FANGDA PARTNERS
方達律師事務所

PRC FINANCIAL REGULATION

2023

Annual Report

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Preamble

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We look back into the year 2022 and see both challenges and opportunities. 2022 would be remembered as a turbulent year, regrettably and largely for the Russia-Ukraine conflict, global inflation and the impact of the pandemic, negatively affecting the markets. Despite all these challenges, 2022 would still be celebrated as the year of transition and rebirth, during which uncertainties on certain matters are gradually eliminated, while opportunities are gestating amidst challenges with brighter prospects in the near future.

The best way out is always through. Confronted with the complex and unpredictable international environment in 2023, we believe that Chinese financial industry will stay true to its founding principles, following the general guideline of "prioritizing stability while pursuing progress" and adhering to the aim of serving the real economy. Financial policies will be developed under regulation to support the "economic recovery" and hold on to the bottom line of risk prevention and financial security, continuing to build the financial regulatory and judicial system with Chinese characteristics.

To walk into the future in retrospect, the PRC Financial Regulation: Annual Report (2023) issued by Financial Industry Group of Fangda Partners comes in time. We have prepared this PRC Financial Regulation: Annual Report (2023) to provide forward-looking guidance for you, covering milestone events, main regulatory developments and outlooks in the sectors of banking, securities and futures, asset management/wealth management, FinTech and insurance and a special sector of green finance and carbon markets.

Finding certainty in the midst of uncertainty and helping our clients to achieve stable and long-term development are the unremitting pursuit of our Financial Industry Group of Fangda Partners. We advise both domestic and overseas clients on the most cutting-edge and complex legal issues involved in China's financial service sector. We are at the forefront of significant initiatives in such sector, leading the market's most groundbreaking transactions and new product structures. With our profound understanding of the market, we are able to provide creative solutions to our clients in a complex financial regulatory environment.

We believe that, as market participants, you may have your comprehensive and practical observation and understanding of the market. If you have any comments or suggestions on the content of this report, please feel free to contact us. We have been committed to China's financial service sector for many years and are looking forward to observing the market, facing the changes and identifying the future trends together with you and are willing to have your thoughts and feedback!

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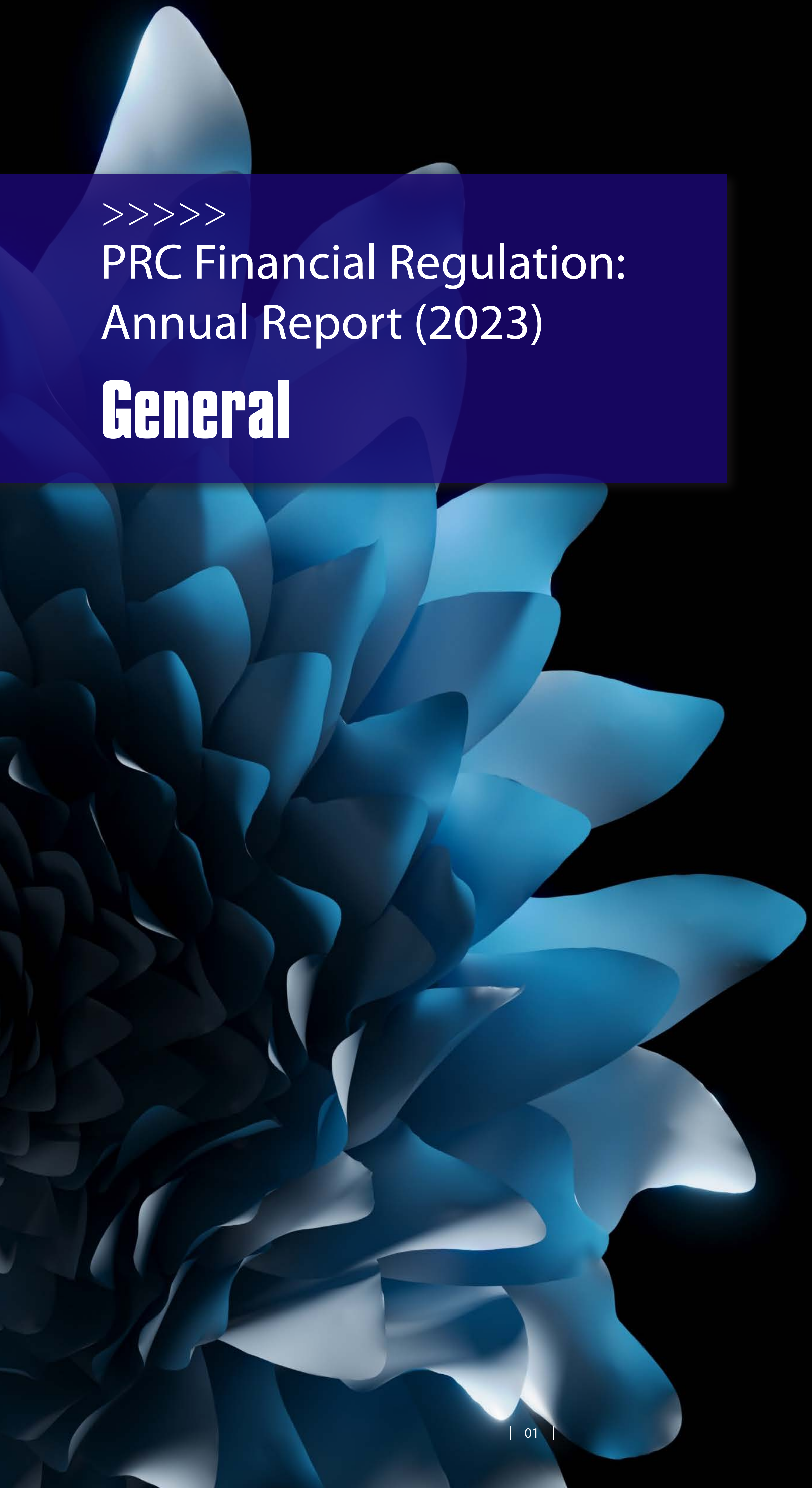

