



THE US-CHINA BUSINESS COUNCIL

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Financial Services in China

An Overview and Assessment of Reforms and Market Openings, with Recommendations for Further Progress

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Modernizing the financial sector is the most important of China's unfinished economic reforms. A rational, sound, and competitive financial system lies at the heart of a market economy, channeling capital to its most efficient and productive uses. Consumers benefit from better savings, investment, and credit systems. In short, financial sector reforms are critical to China's sustained economic growth, which is important not only to China but also to the rest of the world.

China's leaders understand the importance of financial sector reform and have made much progress in a relatively short time. The PRC government has established financial laws and regulatory institutions where, in essence, none had existed before. PRC policy makers began this work in earnest the late 1990s with the establishment of a host of new regulators and continued the transformation through China's World Trade Organization (WTO) entry agreement in 2001. Their efforts have affected all sectors of the financial services industry, including banking, securities, insurance, credit rating services, consumer finance, electronic payments, asset and fund management, and leasing services. At the same time, regulations govern, or are under development for, an ever-increasing number of new or sophisticated financial instruments, including financial derivatives, securitizations, and other modern capital markets products.

China's efforts to develop a modern financial sector nevertheless constitute a work in progress. China's financial system still contains remnants of the socialist planned economic system that was in place before economic reforms began. China's largest domestic financial institutions are overwhelmingly owned by the state. These state-

owned lenders are believed to still finance unproductive investments on noncommercial criteria, frequently at the behest of local governments eager to boost short-term growth. High rates of household savings and enterprise reinvestment—both in large part a result of underdeveloped financial markets—fuel this inefficient investment, which many economists in and outside of China believe is unsustainable. These and other characteristics of China's partially reformed financial system reduce China's prospects for sustaining its unprecedented rate of economic growth.

While the benefits to China of modernizing its financial sector are obvious, China's successful construction of a modern financial sector is in America's interest, as well. A modern and more transparent financial system will help address several concerns in the bilateral economic relationship: China's exchange rate policy, the US trade deficit with China, and the fostering of a competitive "level playing field" for foreign companies competing with Chinese counterparts. Continuing to open market sectors to US financial service providers could greatly aid reforms affecting all three areas. By bringing their expertise to the market in China and exposing Chinese companies to international best practices, both through competition and partnership, American companies can help China as it builds the infrastructure of a modern financial sector.

For example, China can only adopt a fully market-determined exchange rate—a goal of China's economic policymakers and a key concern in Washington—if it develops a robust financial system that will allow for the removal of capital controls and the creation of a fully convertible currency. Strengthening China's banks is one

critical step toward the removal of capital controls. Allowing greater participation in the domestic market by American financial institutions would bring international standards and practices to Chinese banking sector and help China build the financial instruments that facilitate a floating exchange rate.

It goes without saying that China can and should, in the meantime, allow its exchange rate with the dollar to fluctuate more freely to reflect changes in trade flows. At the same time, it should be noted that the effect of China's exchange rate policy on bilateral trade is likely overstated. Any production that becomes unprofitable in China because of an exchange rate appreciation is likely to shift not to the United States but, rather, to other low-cost producers in Asia or elsewhere.

Even so, any benefit China gains from an undervalued currency should be addressed. The best way to eliminate any such unfair trade advantage is to continue to advocate for greater market influences to be reflected in the exchange rate now, for broader financial reforms that will lead to the removal of capital controls at the appropriate time, and for a fully market-based currency in the future.

China has expanded the investment opportunities for foreign investors and is progressively granting domestic companies greater access to a pool of foreign capital. This is an important step in modernizing China's capital markets and may also contribute to resolving issues related to valuation of the China's currency. One key measure of this has been the liberalization of the Qualified Foreign Institutional Investor (QFII) program, launched in November 2002, which gives certain foreign investors limited access to the domestic A-share market.

During the second round of the Strategic Economic Dialogue (SED) in May 2007, the China Securities Regulatory Commission (CSRC) and the State Administration of Foreign Exchange (SAFE) agreed to increase the quota cap for QFIIs' investment from \$10 billion to \$30 billion by the time of the third round of the SED, scheduled for December 2007. In addition, CSRC approved 18 new QFIIs in 2006, bringing the total number of institutions to 52.

