Seminar Series on Chinese Economy

Department of Economics
HKBU

BBA-Applied Economics Concentration
China Studies-Economics Concentration
Master of Science in Applied Economics

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Seminar Series on Chinese Economy

• China’s Foreign Trade
  - Dr. Kwok, Yun-kwong
  - Senior Lecturer, Department of Economics, HKBU
  - 2 May 2017 (Tuesday), 2:00-5:00

• China’s Financial Reforms and Future Challenges
  - Dr. Cheng, Yuk-shing
  - Head & Associate Professor, Department of Economics, HKBU
  - 12 May 2017 (Friday), 2:00-5:00

• Chinese Exchange Rate and Capital Account Liberalisation
  - Dr. Luk, Sheung-kan Paul
  - Assistant Professor, Department of Economics, HKBU
  - 25 May 2017 (Thursday), 2:00-5:00
Outline

1. A brief review of China's financial reform

2. Banking reforms – redefining the role of the government and the rise of shadow banking

3. Stock market - development through boom and bust

4. FinTech and financial reforms

5. Future challenges
I. A brief review of China's financial reform
The role of the financial sector

Indirect Finance
間接融資

Financial Intermediaries
金融中介

Lenders / savers
貸出者/儲蓄者
1. 住戶 Households
2. 企業 Business firms
3. 政府 Government
4. 國外 Foreigners

Borrowers / Spenders
借入者/資金使用者
1. 住戶 Households
2. 企業 Business firms
3. 政府 Government
4. 國外 Foreigners

Direct Finance
直接融資

Financial Markets
金融市場

Funds 資金

Funds 資金

Funds 資金

Funds 資金
Functions of the financial sector

- Financial markets (e.g. bond and stock markets) and financial intermediaries (banks, insurance companies, pension funds) have the functions of channeling savers’ money to the spenders.

- A properly functioning financial system should be able to allocate funding efficiently – provide adequate funding to “good borrowers” and punish “bad borrowers”.

Direct versus Indirect finance

• In **direct finance**, borrowers obtain funding directly from lenders in financial markets by selling them securities (or called financial instruments).

• **Indirect finance** involves a financial intermediary that stands between the lender-savers and then use these funds to make loans to borrower-spenders. A financial intermediary is supposed to be economizing the transaction costs in a financial transactions – it develops expertise in lowering transactions and it take the advantage of economies scale.

• Since the beginning of economic reform, China has relied heavily on indirect finance, though the role of direct finance has been growing in recent years.
## Financing sources in China

### 中國的融資結構

<table>
<thead>
<tr>
<th>年份</th>
<th>Total financing amount</th>
<th>% share of bank loans</th>
<th>% share of treasury bonds</th>
<th>% share of corporate bonds</th>
<th>% share of stock issuance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>14,174</td>
<td>80.0</td>
<td>13.2</td>
<td>0.2</td>
<td>6.6</td>
</tr>
<tr>
<td>1998</td>
<td>14,909</td>
<td>79.5</td>
<td>14.9</td>
<td>0.3</td>
<td>5.4</td>
</tr>
<tr>
<td>1999</td>
<td>14,562</td>
<td>73.6</td>
<td>19.1</td>
<td>1.1</td>
<td>6.2</td>
</tr>
<tr>
<td>2000</td>
<td>17,163</td>
<td>72.8</td>
<td>14.4</td>
<td>0.5</td>
<td>12.3</td>
</tr>
<tr>
<td>2001</td>
<td>16,555</td>
<td>75.9</td>
<td>15.7</td>
<td>0.9</td>
<td>7.6</td>
</tr>
<tr>
<td>2002</td>
<td>24,233</td>
<td>79.3</td>
<td>15.3</td>
<td>1.3</td>
<td>4</td>
</tr>
<tr>
<td>2003</td>
<td>35,154</td>
<td>85.1</td>
<td>10</td>
<td>1</td>
<td>3.9</td>
</tr>
<tr>
<td>2004</td>
<td>29,023</td>
<td>82.9</td>
<td>10.8</td>
<td>1.1</td>
<td>5.2</td>
</tr>
<tr>
<td>2005</td>
<td>31,507</td>
<td>78.1</td>
<td>9.5</td>
<td>6.4</td>
<td>6</td>
</tr>
<tr>
<td>2006</td>
<td>39,874</td>
<td>82.0</td>
<td>6.7</td>
<td>5.7</td>
<td>5.6</td>
</tr>
<tr>
<td>2007</td>
<td>49,817</td>
<td>78.7</td>
<td>3.6</td>
<td>4.6</td>
<td>13.1</td>
</tr>
<tr>
<td>2008</td>
<td>59,984</td>
<td>83.1</td>
<td>1.7</td>
<td>9.1</td>
<td>6.1</td>
</tr>
</tbody>
</table>