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PRC Financial Regulation: Annual Report (2023)

General

2022 Regulatory Milestones

January 4

The PBOC released the Financial Technology Development Plan (2022-2025).

March 17

Approval for CITIC Financial Holdings Limited and Beijing Financial Holding Group Co., Ltd. was granted; September 2: approval for Shenzhen Zhaorong Investment Holding Co., Ltd was granted.

April 6

The PBOC introduced the *Financial Stability Law* (draft for comments); in December, a further-revised version was submitted to the National People's Congress for review.

April 8

The *Opinions on Promoting the Development of Personal Pensions* was released, establishing a system for personal pensions; implementation followed in November with multiple detailed rules being issued.

April 20

The *Futures and Derivatives Law* was passed and came into effect on August 1.

From May onwards

Regulatory authorities issued policies covering the financing needs of real estate sector to promote and support the recovery and development of real estate sector.

From July onwards

Regulatory authorities approved the liquidation and restructurings of financial institutions including Xinhua Trust, Yi'an Property Insurance and some small banks.

July 7

The Data Exit Security Assessment Measures were released.

August 26

China and the US signed an audit and regulatory cooperation agreement; on December 15, the US announced that it could review the audit records of Chinese stocks listed in the US, temporarily lifting the 'delisting crisis' for Chinese stocks listed in the US.

October

UBS's fund distribution company began to offer services to the public through its digital wealth management platform.

December 14

The PBOC released the "Financial Infrastructure Supervision and Management Measures (Draft for Comments)".

December 30

The CSRC issued a notice on illegal cross-border business development of Futu Securities and Tiger Securities.

2022 Regulatory Mainline Review

01 Financial support for the real economy and economic recovery was implemented

In order to implement the top-level policy guideline of "stability in the forefront and progress in the midst of stability", regulators have introduced a series of policies and regulations oriented for real economy in 2022. Since the second half of the year, "promoting economic recovery" has been directly incorporated into policy discussion and evaluation.