Financial reforms such as QFII may also help lower the US trade deficit with China by encouraging China's transition from economic growth driven by exports and fixed-asset investment to a more balanced growth model that incorporates greater domestic consumption, an oft-stated aim of PRC policy makers.

Market openings may be able to assist China's economy with other challenges such as underutilization of personal wealth. Economists estimate that many Chinese households save as much as 50 percent of their incomes. This high level of household savings is mainly due to the need to save for basics such as retirement, medical costs, education, and many consumer purchases. The pension, insurance, personal investment, and consumer financing products that come with a modern financial sector—products in which American financial service providers have developed a wealth of expertise—could reduce excessively high household savings in China and allow for greater consumption.

Over the long term, increased domestic consumption could result in the diversion of some of China's exports to domestic sales. Higher consumption could also spur an increase in China's imports and contribute to more export opportunities for American companies, helping to ease the US trade deficit.

Developing China's financial sector could also help reduce the US trade deficit by removing a cause of industrial overcapacity, which helps fuel China's production of cheap exports. Chinese enterprises tend to reinvest a large portion of their retained earnings in new production facilities because of the dearth of attractive alternative investment options and because these companies generally do not pay shareholder dividends. As their productive capacity increases, sometimes without regard to reasonable projections of market growth, Chinese companies seek out export markets, including the United States, and contribute to downward pricing pressures on industrial products. The State-owned Asset Supervision and Administration Commission (SASAC) early 2007 announcement that state-owned enterprises (SOEs) will be allowed to pay dividends was a positive step; banking and financial reforms that expand investment options for PRC companies will also alleviate this trend.

Finally, the commercially based lending criteria that would be part of a fully modernized financial system in China would help American companies compete on a more level playing field with their Chinese counterparts in China and around the world. Although China's central government has done much to introduce commercial lending criteria to state-owned banks, these banks too often revert to their previous roles as policy-driven lenders. Provincial branches of state-owned banks, which operate with some degree of autonomy from their headquarters,

reportedly often extend loans to enterprises at the behest of local governments. Lending and repayment are, at times, on non-market terms. Such practices give these companies an unfair advantage over American companies in China and in international markets. Expanding the participation of US financial firms in China's financial sector would help to hasten the adoption of commercial lending practices throughout China's financial sector, thereby helping to level the playing field for all American companies.

In concluding its WTO commitments roadmap – which included important commitments to remove geographic and client restrictions in December 2006 – China has partially opened the door to American and other foreign financial service providers. Yet several commitments remain unresolved and some broader, structural questions remain unanswered. To gain the full benefits that the presence of foreign financial companies can bring to China's economy, China must complete its WTO commitments and now move beyond them. Such progress and market openings would benefit both China and its commercial partners.

Reforms and Developments

Though the pace of China's financial reforms has not been as fast as many observers would like, China has taken some notable steps in a number of areas important to American financial service providers.

Bilateral engagement and dialogues

The United States and China have numerous bilateral exchanges that address financial sector issues: The Joint Commission on Commerce and Trade (JCCT), which involves the PRC Ministry of Commerce (MOFCOM) and the US Department of Commerce and Office of the US Trade Representative; the SED, which is led by PRC Vice Premier Wu Yi and Treasury Secretary Henry M. Paulson Jr.; the Joint Economic Committee, involving the PRC Ministry of Finance and the US Treasury Department; the multi-agency Financial Services Working Group; and the insurance industry dialogue under the JCCT.

Throughout 2006 and the first half of 2007, participants in the bilateral dialogues of the JCCT and the SED paid special attention to the role of financial services in securing mutual benefits for the United States and China. These separate but complementary dialogues have different purposes.

The SED is a forum for discussing solutions to structural issues at the macro-level. The JCCT seeks agreement on the specific recommendations that will contribute to this progress.

Financial sector issues have been important topics of discussion at these meetings and have been among the key outcomes. Outcomes from the second round of the SED in May 2007 included China's affirmation to end an eight-month-long moratorium on new foreign investment in PRC securities firms in and expedited processing of certain insurance licenses. Preparations for the third round – set to take place in Beijing in December 2007 – are well under way. Participants expect financial services reforms and market openings to remain a key fixture in the SED.