**Note:**
1. 國債中不含1.55萬億元特別國債。
2. 股票融資中不包含金融機構的上市融資額。
3. 企業債包括短期融資券、中期票據和公司債。

**Source:** 中國人民銀行。 出處: 張健華 (編): 《中國金融體系》，北京：中國金融出版社，2010年。
Financial development
- deepening and broadening

• **Financial deepening**
  - defined as an increase in the ratio of financial asset to national income (or GDP), which is a measure of the extent to which past saving has been transformed into investment through the intermediation of financial institutions. It indicates how effectively financial institutions have performed their primary function of mobilizing savings for investment.

• **Financial broadening**
  - refers to an increase in the variety of financial institutions and instruments. It indicates a greater choice for savers and for investors, which allows the financial system to more efficiently match up different uses with various sources of funds. It is associated with the emergence of new market participants, particularly the institutional investors such as insurance companies, pension funds and mutual funds. It also depends on what financial products are allowed to be traded in the market.

→ Since reform started in late 1970s, China’s financial sector has been “deepened” but is still “narrow”.

Financial regulation and shadow banking

• Although financial development can facilitate economic growth, it may also create instability. Thus, regulation is necessary, although not all existing regulations are appropriate.

• With heavy regulations, as well as existing imperfections in the financial system, some financial needs are not fulfilled. This has given rise to informal finance and/or enlarged the shadow banking sector (sometimes through financial innovations).
  
  • Private lending – crisis in Wenzhou 2011

  • Financial innovations – yu’ebao (餘額寶)
II. Banking reforms
– redefining the role of the government and the rise of shadow banking
Banking reform: (1979-1993)

- The mono-bank (one big bank) in the pre-reform era is a government channel to channel funds from government. Remember in the pre-reform era, the government as a whole has one balance sheet.

- The first wave of banking reform is to establish a two-tier banking system to replace the mono-bank system.

- The first tier is the People’s Bank of China (serving as the central bank) and the second tier consists of other banks (and non-bank financial institutions).
The big four

- The reestablishment of the four specialised banks (四大國有專業銀行的重建) - i.e. The Agricultural Bank of China (ABC), the Bank of China, the Construction Bank of China (CBC) and the Industrial and Commercial Bank of China (ICBC).

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>Agricultural Bank of China (中國農業銀行) was re-established</td>
</tr>
<tr>
<td></td>
<td>Bank of China (中國銀行) was detached from People's Bank of China</td>
</tr>
<tr>
<td></td>
<td>People's Bank of Construction (中國人民建設銀行) was detached from Ministry of Finance (財政部). It was later renamed as Bank of Construction (中國建設銀行)</td>
</tr>
<tr>
<td>1983</td>
<td>Setting up Industrial and Commercial Bank (中國工商銀行) to perform the commercial functions of the People's Bank of China</td>
</tr>
<tr>
<td></td>
<td>Assigning People's Bank of China (中國人民銀行) as the central Bank</td>
</tr>
</tbody>
</table>
## A diversified banking system

<table>
<thead>
<tr>
<th>Year</th>
<th>Bank Name</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>Bank of Communications (交通銀行)</td>
<td>The first shareholding bank in China</td>
</tr>
<tr>
<td>1986</td>
<td>China Merchants Bank(招商銀行)</td>
<td></td>
</tr>
<tr>
<td>1987</td>
<td>Shenzhen Development Bank(深圳發展銀行)</td>
<td>Regional commercial Banks</td>
</tr>
<tr>
<td></td>
<td>[renamed as Ping An Bank(平安銀行)]</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>Guangdong Development Bank(廣東發展銀行)</td>
<td>区域性商業銀行</td>
</tr>
<tr>
<td></td>
<td>[renamed as China Guangfa Bank(廣發銀行)]</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>Fujian Industrial Bank 福建興業銀行[renamed as Industrial Bank興業銀行]</td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>Shanghai Pudong Development (上海浦東發展銀行)</td>
<td></td>
</tr>
<tr>
<td>1987</td>
<td>CITIC Industrial Bank(中信實業銀行) [renamed as China CITIC Bank (中信銀行)]</td>
<td>Established by large enterprise groups</td>
</tr>
<tr>
<td>1992</td>
<td>China Everbright Bank(中國光大銀行)</td>
<td>由大型企業集團發起成立的商業銀行</td>
</tr>
<tr>
<td>1992</td>
<td>Huaxia Bank(華夏銀行)</td>
<td></td>
</tr>
</tbody>
</table>
Problems after the initial stage of reforms