Reducing direct costs and increasing efficiency are the focus of financial policies: the PBOC lowered the reserve ratio of financial institutions twice in April and December, so as to lower the capital cost and comprehensive social financing cost of financial institutions; the "Financial 23" issued by the PBOC and the SAFE aimed directly at pandemic control and financial service for social and economic development; the CBIRC has encouraged banks to reduce fees and concessions for clients and to strengthen insurance protection policies to provide relief for small and micro enterprises; and the CSRC has increased direct financing and implemented extension policies to help with the country's economic recovery.

Policies to promote economic recovery also focus on targeted investments in specific sectors. During the course of 2022 regulators have increased support by extending credit and insurance coverage to individuals adversely affected by the pandemic and to enterprises in industries and sectors that have also been badly hit; there are also various special refinancing loans to support important sectors such as agricultural production, energy supply, transportation, and universal retirement; and there has been support for expansion and regular issuance of real estate investment trusts (REITs). In addition, the loosening of policies related to real estate and "one to one" bank cooperation with key real-estate enterprises reflects the targeted financial policies.

As a basic financial policy, "moving from virtual to real and serving the real economy" has become even more important and vital as China recovers from economic setbacks in 2022.

02 The legal framework governing disposal of risky business takes shape and disposal of risks of institutions has been steadily implemented

Throughout 2022, there were a number of milestones aimed at resolving the major financial risks. At the institutional level, proper disposal of a number of risky financial institutions was either realized or achieving significant progress. For example, the risk disposal of five small-sized village banks came to a temporary end; the merger and restructuring of high-risk small and medium-sized banks including Liaoshen Bank, Zhongyuan Bank and related provincial agricultural and commercial banks were also completed; the financial licenses of Xinhua Trust, New Era Securities and New Era Trust either started afresh or eventually exited the market. Three financial holding companies were set up in 2022, which represents the official approval of licenses for financial holding companies granted for the purpose of preventing regulatory grey areas. Some RMB1.74 trillion of non-performing assets were disposed of between January and August 2022. Financing trusts and shadow banking businesses were under better control. Financial risks associated with HNA, Founder Group and a number of real estate enterprises have also been effectively controlled.

Regulators have also changed their approach to follow the general principle of "achieving overall stability, ensuring coordination, implementing category-based policies, and defusing risks through targeted efforts".

In the past, risk disposal was mostly done on a case-by-case basis, typically finding a solution which weighed up the interests of many parties. There was no common standard or predictable approach, sound market-based disposal tools, or clear legal provisions on liability apportioned among central, local and industry insurance funds. In April 2022, the regulators issued the draft *Financial Stability Law* and submitted it to the SCNPC for consideration in December. The draft *Financial Stability Law* establishes the basic principles of resolving and disposing of financial risks as determined by the market and governed by the rule of law. The draft also emphasizes the responsibilities of financial institutions and the role of the market in allocating resources. The draft also clarifies the coordination mechanism for stable financial development, responsibilities of financial institutions, authorities of the central and regional regulators, fund resources, and tools available for risk disposal.

The changes were in part brought about by the cases of Baoshang Bank and Anbang Insurance, where concerns were raised about the sustainability of the risk disposal strategy due to large-scale use of industry insurance funds. The draft proposes setting up a financial stability insurance fund as a "general reserve" under the control of the central government for responding to major financial risks and to generate resources for the following risk disposal works.

The Financial Stability Insurance Fund, included in the government work report in March 2022, has generated RMB 64.6 billion. There have been changes to the rules governing insurance guaranty fund and trust guaranty fund. Also, the case of Xinhua Trust, an initial practice of market-based risk disposal approach, indicates that the authorities are able to use the process of bankruptcy as an option to reduce risk. We expect to see a sound system to manage risk in the financial services sector.

03 Financial policies increasingly focused on the people

The first mention by regulators of "the political and people nature of financial work" happened in 2022, underlining the key idea that "finance is for the people" and that there should be a "people-centered" orientation of financial policies.

This "people-oriented" nature of financial work can be seen in a number of aspects of "inclusive" finance reforms: more loans for alleviating poverty; more loans for agriculture; more pilot zones involving "inclusive" finance reform (including Tongchuan of Shaanxi, Lishui of Zhejiang and Chengdu of Sichuan), which aimed at promoting transformation of resource-exhausted cities, rural revitalization and urban-rural integration development; supportive tools for loan extension and credit loan supportive plan for micro and small enterprises has also been modified to better solve problems and support development.