Scheduled for late October 2007, the JEC serves as the main channel for official dialogue on China's financial sector, including securities. Treasury last held a JEC meeting with Chinese regulators in April 2007 in preparation for the second SED meeting.

A separate dialogue also focuses on financial issues, the US-China Financial Sector Working Group (FSWG), which last met on January 29, 2007. Though not limited to China-related issues, the FSWG serves as a forum for officials from the United States to exchange ideas and increase cooperation on technical matters across a range of financial industries with Chinese counterparts. The working group includes participants from a variety of important agencies and organizations including Treasury, the Federal Reserve, and the Securities and Exchange Commission on the US side and the People's Bank of China (PBOC), CSRC, the China Banking Regulatory Commission (CBRC), and the National Development and Reform Commission (NDRC) on the Chinese side.

The last bilateral Insurance Dialogue between China Insurance Regulatory Commission (CIRC) officials and industry representatives took place in November 2006. The meetings were a forum for various industry concerns including branch license issuance, which remains a key opening that foreign insurers would like to see resolved.

Sector assessments

Banking

China's top leadership and foreign industry participants alike consider banking a pivotal sector when addressing potential areas of macroeconomic instability such as capital misallocation and excessive investment. The PRC leadership understands how important banking reform is for

China's development and continues to stress the importance of progress in this area. Banking sector reforms also address microeconomic challenges such as developing new credit and investing options, as well as developing healthy businesses in rural areas, and aiding small and medium-sized enterprises. The PRC government's sustained awareness of these notions is encouraging.

Since China's WTO entry in late 2001, China has gradually granted foreign banks in China somewhat greater powers and market access. Perhaps the most important example is the permission foreign banks gained in 2006, consistent with China's fifth-year WTO commitments, to set up operations across China to offer services to domestic consumers.

Overall, foreign banks have reported strong growth in revenue and expansion of their customer bases and business scopes, stemming largely from domestic economic growth, energetic marketing, and high-quality service offerings. At the same time, the regulatory restrictions remain heavy: foreign banks face high capital requirements, limitations on their business scopes, and burdensome branching requirements, and are required to incorporate in China (rather than rely on branches to conduct business on behalf of foreign headquarters) if they wish to provide the full array of banking services to domestic PRC customers. Only a small number of US banks have established a long-term presence in China and these banks have set relatively modest near-term goals. US banks have the potential to make substantial contributions to China's economic and financial development, however, as they bring valuable skills and services to the market, and because their presence encourages an efficient, competitive banking environment that benefits corporate and individual Chinese customers alike.

Central PRC government-led banking changes over the past several years illustrate central authorities' increasing receptiveness to reform and to the benefits that established foreign banks can bring. For the most part, CBRC has stood as the principal authority for regulations related to banking. In some cases since 2006, however, elements of China's financial system development were of a national scale and beyond CBRC's scope. In 2007, for example:

- The National People's Congress (NPC) passed the bankruptcy law.
- PBOC sought to further develop China's credit information database, and the NPC pushed for a related privacy law.
- PBOC, CIRC, CSRC, and CBRC took further

- steps to authorize crossover shareholdings.
- CSRC, SAFE, and CBRC introduced a joint effort in further expansion of Qualified Domestic Institutional Investor (QDII) and QFII programs.
- The government recapitalized several Chinese banks and some banks undertook steps to prepare for stock market listings.

Since 2006, CBRC has made several direct reforms in its own areas of responsibility. These included:

- Releasing new bank-owned leasing company regulations;
- Proposing a scheme for deposit insurance;
- Reviewing over 100 city commercial banks and four large city-based banks in Nanjing, Jiangsu; Ningbo, Zhejiang; Beijing; and Dalian, Liaoning, for launch and listing. (To date, two of these listings have been completed.)
- Reviewing branching regulations for city commercial banks.

CBRC also engaged in significant activity regarding foreign banks in China. These included:

- Officially opening the individual consumer banking sector to foreign companies on December 11, 2006;
- Producing local incorporation regulations for foreign banks as well as accompanying implementation details;
- Approving 12 foreign banks in the first step toward full registration in China to conduct RMB business with all individuals. Four have been fully approved to date: Citibank, HSBC, Standard Chartered Bank and Bank of East Asia.