• Insufficient competition
  • The market share of the four specialised banks is too big. Competitions from foreign banks, cooperative banks, and non-bank financial institutions were not sufficient.

• Heavy policy burdens of the specialised banks
  • The four specialised banks had to follow government policies to provide loans that might give rise to losses.
    • The government asked the banks to provide low-interest loans to support agriculture and construction of intra-structure.
    • Firms that were not managed well should go bankrupt, but the government wanted the banks to provide credits to these firms (安定團結貸款).

→ This has led to the confusion of “policy-induced losses” (政策性虧損) and “operating losses” (經營性虧損). The costs of implementing the policies became unknown, resulting in the lack of incentives to improve the management by the banks.
Banking reforms: (1994-2002)

• Differentiating the roles of state banks
  • The four state-owned specialised banks were renamed as state-owned commercial banks, with most of the “policy loans” transferred to the policy banks.
  • Three policy banks are established in 1994:
    • National Development bank (國家開發銀行),
    • Agricultural Development Bank (農業發展銀行) and
    • Import and Export Bank (中國進出口銀行).

• Increasing competition in the banking sector
  • More banks and non-bank financial institutions were set up:

• Strengthening the robustness of the banking system
  • setting up four asset management companies (AMCs) in 1999 to take over a total of Rmb 1400 billion of the non-performing loans (NPL, 不良貸款)
  • Enforcing the requirement in capital adequacy ratio (資本充足率) suggested by the Basel Accord.
Banking reforms: (2003 onwards)

- The Chinese government has explicitly followed the strategy of
  - capital injection (注資)
  - shedding off bad assets (剝離不良資產)
  - introducing (foreign) strategic investors
  - Initial public offerings (上市).

- It was hoped that the foreign investors could bring in (a) capital, (b) improve the corporate governance of the banks; (c) provide management skills and business strategies, and (d) reputations for raising more funds in the subsequent IPO.

- By mid 2010, All the four major banks have been listed in the stock market.
A more diversified market structure

• China has now a more diversified market structure, with much more financial institutions and more competition.

• The dominance of the large state-owned banks has declined steadily.
Has the reform finished?

- Will the state-owned banks be immune to policy burdens or government intervention?
  - The 2008 “4 Trillion stimulation package” resulted in another round of policy lending. Local governments have borrowed directly or indirectly from the banking sector.
    - Another round of bailout?

- Is the current financial system satisfying the needs of the economy?
  - There have been complaints that state-owned banks tend to extend loans to large state-owned enterprises.
  - A **shadow banking system** outside the banking system.
Shadow banking system

• The **shadow banking system** is a term for the collection of non-bank financial intermediaries that provide services similar to traditional commercial banks but do so outside, or in ways only loosely linked to, the traditional system of regulated depository institutions.

• The shadow banking system in many countries have grown significantly since 2008 (due to tightened regulations towards the formal banking system).

• The financial firms outside the formal banking system generally lack a strong safety net, such as publicly guaranteed deposit insurance or lender of last resort facilities from central banks, and operate with a different, and usually lesser, level of regulatory oversight.

• **Costs and benefits:** funding from shadow banks can facilitate growth, but involves higher risks for financial stability
Shadow banking in China - causes

Pressures pushing business away from banks towards shadow banks

• There are caps on bank lending volumes imposed by the People’s Bank of China (PBOC).

• The limit of bank loans to deposits of 75% is constraining.

• Regulators discourage lending to certain industries

• Most non-bank channels have lower capital and liquidity requirements.

• Shadow banks are not subject to bank limits on loan or deposit rates.

