

# Measuring Value® Shanghai 2020



## Defining the challenge

Shanghai hosted two major events this June, a meeting of the Shanghai International Financial Advisory Committee and a Forum in Shanghai's financial center of Lujiazui on financial reform.

Both events engaged Shanghai's top Party and government officials, all key Chinese financial regulators and a blue ribbon group of international business leaders.

Both events ultimately were about Shanghai's goal to become a global financial center by 2020.

Both events demonstrated that Shanghai is serious about this goal, and the leaders are looking far and wide to improve their understanding of the best way to get there. Amidst some comments from the outside that China appears very satisfied - perhaps too satisfied - with what it has accomplished, throughout reforms and in the wake of the global financial crisis, Shanghai Party

Secretary Yu Zhengsheng was quoted as saying "Shanghai embraces advice and suggestions on how to grow better as a global financial center."

The goal itself and the openness of leaders to discussion of it are important to domestic and foreign business interests. The process will accelerate changes as the city leaders identify what Secretary Yu called "initiatives to break through the bottleneck that limits the city's rise in the financial area." (Shanghai Daily, 27 Jun 2010).

This sharp assessment was echoed by Tu Guangshao, Shanghai's deputy mayor in charge of the city's financial industry. Tu emphasised the need to open the city to more financial professionals, citing what he called a "severe lack of experienced professionals in areas such as financial technology and financial marketing."

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We see the convergence of these three factors - a serious commitment to this goal, admission of current shortcomings, and an invitation to global leaders to join the discussion - as a positive indication that Shanghai has a good chance of meeting its goal

Business leaders with vision into the “initiatives” Secretary Yu mentioned will have competitive advantages in their strategic planning.

Shanghai of course has a long history of vibrancy as an outward looking financial center, reaching back to the middle of the 19th century when it first emerged as China’s most important banking and trade center. Shanghai’s spectacular Bund testifies to that, where China’s customs, the world’s most powerful banks, and the world’s most innovative trading companies set up their headquarters. The municipal government has implemented a sweeping reconstruction of the original Bund, restoring the Bund as an important symbolic and actual center for Shanghai financial professionals and services.

Across the river now stands Pudong, beyond argument the most ambitious greenfield commercial development ever undertaken. Pudong’s Lujiazui district was purposely built to be the center of financial innovation in China, specifically innovation to support the opening and reform process. Pudong is where national and city leaders pioneered and piloted new regulatory space for foreign banks to operate in local currency and, most recently, for foreign equity investment fund managers to raise CNY funds for domestic investment.

#### **Global financial centers, today and tomorrow**

The world is watching a series of meetings of the G8, G20 and other groups focused on the architecture of a new global financial order and regulatory framework. One subject of that activity of course is the events on Wall Street through mid 2008 and their impact on the global financial system. With New York undisputed as one of the pre-eminent established global financial centers, the discussion naturally encompasses the role of major financial centers. A premise in Shanghai’s vision is that the city must be in the forefront of innovation and regulatory reform consistent with whatever global consensus emerges on a new order.

In terms of Shanghai’s specific characteristics, what Secretary Yu referred to as the “bottleneck that limits the city’s rise in the financial area,” we see more as barriers. These barriers historically had a sound purpose and currently have a need to change. These are the control barriers put in place to protect fragile areas of China’s reforming economy in the early days, although some are as old as a unified China itself and are rooted in China’s basic, sustained approach to governing the large populations it has always had.

Specifically, today these involve control barriers to the availability of accurate and reasonably corroborated financial information, the mobility of foreign professionals, the business scope of foreign financial services, the convertibility and portability of the currency, and the efficiency and security of information systems and technologies. None of these five in and of itself would be easy to advance. Collectively, they are a formidable challenge.

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## Some of the specifics raised by both Chinese and foreign experts included the need to develop international capital markets, the need to open the currency to market forces, and the need to liberalise cross-border investment rules and administrative procedures in both directions

The change needed is not toward an unregulated and unsupervised free market economy but toward an economy in which all aspects of regulation and supervision are aligned with Shanghai's goal of becoming a financial center in 2020. Alignment will mean liberalisation in some cases, sharpening and focusing in others. We believe the commitment is strong among the leaders we have met to work toward the right balance of regulatory reform and market liberalisation to get there.