Though CBRC retains the lead implementing role for banking reforms, PBOC, SAFE, CSRC and even CIRC have some overlapping authority in this sector. Plans for creation of a new super-regulator for China's financial sectors may come up later in 2007, though such plans were discussed in 2006 with no result. It is possible that the PRC government's creation of such a regulator would affect the division of work among the ministry-level regulators. Though clearly demarcating roles and jurisdictions would be a welcome development, any lack of transparency in a new chain of command for decision-making could pose challenges for market participants. Observers will continue to watch movements in this area closely.

Securities

China has made progress over the past several years in building its stock exchanges and in gradually allowing greater domestic access to individual and institutional investors. In response, China's securities markets have experienced rapid growth:

- The Shanghai Economic Composite index for the Shanghai Stock Exchange rose 67 percent between January and July, 2007.
- Total market capitalization on both the Shanghai and Shenzhen stock markets grew by 176 percent in 2006 and 123 percent in the first seven months of 2007 to surpass \$2.7 trillion (19.9 trillion RMB).
- Since June 2006, when CSRC lifted its moratorium on the listing of new domestic initial public offerings (IPOs), domestic companies have resumed listing and China has seen 115 IPOs in the A-share market.

In addition to the domestic stock market, China has also increased investment opportunities for domestic investors in other areas, including corporate bonds, derivatives, and investment funds. Some of the notable developments over the past year have included:

- PRC approval of foreign entities such as the International Finance Corporation and the Asian Development Bank to issue RMB-denominated bonds on the China market to finance development projects.
- Announcement in September 2006 by CRSC, SAFE, and PBOC of new regulations that lowered the threshold for participation in QFII – though not for commercial banks or securities firms – from \$10 million of managed securities assets and 30 years of experience to \$5 million and 5 years. QFII investors are also allowed to contract with up to three domestic brokerage firms, not just one, and are permitted to hold multiple brokerage accounts.
- A pledge by PRC leaders at the third Central Financial Work Conference in January 2007 to increase the number of corporate bond offerings, and to transfer oversight of most types of corporate bonds from the NDRC to CSRC, thus bringing corporate bonds under the same regulatory umbrella as other securities offerings.
- Release by CSRC of two sets of measures in April and June 2007 to reform the QDII program to allow a greater number of

domestic investors to invest in a broader range of overseas investment products.

Foreign firms nevertheless continue to face restrictions on their ownership and participation in the securities sector. They are limited to minority ownership in securities underwriting enterprises, including a 33 percent stake in joint-venture securities brokerages, and a 49 percent cap in asset-management firms.

At the same time, China has taken small steps toward expanding the ownership roles and activities available to foreign firms in the domestic securities sector. At the second SED meeting in May 2007, China confirmed the intent to lift the moratorium on approving new foreign-invested securities firms, and to resume licensing securities companies, by the end of 2007. In addition, China agreed that before the third SED meeting in December 2007, it would permit foreign securities firms to conduct a broader range of activities in China, including brokerage services, proprietary trading, and fund management. US Treasury Secretary Paulson continued discussion on these points during his July–August 2007 visit. Chinese officials at the second SED meeting also committed to allow the New York Stock Exchange (NYSE) and NASDAQ to set up offices in China, and did so under regulations that were implemented on July 1.

QDII programs, which allow domestic institutional investors to access a variety of financial instruments and capital markets outside of mainland China, represent an important step for China's liberalization of investment opportunities. Yet these programs have been, to date, small relative to the potential pool of Chinese funds that are now legally allowed to invest in these programs. The *Financial Times* reported in April 2007 that only 5 percent of China's \$18.5 billion QDII quota had been invested abroad and the vast majority of this was in the form of Hong Kong-listed H-shares.

Electronic payments and consumer financial services

According to its WTO General Agreement on Trade in Services (GATS) Financial Services Schedule, China is required to allow unrestricted market access and national treatment for "payments and money transmission services, including credit, charge, and debit cards," beginning in 2007. Despite this commitment, many foreign-owned electronic payment providers say China continues to restrict market access by

maintaining a government-protected domestic monopoly, China Union Pay (CUP), for all domestic, RMB-denominated electronic payment transactions.