• Shadow banking avoids costly PBOC reserve requirements.
### Examples of shadow banking

<table>
<thead>
<tr>
<th>Loans and leases by trust companies.</th>
<th>Microfinance companies. These are separately regulated financial firms that are licensed to lend in small amounts to help encourage credit access for small and rural borrowers.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trust companies are financial firms in China that have a quite flexible charter and combine elements of banks and asset managers.</td>
<td>.position(5,6,2160,410)</td>
</tr>
<tr>
<td><strong>Bankers’ Acceptances.</strong> These are notes issued by banks that promise to pay a fixed amount a few months in the future. Generally these are supposed to be issued in connection with a non-financial transaction, such as a purchase of goods, but reports suggest they are often used more loosely.</td>
<td><strong>Entrusted loans.</strong> These are loans made on behalf of large corporations, using banks or finance companies as intermediaries. They are most commonly to other companies in the same group or to suppliers or customers.</td>
</tr>
<tr>
<td><strong>Pawn shops and various unofficial lenders.</strong> Pawn shops are important lenders to some households and small businesses. In addition, there are other types of lenders that operate informally or even clearly illegally.</td>
<td><strong>Wealth management products.</strong> These are investment products that provide a return based on the performance of a pool of underlying assets. Typically the underlying investment is a single large loan or a pool of loans.</td>
</tr>
</tbody>
</table>
Although most WMPs do not formally guarantee returns to investors, investors always receive the expected return and seldom suffer any loss. Therefore, the banks behind these WMPs still bear credit risk, even though the assets have been moved off balance sheet. (Liao, Sun and Zhang, 2016)
Total social financing in China

Exhibit 1.
Net Flows of Total Social Financing

Source: People's Bank of China / Haver Analytics
International comparison – growing size but not really big yet

Table 5.
Shadow banking size comparison

<table>
<thead>
<tr>
<th>Shadow Banking Assets as % of 2013 GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
</tr>
<tr>
<td>United Kingdom</td>
</tr>
<tr>
<td>Switzerland</td>
</tr>
<tr>
<td>United States</td>
</tr>
<tr>
<td>China</td>
</tr>
</tbody>
</table>


Note: Estimates of the size of shadow banking in China ranged form RMB 5 trillion to RMB 46 trillion, or roughly 8 to 80 percent of the size of China’s Gross Domestic Product (GDP). The choice of definitions matters a lot.
III. Stock market
- development through boom and bust
# World’s Largest Stock Exchange

<table>
<thead>
<tr>
<th>2016 Ranking</th>
<th>World’s Largest Stock Exchange</th>
<th>Total Market Capitalization (USD)</th>
<th>% Change in 2015 (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>New York Stock Exchange</td>
<td>$19.6 Trillion</td>
<td>10.00%</td>
</tr>
<tr>
<td>2</td>
<td>NASDAQ</td>
<td>$7.8 Trillion</td>
<td>6.80%</td>
</tr>
<tr>
<td>3</td>
<td>Tokyo Stock Exchange</td>
<td>$5.1 Trillion</td>
<td>3.40%</td>
</tr>
<tr>
<td>4</td>
<td>Shanghai Stock Exchange</td>
<td>$4.1 Trillion</td>
<td>9.80%</td>
</tr>
<tr>
<td>5</td>
<td>London Stock Exchange</td>
<td>$3.5 Trillion</td>
<td>9.90%</td>
</tr>
</tbody>
</table>
## Asia Stock Exchanges