### What will a global financial center in 2020 look like?

In several presentations and private meetings, James H. Quigley, the Chief Executive Officer of Deloitte Touche Tohmatsu, discussed our firm's preliminary analysis of what makes a global financial center. Some of these are established and some emerging. Some are universal and stable, others rapidly developing as key criteria. This list is not meant to be a certain prescription or plan to make a global financial center. It is something of a strategic framework for discussing and testing such plans.

The four universal requirements for all successful global financial centers, and indeed, business and investment environments, are:

1. Sound financial reporting
2. Transparency
3. Accountability (and)
4. Balanced control - the right equilibrium between regulated control, on one hand, and liberalisation and market freedom on the other

The reason these four elements are universal is that they are the foundation for investor trust and confidence, and those in turn are the foundations of stable capital markets. Markets do not function effectively without trust and confidence.

We also see six specific characteristics we believe are essential in global financial centers. From their emergence to the present day, London and New York have these. Singapore, Zurich, Hong Kong and Dubai share them. How does Shanghai compare?

Here are the first three:

- Infrastructure and access
- Facilities, education and talent pool
- IT proficiency, efficiency and security

Infrastructure includes the "nuts and bolts" of globally networked financial and financial support services, including legal and regulatory services. Access is physical, not virtual, access. Global financial centers must be central global travel hubs. To this point, the addition of the huge new Hongqiao airport to the substantial capacity of the Pudong airport gives Shanghai the largest daily airport capacity of any city in the world.

Global financial cities have world-class facilities for education and not just in banking, finance, business and education, but also in law, the social sciences and technology. Shanghai has of course several of the most highly respected universities in China, as well as the internationally staffed China Europe International Business School, or CEIBS.

And empowered governors, managers and the overall talent pool must be both polyglot and multicultural. It is not a coincidence that the most influential global financial centers have among the world's highest levels of cultural, linguistic and ethnic diversity.

Establishing and sustaining high levels of IT support, information security and access within the financial services industry is difficult under the best of circumstances. And no one's IT infrastructure and policy today will be their infrastructure and policy tomorrow. Growth and evolution are inevitable, and maintaining benchmark levels of IT support at any time will be among everyone's biggest challenges.

Everywhere, the computer and communications environment is rapidly changing, extremely fluid and, in many cases, paradoxical.

The requirement for currency and transaction flexibility is straightforward; it must enable businesses to transact in a variety of key currencies and to hold assets in diverse denominations, build shared services regionally and even globally, without significant regulatory burdens or administrative complexity or uncertainty. It must hold markets open to enterprises from around the world, with transparent listing and reporting rules consistent with major competitive equity markets elsewhere.

The last of the six, quality of life, is in some ways a "soft" criterion, but it is no less important to potential success because quality of life is the platform for developing diversity. It embraces the full spectrum of how the tens of thousands of professionals and their families will experience Shanghai - outside of the trading floor or the back office.

It includes life-style elements from culture to cuisine, from public transportation to private recreation, from housing to healthcare, that reflect strong local traditions and international levels of variety and quality.

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## Maintaining the balance point between information freedom and information control requires objective and relevant measures of risks associated with excesses of either

Continuing, we have identified the next three criteria for success as

- Tax policy, corporate and individual
- Currency and transaction flexibility
- Quality of life

Of all the ways that investors and institutions "do the math," computing tax exposure ranks among the highest in importance. The aggregate tax burden in any given location is perhaps the key competitive issue in decisions to locate offices and resources, especially for service industries, and most especially for financial services. Our survey work tells us that tax rates are only a part of the picture. Rates are important, but so also are complexity, consistency and predictability of the tax system in any location.

### Looking ahead

The dynamics of globalisation create competition in all aspects of wealth and value creation.

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## Many cities have aspirations to become global financial centers, but few have the natural geographic and economic advantages of Shanghai

Few have the momentum of Shanghai, with its established role in the global pace-setting Chinese economy.

That is the source of our confidence in Shanghai and its goals. And judging by the attention and attendance drawn by events like those in Shanghai this week, many business leaders also see Shanghai's market strengths. For after all, in the competition for financial services, markets decide. Governments and regulators lay the foundation, but in the end, global financial centers are built by the marketplace.

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