At the second round of the SED, China announced that it would allow foreign banks and financial institutions to issue local currency credit and debit cards, as long as they carry the CUP logo. They also maintained the requirement that all transactions conducted on these cards in China be processed over the CUP network.

Foreign electronic payment providers contend that this announcement does not satisfy China's WTO commitments and in fact further solidifies CUP's monopoly status.

Meanwhile, Chinese consumers are underserved, with limited payment devices and financial services products, and insufficient service channels. The current consumer financial services market is still restricted to financial institutions, which cannot satisfy both domestic and international consumer demand.

Insurance

Since the third quarter of 2006, CIRC has rolled out a series of regulations aimed at increasing guidance and monitoring of the domestic insurance industry. On June 1 2007, CIRC released a draft of the Provisional Measures for Insurance Fund Management for comment. Though CIRC gave only one month for comments, the release was a solid step toward better transparency in the regulatory process. Insurers hope that this trend will continue for the significant and far-reaching laws that are currently in the drafting pipeline, namely, the draft insurance and pension laws.

Since 2006, some of the most important regulations that CIRC has drafted include new measures that:

- Strengthen oversight of the issuance of insurance licenses;
- Bolster transparency and corporate governance in the insurance industry and define disclosure requirements;
- Detail oversight procedures and requirements for the administration of life insurance products;
- Emphasize supervision and corporate governance.

Observers are keeping a close eye on authorities' moves to issue licenses for wholly foreign-owned insurance subsidiaries offering non-life insurance (including insurance for vehicle, enterprise property, cargo, casualty, liability and

other areas). The Chinese side made this commitment as part of the 2003 JCCT and 2007 SED insurance dialogues. Industry participants are also waiting to assess the impact of China Post's announcement that it expects to launch an insurance subsidiary this fall.

As is the case with many of the industries within the financial sector, liberalization in one area can bring about an improved environment in others. For example, in February 2007, the Ministry of Labor and Social Security and PBOC announced that annuity funds from non-bank corporations would be allowed to invest in China's interbank bond market. This move marks a development in the domestic securities market that implies possibilities for an increase in investment options for China's insurance market.

Futures

PRC regulators have also begun to develop other investment and risk management markets, though at a gradual pace. CSRC issued several draft measures in April 2007 designed to regulate the futures market. These measures included a risk warning index for futures companies, as well as high capital requirements for participation in the markets – RMB 15 million (\$2 million) in net capital, RMB 45 million (\$6 million) for exchange settlement net capital, and RMB 90 million (\$12 billion) for comprehensive settlement net capital. A revision of earlier rules governing certification and activities of brokers in the futures market was issued in July 2007.

Unfortunately, high capital thresholds and other regulations have deterred many investors. Stipulations requiring comprehensive settlement net capital to exceed RMB 90 million (\$12 million) automatically exclude most futures companies from participating, considering that the average registered capital of such companies in China is about RMB 30 million (\$4 million).

Asset-backed securities

Though China has seen a few high-profile issuances of asset-backed securities – including China Development Bank's 2005 issue of RMB 4.3 billion (\$573.3 million) in securities backed by unsecured corporate loans – China limits the number of issues, range of issuers, and the variety of assets used to back securities.

Mutual funds

Mutual funds have also continued to grow along with the stock market. In May 2007, CBRC's expansion of its QDII program permitted

commercial banks operating in China to offer Hong Kong-authorized mutual funds as part of their QDII investments. In the first seven months of 2007, turnover in mutual funds reached RMB 44.2 billion (\$5.9 billion), a more than six-fold increase over the previous year.

Rating agencies

CSRC promulgated measures in August 2007 governing credit rating services in China. The measures, which took effect September 1, require agencies planning to apply for a securities rating license to meet certain requirements such as possessing legal entity status and registered capital or net assets exceeding RMB 20 million (\$2.6 million).