<table>
<thead>
<tr>
<th>2016 Ranking</th>
<th>Asia Stock Exchange</th>
<th>Total Market Capitalization</th>
<th>% Change in 2015 (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Tokyo Stock Exchange</td>
<td>$5.1 Trillion</td>
<td>3.40%</td>
</tr>
<tr>
<td>2</td>
<td>Shanghai Stock Exchange</td>
<td>$4.1 Trillion</td>
<td>9.80%</td>
</tr>
<tr>
<td>3</td>
<td>Shenzhen Stock Exchange</td>
<td>$3.2 Trillion</td>
<td>6.10%</td>
</tr>
<tr>
<td>4</td>
<td>Hong Kong Stock Exchange</td>
<td>$3.2 Trillion</td>
<td>0.30%</td>
</tr>
<tr>
<td>5</td>
<td>Bombay Stock Exchange</td>
<td>$1.5 Trillion</td>
<td>3.00%</td>
</tr>
<tr>
<td>6</td>
<td>National Stock Exchange of India</td>
<td>$1.5 Trillion</td>
<td>3.30%</td>
</tr>
<tr>
<td>7</td>
<td>Korea Exchange</td>
<td>$1.3 Trillion</td>
<td>4.10%</td>
</tr>
<tr>
<td>8</td>
<td>Australia Stock Exchange</td>
<td>$1.3 Trillion</td>
<td>10.90%</td>
</tr>
<tr>
<td>9</td>
<td>Taiwan Stock Exchange</td>
<td>$0.9 Trillion</td>
<td>15.70%</td>
</tr>
<tr>
<td>10</td>
<td>Singapore Stock Exchange</td>
<td>$0.6 Trillion</td>
<td>1.50%</td>
</tr>
<tr>
<td>11</td>
<td>Malaysia Stock Exchange</td>
<td>$0.4 Trillion</td>
<td>5.20%</td>
</tr>
<tr>
<td>12</td>
<td>Indonesia Stock Exchange</td>
<td>$0.4 Trillion</td>
<td>22.80%</td>
</tr>
<tr>
<td>13</td>
<td>Stock Exchange of Thailand</td>
<td>$0.4 Trillion</td>
<td>25.40%</td>
</tr>
<tr>
<td>14</td>
<td>Philippine Stock Exchange</td>
<td>$0.2 Trillion</td>
<td>0.40%</td>
</tr>
</tbody>
</table>
Characteristics of China’s stock market

• Highly policy-driven
  • Approval of IPOs
  • Policies towards the fundraising activities of listed state-owned enterprises

• High proportion of transactions by individual investors with poor investment knowledge (rather than institutional investors)

• High volatility

• Seen to have unsatisfactory regulation/supervision
Growth in the number of listed companies

- 上海证券交易所上市公司数目
- 深圳证券交易所上市公司数目
- 全国上市公司合计
Stock price indexes

- Shanghai Stock Exchange A-share Index
- Shenzhen Stock Exchange A-share Index
Individual investors as market follower

中國股票市場-新開戶數

(千個)
Market capitalization – swinging with the stock prices
Why did China have higher volatility?

Sources: Bloomberg L.P.; IMF staff estimates.
Note: January 2006 is taken as the benchmark date to calculate the stock price indices. Data as of September 2015.
IV. FinTech and financial reforms
Case study:
Wechat’s payment system

中国即将进入“无现金时代”
http://chuansong.me/n/1810233841059

江门首个智慧菜市场买菜可溯源可微信支付
Case study: Ant Financial Services

企業簡介
浙江螞蟻小微金融服務集團股份有限公司（以下稱"螞蟻金服"）起步於2004年成立的支付寶。2014年10月螞蟻金服正式成立。螞蟻金服以"為世界帶來微小而美好的改變"為願景，致力於打造開放的生態系統，通過"互聯網推進器計畫"助力金融機構和合作夥伴加速邁向"餐館 + "為小微企業和個人消費者提供普惠金融服務。

螞蟻金服集團旗下及相關業務包括生活服務平臺支付寶、智慧理財平臺螞蟻聚寶、雲計算服務平臺螞蟻金融雲、獨立協力廠商信用評價體系芝麻信用以及網商銀行等。另外，螞蟻金服也與投資控股的公司及關係企業一起，在業務和服務層面通力合作深度整合共推商業生態系統的繁榮。

Source: https://www.antfin.com/index.htm?locale=zh_CN
China’s growing digital finance

FinTech in China

• FinTech - the application of technology within the financial services industry
  • covering a wide range of activities from financial data and analysis to financial software, digitised processes and payment platforms.

• WeChat sent 32 billion digital red envelopes over the Chinese New Year holiday in 2016 (compared to 4.9 billion mobile and desktop transactions PayPal did for the entire 2015)

• China is emerging as a leading FinTech market in the globe, owning 8 of the 27 current FinTech “unicorns” – technology firms that investors value at more than US$1 billion.

