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Opportunities and challenges to foreign institutions as Chinese financial industry opens further

Chinese financial industry updates

In April 2018, China announced to further open up its financial industry to foreign institutions. This article outlines the opportunities with the policy change and challenges foreign institutions need to beware, considering that the market of China is rapidly reshaped by reforms and is transforming fast.

"More foreign investors are excited about the fast development of the Chinese financial services market and they would require the right strategy to achieve new heights."

Fang Ye
Partner, Deloitte China

New opportunities

Announced by the President Xi Jinping, China seeks to further open its financial industry with a number of significant measures. Some of the notable policy changes include the relaxation of foreign share ownership restriction in the banking, securities and insurance sectors. The Chinese insurance sector will be opened up, seeing less restrictions on the establishment of foreign financial institutions, on the business scope of foreign financial institutions, and in the areas related to the Sino-foreign financial market cooperation.

Some foreign financial institutions have deepened their presence in China. In May 2018, UBS announced the plan to increase its equity in UBS Securities from 24.99% to 51% for a controlling position. Nomura Securities submitted the application of establishing a foreign-invested securities company to the China Securities Regulatory Commission (CSRC). Several bank institutions from Germany, Austria and Australia also submitted their respective applications for establishing new branches or subsidiaries in China.

Navigating through reform changes for success

Opportunities more than often arise with challenges. Deloitte believes that domestic and foreign financial institutions need to solve two key issues to secure success amid the increasingly fierce competition.

1. Effective compliance to enter the market

The establishment of a foreign financial institution in China requires successful applications to open the business, to operate in general, and to operate with special business licenses where applicable. Various regulations are involved covering organization structure, internal set-up and control, tax compliance and more.

In this connection, Yi Gang, Governor of People's Bank of China (PBOC), announced 11 measures in April 2018. Of which, six measures have been implemented and five will be implemented by the end of 2018. He highlighted three principles regarding the financial opening:

- Pre-establishment National Treatment (i.e. treated the same as Chinese companies) and the negative-list management;
- Reforms encompassing the opening of financial industry and exchange rate formation mechanism have a synergy effect with the reform of the capital account convertibility, and these reforms may progress in parallel;
- In the course of opening, it is critical to guard against financial risks to ensure that the financial regulatory capacity is compatible with the magnitude of the opening.

In addition to the PBOC measures, the Shanghai authorities declared its support to the city's financial opening.

- The city will adhere to the market-driven principle, promote the internationalization of RMB, support innovation and pilot RMB cross-border business and products, so as to perform well its role in the RMB pricing and settlement for bulk commodities.
- It will steadily promote the convertibility of capital accounts, support the city's pilot reform of foreign currency management.

- It will further enhance its financial market and financial services and strengthen the market depth and breadth, level of convenience and efficiency for transactions to take place, legal and market environments, trusteeship and clearing of transactions and etc. These efforts will enable Shanghai to develop itself as a robust market and as a world-class financial and market centre.
- The essence of opening up China's financial industry is to align the principle of national treatment by gradually relaxing the share ratio and business license limits. With its unique competitive advantages, Shanghai is working to get prepared for the strategic position of accommodating the presence of more foreign banks, securities, insurance and investment bank institutions.
- The city will continue to advocate the financial technology development.

In this light, the Shanghai Pilot FTZ Management Committee issued the "Opinion of China (Shanghai) Pilot Free Trade Zone on the Opening of the Financial Service Industry for New Advantages of Development". This document has assessed six major aspects including the attraction of foreign financial institution clusters, facilitative measures for the establishment of foreign financial institutions, advocacy for innovation in financial reforms, establishment of financial service technical innovation centres, nurturing of high-level financial talents, building of a financial legal environment compatible with the international rules. The document has covered the sectors of banking, securities and insurance with a total of 25 major measures in Shanghai.

2. Right strategy for local market

In addition to the more relaxed equity structure for foreign financial institutions, the new policy also brought about new opportunity in business access. They can now utilize the advanced technologies and concepts and seek to expand their operations in China rapidly. This can become attractive growth areas in comparison to the stable growth in their home countries. Nonetheless, how to adapt to the Chinese market and avoid strategic risks deserves deliberate consideration.

The financial opening policy is compliment with a new round of foreign currency management policy reforms, which cover mainly three aspects:

a. Cancellation of the requirement of proportion of 20% for outward remittance of Qualified Foreign Institutional Investor (QFII) funds;
b. Cancellation of lock-up period requirement of QFII and Renminbi Qualified Foreign Institutional Investor (RQFII);
c. Permission of QFII and RQFII to carry out foreign currency hedging.

It is important to note that **foreign insurance companies** by the end of 2018 are no longer restricted to set up a representative office for two years before they can set up an institution in China. This is a major move to promote the opening and allow competition to lead to industry improvement.

Moreover, **foreign banks** may consider how to enter the business areas such as wealth management and financial assets investment based on their own experiences and capacities. Meanwhile, existing foreign banks may enjoy more benefits through the expansion in business scope, service outlets and talent nurturing. The growth and experience of foreign financial institutions such as the global network and cross-border services will also bring positive impact to the development of the Chinese real economy.

The "Notice on Enlarging the Scope of Operation of Foreign Insurance Brokerage Company" issued by the China Banking and Insurance Regulatory Commission (CBIRC) in April 2018, formally extends the scope of operation of **foreign insurance brokerage institutions.** Qualified foreign insurance brokerage institutions may apply to local CBIRC to upgrade the licence and are entitled to conduct businesses with the same business scope of the Chinese insurance brokerage institutions. Also, the new policy will allow qualified foreign investors to operate insurance brokerage and insurance assessment businesses in China to lead to a further opening of the insurance industry.

In relation to **investment**, the State Administration of Foreign Exchange announced the pilot program of promoting qualified domestic institution investment (QDII), qualified domestic limited partnership (QDLP) and qualified domestic investment enterprise (QDIE), and approved an increased amount of investment to adapt to the market demand.

In relation to **finance leasing**, among the new 25 supportive measures in Shanghai, positive signal is given to foreign institutions that operate a substantive business to establish a finance leasing company in the Shanghai Pilot FTZ. It is also supportive to overseas aircraft leasing companies to establish a project subsidiary or a regional centre in the FTZ. In order to promote the pilot facilitation of foreign debt associated with finance leasing, it is possible for the project subsidiary of the finance leasing company registered at the Shanghai Pilot FTZ to share the parent company's foreign debt threshold. Based on the Belt and Road Initiative (BRI), finance leasing companies are encouraged to operate cross-border RMB businesses and explore the overseas leasing market.

Furthermore, Shanghai also announced a series of supportive measures in relation to convenience for residence, international medical treatment, cross-border finance services and talent policies.

In short, a number of measures in relation to the financial opening have been announced intensely in recent months presenting exciting opportunities for both local and overseas players in the market.

With an unrivalled team of industry professionals and experts locally and internationally, Deloitte is ready to offer diverse services and tailor-made advisory solutions for foreign financial institutions eyeing the new growth opportunities.

- Feasibility study
- Reporting and compliance
- Strategic planning for establishment
- Tax and foreign exchange control compliance advisory
- Implementation planning
- Business process design and control advisory
- Risk governance and management
- Special business licence application advisory

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