These new regulations are an important step in establishing some ground rules for credit rating agencies (CRAs), though a number of issues remain. Foreign investors face a 49 percent cap in ownership in PRC CRAs. Moreover, the law imposes liabilities on CRAs for their opinions by burdening them with requirements to verify the accuracy of the information received from issuers. This requirement could have a particularly marked effect on the willingness and ability of CRAs to issue ratings in an efficient matter. In addition, a lack of regulatory clarity threatens to prevent open competition. Matters regarding foreign ownership requirements also remain unclear for acquisitions. Unless resolved, these concerns may make it impossible for US CRAs to issue ratings in China.

Recommendations for Further Progress

Despite the progress achieved to date, China's leaders have significant work ahead of them on the path to full financial sector modernization.

Banking

Ownership, branching and capital requirements

The efficiency and depth of China's banking sector would improve greatly if PRC regulators were to:

- Eliminate or relax foreign ownership restrictions in Chinese banks.
- Reduce the lengthy approval process for opening new branches and offering new products and services. Clarify regulator responsibilities as they apply to overlapping duties, multiple approvals, and other administrative jurisdictional issues.

- Harmonize capital requirements for foreign bank branches with those for domestic banks.

Other banking recommendations

Regulators would also benefit the sector as a whole by

- Allowing foreign banks greater access to China's debt and equity markets.
- Allowing foreign banks to offer customers more products and services, such as credit and debit cards supported by payment brands of their choice, as well as online banking.

Securities

As China's securities sector expands, China's ability to manage this growth can be aided by permitting openings in the following areas (which will be laid out in greater detail in the following section):

- Remove or raise the 33 percent cap on foreign ownership in joint-venture securities firms and the 49 percent cap on foreign ownership of asset-management firms.
- Eliminate ownership restrictions on foreign banks trading RMB and RMB-linked products.
- Expand the role of foreign institutions in investing in sophisticated financial products such as asset-backed securities and futures and allow foreign brokerages to participate in the derivatives market.
- Lower capital requirements for securities firm participation and for participation in the futures market.
- Allow foreign firms to sell and trade A-shares.
- Increase transparency and put in place a transparent road map, on an agreed timetable, to provide foreign securities firms the ability to engage in a full range of securities activities.

Ownership restrictions and capital requirements

Banks continue to drive financial intermediation in China, limiting opportunities for other financial vehicles. While China's stock market has grown by leaps and bounds in recent years, sectors that are traditionally cornerstones of countries' financial systems, such as markets for corporate bonds, asset-backed securities, and derivatives, remain underdeveloped.

Key to improvement in this sector is removing or raising the current 33 percent cap on foreign ownership in joint venture securities firms and the 49 percent cap on foreign ownership of asset-management firms.

In addition, there are limitations on the activities that foreign firms are permitted to carry out and offer their clients. Foreign securities firms should be able to offer a full range of financial activities, including trading in and underwriting all tradable classes of securities, including A, B, and H shares. Foreign firms should also be allowed to participate on an equal footing in China's less-developed financial sectors, including futures and derivatives markets. Foreign expertise and capital have the potential to play a pivotal role in accelerating the development of these markets, and foreign players can also assist in creating new products and services while demonstrating the benefits of high corporate governance standards. This would benefit both China's economy, for issuers, investors and markets alike, as well as provide competition that will strengthen domestic securities companies.

Futures and asset-backed securities

Chinese regulators should follow through on public pronouncements of their intentions to liberalize and diversify their financial markets. To create the balanced economy that its leaders seek, Chinese regulators, including CSRC, PBOC, and SAFE, should develop regulations that will promote the growth of the corporate bond, futures, asset-backed securities, and other derivatives sectors, and encourage Chinese investors to invest in these new markets. The proliferation of investment and lending options for individuals and financial institutions will contribute to the more efficient allocation of capital and provide new market opportunities for Chinese and foreign firms alike.

Opening investment in financial derivatives and in a greater variety of bonds, including asset-backed securities, will expand investors' options and China's capacity to manage increasingly sophisticated financial instruments. Foreign firms already possessing proven expertise in these areas can facilitate this process and lifting capital requirements and raising ownership limits can allow this expertise to grow in China.