• FinTech investments in China surging to US$8.8 billion between July 2015 to June 2016.
Questions to think about:
Why fintech can grow so fast in China?
1. Unmet Financial Needs

- The exponential growth in both China’s economy and middle class
  → Huge demand for financial services
- But China’s banking sector is underdeveloped
  → Happy to have convenient and cheaper financial services from non-bank entities

<table>
<thead>
<tr>
<th></th>
<th>China</th>
<th>USA &amp; Canada</th>
<th>Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial bank branches</td>
<td>8.1</td>
<td>28.2</td>
<td>28</td>
</tr>
<tr>
<td>ATMs</td>
<td>55</td>
<td>222</td>
<td>81</td>
</tr>
</tbody>
</table>
• Current retail loan penetration in China is 20% - one of the lowest in the world.

• 1 in 5 of China’s adult population remain unbanked (consider the poor financial services in rural areas).

• State-owned banks have largely underserved the small and medium-sized enterprises (SMEs) and retail customer segments.
  • SMEs are accountable for 60% of GDP and 80% of urban employment, but receive only 20-25% of bank-disbursed loans.

• SMEs also suffer from asymmetric information, with limited transparency in their financial positions and credit rating assessments.
  • Even if they do secure bank loans, the interest rates are typically double that of large corporations, based on perceived risk concerns.

→ Can fintech solve the problem with big data?
2. Ubiquitous Connectivity

- China’s digital infrastructure is far more mature, with a population ready and able to use their smartphones for mobile banking.
  - In June 2016, China had 710 million internet users (more than the US and Europe combined), bringing its online penetration rate up to 51.7%.
  - the smartphone is becoming the universal internet access device. In June 2016, 656 million/92.5% of users were going online via connected devices.
3. E-commerce with Chinese Characteristics

- China has become the world’s *largest* and *most developed* retail e-commerce market.

- Despite China’s massive e-commerce growth, incumbent banks have been unable to capitalize on digital payments due to low credit card penetration rates.

![Diagram 6: Share of global retail e-commerce sales, China vs. U.S., 2015-2020F](source: eMarketer, August 2016)
4. The pushing force of the local internet giants

- Consumers are now comfortable with e-commerce and online payments, business is booming for payment service providers.
  - Alibaba’s Alipay (支付寶) is now the largest online payment gateway in China, accounting for half of Chinese third-party online payments (and 68.4% of the mobile payments market);
  - Tencent’s Tenpay (財付通) currently commands another 10% (20.6%).

- Mobile payments are growing, fueled by QR (quick response) codes and, by online-to-offline (O2O) services.
  - In the O2O business model, although customers are acquired online, delivery of the product or service takes place at physical locations.

- The reverse interaction – offline-to-online – is also popular.
  - A rising number of Chinese retailers (both bricks-and-mortar and e-commerce companies) have started using QR codes on billboards, posters and flyers to offer discounts and product information.
Chinese consumers are familiar with FinTech offerings, creating opportunities for both incumbent and new financial services providers.

The digital consumers are more tolerant towards financial risks and greater propensity to spend than the older generations.

Ironically, e-trust in China also stems from the social norm of reduced anxiety over data privacy.
Chinese consumers are more willing to trust companies with their personal data

6. The availability of talents

• Developing a FinTech sector requires a *highly skilled work force* with an agile mind-set. In China, the hubs for such talent and financial innovation are:

- *Beijing* – hosts country headquarters of a number of foreign and local technology multinationals such as Microsoft, IBM, Cisco, JD.com (京东) and Baidu (百度).

- *Shenzhen* – near the financial centre of Hong Kong, is home to local tech giants such as Huawei, ZTE and Tencent.

- *Shanghai* – an international financial hub and near Hangzhou, where Alibaba is based.

- FinTech firms are also located near some of the world’s top-ranked universities for technology and engineering, such as Peking University and Tsinghua University.
Towards increasing regulatory focus?

