Engage China

July 2, 2014

The Honorable Jacob Lew
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Lew,

The **ENGAGE CHINA**[1] coalition thanks you for your continuing efforts to strengthen one of the most important bilateral relationships in the world today – the U.S.-China economic relationship. In anticipation of your participation in the upcoming Strategic and Economic Dialogue meetings in Beijing, we write to call your attention to the critical importance of a more open market and level playing field for foreign participants in China's financial services marketplace.

In our view, one of the most fundamental and important reforms necessary for the United States to harness the job-creation power of a rapidly growing China – and for China to achieve the important goal of a more internally driven, consumer-focused economy – is accelerated modernization and liberalization of China's financial system. The world's second largest and fastest growing economy continues to be supported by a financial system inhibited by a number of policy and practice issues. For example:

- China's financial system remains highly bank-centric, with banks intermediating more than three-quarters of the economy's total capital, compared to about half in other emerging economies and less than 20 percent in developed economies.

- Non-commercial lending – or "policy lending" – to state-owned enterprises continues. As a result, the stock of nonperforming loans on banks' balance sheets remains high.

- Off-balance sheet and non-bank lending through trust companies, especially to local government run state-owned companies, has greatly expanded and is largely unregulated.

[1] **ENGAGE CHINA** is a coalition of twelve financial services trade associations united in our view that active engagement and cooperation between the United States and China remains the most constructive means of ensuring that the citizens of both nations mutually benefit from the growing bilateral economic relationship.

- China's banks remain undercapitalized compared to western counterparts and lending practices, risk management techniques, new product development, internal controls, and corporate governance practices remain problematic.

- Supervision and regulation of the financial sector remains opaque and is applied inconsistently.

- China's equity market, the world's sixth largest by total capitalization, is also one of the most restrictive in terms of foreign participation. Foreign investors currently hold only about 1.5 percent of China's domestic share market and can only invest in Chinese companies through funds managed by brokerage firms, banks, and other financial institutions.

- Despite significant growth since 2008 and especially more recently, China's bond market remains comparatively small and underdeveloped. The big five state-owned banks hold over 60 percent of all outstanding bonds, other state-owned entities hold another 30 percent, and 95 percent of all corporate issuers are state-owned enterprises.

- Low penetration of insurance and pension products creates unmitigated risks and undermines investment and family security, which in turn creates unproductive precautionary savings. Currently less than 0.1 percent of Chinese long term assets are in any formal pension plan such as the Enterprise Annuity and/or Group Annuity. There are currently no tax incentives either to the employee or the employer to encourage participation in any defined contribution pension program.

More fully developed capital markets would provide healthy competition to Chinese banks and facilitate the development and growth of alternative retail savings products such as mutual funds, pensions, and life insurance products. And by broadening the range of funding alternatives for emerging companies, more developed capital markets would greatly enhance the flexibility and, therefore, the stability of the Chinese economy.

The fastest way for any developing economy to acquire the modern financial sector it needs is to allow foreign financial institutions to establish in-country operations though the establishment of branches and wholly-owned subsidiaries, partnerships with domestic institutions, and cross-border mergers and acquisitions. U.S. financial institutions can share with China their extensive expertise and best practices with regard to products and services, credit analysis, risk management, internal controls, and corporate governance.

The U.S. financial services industry is encouraged by recent statements by China's senior leadership regarding its commitment to continued reform and modernization of China's financial system. We look forward to working with your Administration to ensure further progress on issues such as:

- The critical importance of open commercial banking, securities, futures, insurance, pension, and asset management markets to promoting the services- and consumption-led economic growth that China's leaders seek;

- The clear benefits to China of increased market access for foreign financial services firms – including allowing full ownership of banking, securities, futures, insurance, and other financial companies – and the introduction of broad financial sector expertise, technology, and best practices;

- The negotiation of a high-standard U.S.-China Bilateral Investment Treaty that creates certainty and open markets for investors in both markets;

- Furthering China's commitments to non-discriminatory treatment with regard to licensing, corporate form, and permitted products and services – for example, China should issue reports in advance of the annual S&ED meetings regarding applications and approvals of domestic and foreign-invested insurance providers for concurrent branch licensing;

- Non-discriminatory national treatment with regard to regulation and supervision – for example, U.S. insurance firms should enjoy the same opportunities with regard to Internet distribution of products and services that Chinese companies already enjoy;

- Regulatory and procedural transparency; and,

- Further increasing institutional investors' participation in China's capital markets by expanding the Qualified Foreign Institutional Investor (QFII) and Qualified Domestic Institutional Investor (QDII) programs.

By providing financial products and services that help China's citizens and businesses invest, insure against risk, provide for retirement, raise standards of living, and consume at higher levels, foreign financial institutions – including U.S. providers – would help China develop an economy that is less dependent on exports, more consumption-driven and, therefore, more stable and sustainable over the long-term.

Again, thank you for your continued work to strengthen the relationship between the United States and China. The **ENGAGE CHINA** coalition looks forward to working with you to ensure that American citizens, manufacturers, farmers, and services providers benefit from the increasingly important U.S.-China relationship.

Respectfully,

The Engage China Coalition:
American Bankers Association
American Council of Life Insurers
American Insurance Association
BAFT

The Council of Insurance Agents and Brokers
The Financial Services Forum
The Financial Services Roundtable
The Futures Industry Association
Insured Retirement Institute
Investment Company Institute
Property Casualty Insurers Association of America
The Securities Industry and Financial Markets Association

cc:

The Honorable Marisa Lago, Assistant Secretary for International Markets and Development, U.S. Department of the Treasury;
Sharon Yuan, Deputy Assistant Secretary for Trade and Investment Policy, U.S. Department of the Treasury;
Mark Sobel, Deputy Assistant Secretary for International Monetary and Financial Policy, U.S. Department of the Treasury
Robert Dohner, Deputy Assistant Secretary for Asia, U.S. Department of the Treasury