Insurance

Still outstanding are several insurance-related concerns. Areas where progress is necessary include:

- National treatment in approval processes including concurrent, rather than consecutive, issuance of branching licenses for both life and non-life foreign insurers.
- Fulfillment of 2003 JCCT and 2007 SED commitments to approve and issue licenses for wholly foreign-owned non-life insurance subsidiaries.
- Allowance for all qualified companies to provide political risk insurance for Chinese companies with exposures outside of China.
- Companies have also repeatedly requested that CIRC release draft regulations for comment.

Moreover, several important insurance sectors remain closed to foreign investment. These include the so-called "statutory insurance" sectors, such as mandatory third-party auto liability insurance. In light of the growing number of vehicles on the road, liberalization of this sector will ensure the inflow of expertise and quality products and services that will help forestall a rise in insurance claims and premium costs. Sudden increases of claims and premium could overwhelm the capital resources of Chinese insurance companies. In sum, further liberalization will ultimately benefit China's companies and its society.

Electronic payments and consumer financial services

The opening of the electronic payments sector to foreign and domestic participants would benefit all sides. A competitive payments system will serve China's overall economic interest by enhancing the infrastructure and stability of the country's banking industry, spurring innovation, promoting retail industries, and stimulating consumer spending.

To realize this system, progress is necessary in a variety of areas. PRC authorities can facilitate progress by:

- Issuing final regulations to implement China's year-five WTO commitment to lift all restrictions on payment and money transmission services.
- Meeting China's year-five WTO commitment to open the domestic market to 100 percent foreign-owned electronic payment card systems.
- Adopting international technical standards for electronic payments.

US electronic payment providers, through years of experience and investment, have developed fast, secure, and reliable worldwide networks for electronic payments. CUP, alternatively, uses a single settlement and clearance network that fails to produce the redundancy necessary to increase the overall stability of the payments system in China. An open and competitive system would benefit the industry by exposing it to global best practices, industry innovations, and access to global interoperability standards. Financial institutions in China that rely on electronic payment networks for payment services would benefit greatly in a more competitive market, and a more secure transactions network.

A greater variety of transaction networks and electronic payment providers should be available for financial institutions to choose from when issuing RMB-denominated or dual currency credit and charge cards. This would enhance the options available for banks and other financial institutions when offering credit and currency services. The benefits of an open and competitive electronic payments system would be felt by Chinese consumers as well.

Meanwhile, Chinese consumers are keen on financial services with easy access, greater convenience, safety, and cost savings. Non-financial institutions, such as retailers, can make greater contributions in this area by sharing resources and providing complementary services to those that financial institutions offer. Retailers' participation in providing financial services, especially by providing money services such as money transfers and traveler's check cashing, can also stimulate consumer spending.

One of China's stated macroeconomic goals is to increase domestic consumption, a goal that is shared by the United States. An open and competitive market for electronic payments and for consumer financial services would clearly be a positive step in that direction.

Rating agencies

Despite PRC regulatory efforts to lay out a clear foundation for the operating landscape of CRAs in China, the process is not yet complete. The flow of accurate financial information would be greater facilitated if authorities:

- Lift the restriction on 49 percent foreign ownership of established credit rating institutions and clarify rules relating to foreign ownership requirements.
- Adjust or ease regulatory burdens and verification requirements for CRAs.

Improving transparency

Transparency is an important part of a robust financial sector, and one that PRC regulators must take seriously. Though regulators such as CSRC have attempted to increase transparency by involving industry in the review process for new regulations, draft regulations are often released for short periods of time – a week or two, or a month – that are insufficient given the complexity and detail of the regulations involved. Improved transparency will serve all sides by allowing regulators a more steady dialogue with affected industries and ensuring that outcomes take into consideration established, international-standard best practices. It remains to be seen whether the transfer of supervision of securities markets from NDRC to CSRC will signal broader changes. As authorities move toward financial stability facilitated by foreign cooperation, having a transparent road map and agreed-upon timetable to provide securities firms with the ability to engage in a full range of securities activities will be necessary in order for these authorities to make the most out of the openings they provide in good faith.

Financial services-related laws and regulations that should be released for adequate public comment periods prior to finalization include the insurance and pension laws and pending bank card regulations. These are just three of the pending laws and regulations in many financial services sub-sectors that would benefit from improved transparency.