• Since 2015 a stricter regulatory approach has been announced. In the P2P sector nearly one-third of all online financing platforms in China ran into financial difficulties by the end of 2015. The new rules
  • imposed credit limits
  • prohibited pooling and lending of funds by P2P platforms
  • required a principal guarantee by the platform,
  • Required debt securitization to mitigate lenders’ credit risks.
• The National Internet Finance Association, run by the central bank and with 400 member traditional financial and internet finance companies, was established to regulate Chinese FinTech firms and control risks in the sector.
• High profile scandals, such as Ezubao’s Ponzi scheme disguised as a P2P platform, also prompted the government to establish a task force to crackdown on fraudulent P2P lenders.
• A more substantive data protection framework is now being implemented in Chinese legislature.
  • Includes additional requirements for non-bank payment institutions around effective protective measures, risk control systems and KYC measures, and storage of sensitive information.
### Comparative P2P regulations in core FinTech markets

<table>
<thead>
<tr>
<th>Specific regulations/guidelines for P2P</th>
<th>China (Mainland)</th>
<th>Hong Kong</th>
<th>Singapore</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>License requirement</td>
<td>Yes (Finalised In August 2016)</td>
<td>License required to be registered with local financial authority.</td>
<td>The Securities and Futures Ordinance prohibits retail investors under current legislation.</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Minimum capital requirement</td>
<td>No minimum capital requirement as P2P players are Information Intermediaries and do not assume any credit risk.</td>
<td>N/A</td>
<td>Base capital requirement of S$500,000 to offer loans to retail lenders and S$50,000 to offer loans to accredited and institutional lenders.</td>
<td>Loan-based crowd funding platforms are required to fulfil a minimum capital requirement of £20,000.</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Source: China Banking Regulatory Commission, Financial Conduct Authority, Monetary Authority of Singapore, Securities and Futures Commission of Hong Kong, 2016
More Formalised Funding

• State Funds – State-owned and state-controlled entities have growing interest in the FinTech industry has been spreading from private financial institutions.
  
  • The Chinese Government operates more than 750 government-guided funds nationwide. In 2015, it raised a massive US$231 billion to fund start-ups

• FinTech firms, even already financially backed by large internet players, have been able to secure funding from government-affiliated firms.
  
  • E.g. when Alibaba’s FinTech affiliate Ant Financial raised US$4.5 billion in a Series B funding round in April 2016, it attracted investments from state-controlled entities like China Investment Corp.
• Private Funds - In May 2016, China saw its first FinTech angel fund and accelerator, FinPlus, which was backed by the Fugel Group. The angel fund intends to invest RMB1 to 5 million.

• Volume of Investment is reaching historical high.

% growth of FinTech funding from 07/2015 – 06/2016

Source: IC Dowson and William Garrity Associates, July 2016
Making Chinese FinTech globalized

*The BAT giants = Baidu + Alibaba + Tencent*

- Aggressive Chinese tech firms flush with cash, and equipped with skilled IT infrastructure and application development are looking to internationalize.

- In addition to investing in Silicon Valley and mature markets, the BAT giants are expanding to serve outbound Chinese travelers and expats, while seeking out new customers in *emerging economies* from Africa to South and South-east Asia.

- They are particularly interested in the future possibilities of new O2O revenue streams
V. Future challenges
China’s New Financial Landscape

China’s financial system is:
- becoming larger
- more diversified
- having higher leverage ratio
- becoming more interconnected

Questions:
How can financial stability be maintained?
Can China regulate new financial activities properly?
Will there be regulatory gaps between different financial sectors?

Figure 2. China’s Share of Global Financial Assets
(in percent)

Sources: Bank for International Settlements (BIS); Bankscope; Board of Governors of the Federal Reserve System, Flow of Funds; Bloomberg, L.P.; IMF, International Financial Statistics (IFS) and World Economic Outlook databases as of September 22, 2014; World Federation of Exchanges; and IMF staff estimates.
Institutional framework for financial stability

• The Law on the People’s Bank of China (PBC) specifically charges that institution with guarding against systemic financial risks and the maintenance of macro-financial stability.

• The China Banking Regulatory Commission (CBRC) is the prudential regulator of commercial banks and other banking financial institutions.

• The China Securities Regulatory Commission (CSRC) regulates the securities and futures markets.

• The China Insurance Regulatory Commission (CIRC) regulates the insurance industry.
Can this system work?

• Strength

  • The institutional separation of functions among the PBC, CBRC, CSRC, and CIRC has some strength – each institution remains focused on its own mandate.

• Weaknesses

  • insufficient collecting and sharing of cross-sector granular data

  • insufficient cross-sector analysis on systemic risk (e.g. lacking analysis of interconnectedness across sectors in PBC’s comprehensive annual Financial Stability Report (FSR)).

  • insufficient policy coordination (e.g. that among exchange rate, interesting rate and fiscal policy) to prevent buildup of system risk
Recommended readings:


