A review of China's financial liberalization and opening up in Q1 2024

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Since the beginning of 2024, multiple policies and measures on financial liberalization have been introduced at different levels, demonstrating China's determination to expand high-level institutional opening up. China is accelerating the further opening up of its financial sector as the People's Bank of China and the Hong Kong Monetary Authority (HKMA) launched six measures that involve financial market connectivity, cross-border capital facilitation and deepening of financial cooperation; the Measures for Banks to Develop Foreign Exchange Business (for Trial Implementation) was formally implemented to strengthen process reengineering of commercial banks, and an implementation plan for Pudong's pilot comprehensive reform between 2023 and 2027 was officially released.

According to market observation from the EY team, China has been advancing financial reform, opening up and innovation in an orderly manner and steadily expanding high-level opening up of its financial sector since the beginning of 2024.

January

- Following the central financial work conference, President Xi Jinping made an in-depth elaboration on financial tasks with prioritized agenda, stressing China's determination to follow the path of financial development with Chinese characteristics and promote high-quality development of China's financial sector. Chinese Vice Premier He Lifeng stated that China would continue to deepen its reform and two-way opening up of the capital market, further facilitate cross-border investment and financing, and attract more foreign investors and long-term capital.
- The range of eligible exchange-traded funds (ETFs) under the Shanghai-Hong Kong and Shenzhen-Hong Kong stock connect schemes continued to be expanded, with 11 new eligible ETFs added. Since the trading of ETFs under the Chinese mainland and Hong Kong stock connect schemes commenced on 4 July 2022, the range and volume of ETFs have been expanded steadily, further facilitating the trading by onshore and offshore investors.

February

As the amended regulations on cross-boundary wealth management connect pilot scheme (Cross-boundary WMC scheme) in the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) were formally implemented, the Cross-boundary WMC scheme entered the 2.0 stage. The investment access will be further eased and the investment quota for individual investors will be further increased, and the range of eligible investment products will be further expanded, thus facilitating interconnectivity among financial markets in Guangdong, Hong Kong and Macau.

March

- The China Securities Regulatory Commission (CSRC) issued four policy documents to support higher-level opening up, coordinating opening up and security, paying equal attention to "bringing in" and "going global", steadily expanding institutional opening up and encouraging eligible foreign-funded institutions to set up establishments. The cross-boundary pilot scheme is expected to be expanded in an orderly manner, including mutual recognition of funds, ETF cross-listings and cross-boundary wealth management connect, and the cross-border brokerage pilot scheme will be promoted. Securities companies will be encouraged to help Chinese enterprises go global through professional services including investment and financing, financial advisory, cross-border mergers and acquisitions, to facilitate their cross-border investment and financing.
- The General Office of the State Council issued the Action Plan to Solidly Promote High-level Opening up and Vigorously Attract and Utilize Foreign Investment (the Action Plan), proposing 24 measures across five aspects to promote high-level opening up and attract foreign investment.

This article reviews China′s financial liberalization and opening up in Q1 2024 and analyzes relevant policies in the Action Plan to provide a reference for the financial sector.

A review of China′s financial liberalization and opening up in Q1 2024

A series of policies and measures on financial liberalization and opening up have been introduced to accelerate the high-quality development of China's financial sector. In the first quarter of 2024, China's efforts to promote financial reform didn't stop and there was remarkable progress in business expansion, bringing in institutions and regulatory models.

Business expansion

Since the launch of the Shanghai-Hong Kong Stock Connect in 2014, the connectivity between financial markets in the mainland and Hong Kong has been strengthened and the cross-boundary connectivity has been further optimized, thus elevating the two-way opening up of China's capital market to a higher level. This has led to the connectivity between financial markets in the mainland and Hong Kong to continue to expand. In recent years, Connect Schemes have been implemented, including Bond Connect, Cross-boundary Wealth Management Connect, ETF inclusion in the Stock Connect and Interest Rate Swap Connect. According to the data disclosed by the HKEX, as of 15 January 2024, 142 ETFs had been included in the Shanghai Stock Connect and Shenzhen Stock Connect schemes.

1 Stock market

Besides, the high-level two-way opening up of the bond market has been deepened. Chinese government bonds and policy financial bonds have been included in FTSE Russell, Bloomberg and other major global indices and their share has been increasing. Data from the People's Bank of China showed that by the end of February 2024, bonds in China's interbank market held by overseas institutions reached RMB3.95 trillion, accounting for about 2.8% of the total.

2 Bond market

In January 2024, the People's Bank of China and HKMA included bonds under the Bond Connect scheme in the list of eligible collateral for the HKMA's Renminbi Liquidity Arrangement and further opening up allowed offshore investors to participate in onshore bond repurchase business. As such, all offshore institutions with access to China's interbank bond market can participate in bond repurchase transactions, thus attracting more foreign inflows into China's bond market.

China continues to bring in eligible foreign-funded financial institutions to develop the underwriting business of non-financial enterprise debt financing instruments to support more foreign-funded institutions to participate in China's interbank bond market. Till now, a total of 13 foreign-funded financial institutions have been granted underwriting licenses for non-financial enterprise debt financing instruments, giving full play to their characteristics and advantages to build a market-oriented, rule of law-based and internationalized interbank market. These licensed institutions come from Hong Kong, Taiwan, the United States, France, Germany, the United Kingdom, Japan and New Zealand.

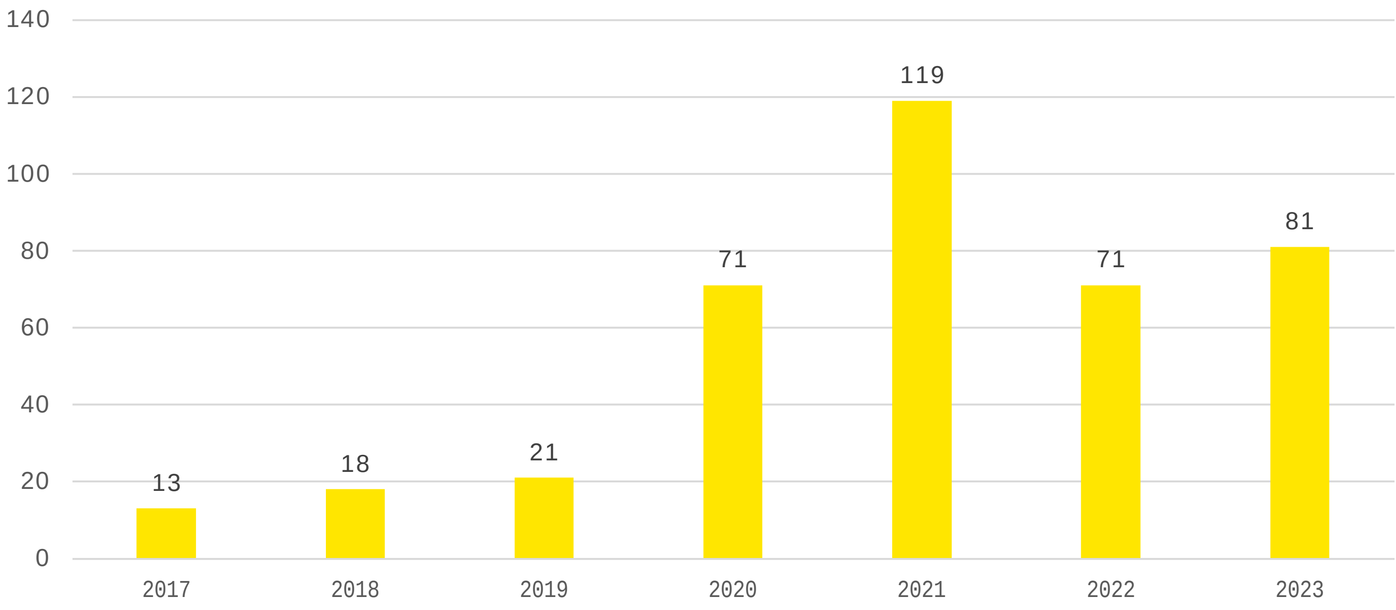
On 22 January 2024, the General Office of the Communist Party of China Central Committee and the General Office of the State Council released an implementation plan for the pilot comprehensive reform of Pudong New Area of Shanghai (2023-2027), highlighting the reform and opening up of the financial sector with specific measures including two-way opening up of financial market and capital account convertibility, financial product innovation and optimized development of asset management industry. The EY team made an in-depth analysis of the pilot comprehensive reform in the report China further opens up the financial sector (XX).

Cross-boundary Wealth Management Connect scheme continues to be optimized. On 26 February 2024, Cross-boundary Wealth Management Connect Scheme 2.0 was officially launched. This initiative will bring opportunities for the expansion of business under the scheme with an adjustment to investor eligibility, participating institutions, qualified investment products and the investment quota for individual investors. According to the latest data from the Guangdong Branch of the People's Bank of China, as of the end of 2023, 69,200 individual investors in the Guangdong-Hong Kong-Macao GBA joined the Cross-boundary Wealth Management Connect scheme, with 43,300 cross-boundary capital transfers totaling RMB 12.81 billion.

