unlike the existing rules applicable outside the PFTZ (under which foreign debt is capped based on the remaining balance of total investment, net of registered capital, for foreign investment entities), the Regulation introduced a method under which the maximum foreign debt (including both foreign exchange and RMB debt) permitted for an entity is calculated by multiplying the entity’s capital by a leverage ratio and a policy parameter. The Regulation aimed to provide more flexibility to PFTZ entities in financing debt from overseas; to encourage mid- or long-term funds (in particular, RMB funds) to be used (instead of short-term funds) for industrial investment in PFTZ; and to help local governments gain experience in administering a new foreign debt control regime providing a more open and liberal environment.

With recent announced measures stated in the policy such as expanding the FTA functions and allowing Qualified Domestic Individual Investors (QDII2) to make overseas industrial, fixed asset and financial investment on a pilot basis, it is expected to take the country’s financial reform journey into a new chapter.

II Measures in the policy

1. Realization of RMB capital account convertibility

- Expand the FTA functions; prudentially manage the convertibility of RMB and foreign exchange funds in FTAs;
- Encourage and support financial institutions including banks, securities and insurance agencies to conduct innovative financial businesses making full use of FTAs;
- Research and launch the QDII2 on a pilot basis, allow qualified individuals to make overseas industrial, real estate and financial investment;
- Allow or expand eligible institutions and individuals to invest in domestic and overseas securities and futures markets;
- Explore to raise ceilings on foreign currency conversion for individuals and foreign currency

² http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/02EBD0886E554B99BD6CB3860DF2F91E.html

³ <http://shanghai.pbc.gov.cn/fzhshanghai/115486/115511/2406052/index.html>

conversion within quotas for non-financial companies.

2. Expansion of cross border RMB usage

- Support parent company or subsidiaries of companies within PFTZ to issue RMB bonds in China;
- Support self-employed individual in industrial and commercial sectors to provide cross border RMB fund for their overseas operations;
- Expand offshore RMB backflow channels; diversify offshore RMB financial products and facilitate the two-way cross border fund flows;

3. Opening of the financial service sector

- Support private capital to set up financial institutions including commercial banks, financial leasing companies, consumer finance companies, etc.
- Support eligible banking financial institutions to set up branches or subsidiaries in PFTZ;
- Expand pilot banks to engage in offshore banking and expansion of business scope;
- Support securities and futures trading institutions to conduct cross border brokerage and asset management businesses within PFTZ; allow subsidiaries of fund management companies to conduct cross border asset management and investment consulting businesses; support securities and futures trading institutions in Shanghai to get involved in foreign exchange spot and derivatives trading on the interbank market;
- Support the set-up of overseas equity investment project companies within PFTZ and overseas equity investment fund;
- Allow foreign invested financial institutions to set up joint venture securities companies with foreign investment not exceeding 49% while the domestic shareholders need not be affiliated to a securities company;
- Support insurance asset management institutions to cooperate with insurance companies investing asset securitization products; develop reinsurance and relevant services;
- Explore the innovative development of Internet finance and financial technology finance; encourage banks focusing on financial technology services to cooperate with venture investment companies and equity investment companies;
- Conduct national security reviews of foreign investment in the opening financial sectors on a pilot basis; support financial institutions of those countries or regions which have signed free trade agreements with China to set up joint venture entities within PFTZ and gradually increase the shareholder's ratio;
- Encourage large financial institutions to set up regional headquarters in Shanghai and support the overseas expansion of PFTZ-registered financial institutions;

4. Globalization of China's financial market

- Support the set-up of international financial asset trading platform by China Foreign Exchange Trade Center (CFETC) and Shanghai Stock Exchange;
- Accelerate the follow-up development of the International Board of the Shanghai Gold Exchange;
- Support the set-up of international energy trading center by the Shanghai Futures Exchange;
- Support Shanghai Clearing House to provide over-the-counter derivative clearing services for shipping finance and commodity products for PFTZ and foreign investors

5. Strengthening supervisions in the financial sector

- Explore to improve the supervision framework in line with international standards and national conditions; strengthen coordination with different authorities, enhance the prevention of financial risk and improve the overall environment for financial development.

III Comments

The plan includes significant development which will enhance the convertibility of RMB and open up additional cross border investment options to PFTZ-registered companies. Further, the launch of QDII2 will expand the available channels for domestic individuals to invest overseas which are currently limited, generally, to participation in the Shanghai-Hong Kong Stock Connect securities trading link and indirect investment through financial products under the QDII scheme.

Recently, the International Monetary Fund announced to include China's currency in the basket of currencies that make up the international agency's Special Drawing Rights (SDR), marking a milestone in China's push to internationalize its currency. Together with more diversified products and active market transactions both onshore and off, it is expected to help further open up of China's capital market and boost financial liberalization. While at the same time it comes with more strict capital flow monitoring standard for regulatory institutions. As a testing ground for future reforms, PFTZ is expected to lead the new round of financial reform amid opportunities and challenges.

The interpretation and actual implementation of financial reform undertaking in the PFTZ should be worthy of attention. The up-to-date information will be provided continuously by our bank.

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