The Influx of foreign institutions

Meanwhile, the influx of foreign-funded financial institutions continues. With investment quota restrictions lifted and investment scope expanded, there has been a significant increase in the number of qualified foreign institutional investors (QFII). According to the data from the China Securities Regulatory Commission, as of 27 March 2024, 810 institutions had been approved as QFIIs, including overseas pension funds, sovereign funds, commercial banks and asset managers. In 2023, 81 institutions were granted QFII license, hitting a record high since 2003, second only to 119 in 2021, thus reflecting the willingness of foreign-funded institutions to invest in China's capital market.

Newly approved QFIIs



Source: China Securities Regulatory Commission, EY statistics

An analysis of the Action Plan to Solidly Promote High-level Opening up and Vigorously Attract and Utilize Foreign Investment

On 19 March 2024, the General Office of the State Council issued the Action Plan to Solidly Promote High-level Opening up and Vigorously Attract and Utilize Foreign Investment (the Action Plan), proposing measures across five aspects including expanding market access, increasing policy support, fostering a level playing field, facilitating the flow of innovation factors and improving domestic regulation, to advance high-level opening up, attract and utilize foreign investment, and promote high-quality economic development.

The financial sector is highlighted in the Action Plan, which proposes to expand the market access and business presence of foreign-funded institutions in a wide range of areas and emerging operations and bring more opportunities to foreign-funded institutions. The Action Plan emphasizes the expansion of market access of foreign-funded banking and insurance institutions and the business presence of foreign-funded financial institutions to invest in the onshore bond market, as well as deepened implementation of the pilot program for onshore investment among qualified foreign limited partners.

A summary of measures on expanding financial opening up proposed in the Action Plan

Banking and insurance markets

- Expanding market access of foreign-funded banking and insurance institutions
- Supporting qualified foreign-funded institutions in establishing bank-card clearing presence in accordance with laws, subject to security, efficiency and stability considerations
- Deepening opening up in the commercial pension insurance and health insurance sectors to support qualified overseas insurance institutions in setting up establishments or investing in onshore insurance institutions

Bond market

- Expanding the presence of foreign-funded financial institutions in onshore bond market
- Optimizing the process for foreign-funded financial institutions to invest in onshore capital market and facilitating foreign investors to invest in China's bond market
- Supporting eligible foreign-funded financial institutions to participate in the onshore bond underwriting in accordance with provisions
- Supporting more eligible foreign-funded banks to participate in treasury bond futures trading

Qualified Foreign Limited Partners (QFLP)

- Deepening the implementation of the pilot QFLP program for onshore investment
- Expanding the pilot QFLP program, standardizing the rules and regulations for QFLP managers and funds on registered capital and shareholders and broadening their scope of investment
- Improving the administration of private equity funds and encouraging foreign investors to establish private equity funds and make investments in accordance with laws

EY insights and perspectives

We believe that the Action Plan issued by the General Office of the State Council will serve as a policy guide for China's financial opening up.

The Action Plan will further promote the reform of the management system for foreign investment access through widening opening up, removing all restrictions on foreign investment access to the manufacturing sector and expanding opening up in the service sector. Particularly, in the financial sector, specific policies have been put in place at market and business levels in addition to institutional opening up, to support foreign-funded institutions to expand their presence and facilitate their operations in China. Optimized business environment and multi-pronged measures are expected to boost the confidence of foreign-funded financial institutions to invest in China.

The Action Plan will further expand market access, promote higher-level opening up in the financial sector, help improve the efficiency of resource allocation, increase diversity in financial offerings, enhance the capability of financial services to bolster real economy. Also, institutions and mechanisms will be aligned with international financial markets and integrated into the international financial system to help China build into a financial power.

Going forward, China needs to pursue higher-level opening up in the financial sector. Foreign-funded financial institutions are faced with challenges arising from policy implementation, regulatory rules and supporting infrastructure. It is necessary to deepen the reform on the negative list for market access beyond easing foreign investment. With the implementation of a series of high-level opening up policies and measures, China is expected to advance financial liberalization and form a new pattern of financial opening up.

For more information, please reach out to your EY contact person or one of the following EY professionals.

EY professional services team

Effie Xin

Managing Partner, FinTech and Innovation, Asia-Pacific
Managing Partner, Financial Services, Greater China
Ernst & Young (China) Advisory Ltd
+86 21 2228 3286
effie.xin@cn.ey.com

Alex Jiang

EY China Financial Liberalization Task Force Leader
Partner, Financial Services, Greater China
Chinese Overseas Investment Network (COIN) FS Leader
Ernst & Young Hua Ming LLP
+86 21 2228 2963
alex.jiang@cn.ey.com

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