There has been more financial support for solving problems related to the public wellbeing, driven by policy of "ensuring the delivery of buildings and stabilizing people's livelihood". There has been more attention paid to the relief for real estate enterprises' difficulties as well as the reasonable housing loan needs of individuals. Government-subsidized rental housing has also developed at a fast pace, including exclusion of project-related loans out of the real estate loan concentration and issuance of pilot REITS. In addition, there has been a boost of financial services for new urban residents, reflecting the financial policy's concern for people's wellbeing in the urbanization process.

"Common prosperity" has been a core concept for regulators in 2022. For example, regulatory requirements such as netting of wealth management products, encouraging securities, funds, guarantees and other licensed institutions to reduce fees, and introducing more financial products (including personal pensions) are all dedicated to enrich safe and steady access for people to make financial incomes. Taking fund management as an example, in response to the problem of "fund managers making money but fund investors not making money", the *Opinions on Accelerating the High-Quality Development of the Public Offering Fund Industry* made it clear that the fund industry should "care all people in the nation", and incorporate environmental, social and governance responsibilities into all their operations, so as to reconcile economic profits with social benefits. Common prosperity has also impacted regulations governing remuneration in state-owned financial enterprises, securities companies and fund companies.

04 Financial Regulation system steadily progressed and strict regulation further developed

In 2022, the multi-dimensional financial reform proceeded in an orderly manner.

The foundations of China's financial regulatory regime were continuously improved. *The Futures and Derivatives Law* was enacted, and the second draft of *the amendment to the Company Law* was finally completed at the end of the year after a long deliberation, laying a solid foundation for deepening and innovating the governance on financial institutions and financial products. The reform of modern financial institutions is in full swing. The introduction of new regulations, including *the Administrative Measures on Related-party Transactions of Banking and Insurance Institutions*, *the Administrative Measures on Internal Control of Wealth Management Companies* and *the Measures for Supervision and Administration of Publicly Offered Securities Investment Fund Managers*, strengthened and improved the modern financial regulation system, setting out the bottom line of compliance for reform of financial institutions.

Other remarkable developments have happened to form the well-structured financial markets. These include: securities companies being granted with market maker licenses on the SSE STAR market; the mechanism of transfer of listing from the CBEX to the SSE/SZSE being implemented; the first industrial silicon futures on the Guangzhou Futures Exchange successfully launched; comprehensive reform of auto insurance; and the interconnection mechanism in the bond market being further developed.

While promoting the reform, innovation and development in the financial sector, the regulatory authorities did not relax their efforts to crack down on illegal and irregular activities. According to *the Report of the State Council on Financial Work*, from January to September 2022, the PBOC fined regulated institutions 521 times, with total fines amounting to RMB630 million; the CBIRC fined banking and insurance institutions some 3,200 times, with fines totaling RMB2 billion. In contrast, in the whole of 2021, the total fines imposed by the PBOC were about RMB540 million and the total fines imposed by the CBIRC about RMB 2.05 billion. As the amount of fine imposed by regulators in the first three quarters of 2022 has already exceeded or almost amounted to that in 2021, 2022 still witnessed strict financial regulation. Moreover, the law enforcement of the regulators has been continuously strengthened, and the most severe penalties were frequently imposed. For example, in March 2022, the CSRC revoked the business licenses of two securities investment consulting companies. It is also increasingly common for individuals to assume liabilities. There were several instances of individuals being banned from practicing in relevant industry for lifetime or serving as senior executives. The regulators also paid more attention to some new businesses in 2022. Fines were imposed on wealth management business of banks' wealth management subsidiaries and credit card repayment policy loan business of insurance companies for the first time.

With the digital transformation of services by financial institutions, regulators have turned their attention to data and internet finance regulation. CBIRC imposed a total fine of RMB87.6 million on 21 national domestic banking institutions for violating EAST data rules, and the CSRC issued warning letters to both CMB and its applicable personnel in relation to a cyber-security incident, which both demonstrate the strong supervision on financial institutions' data governance. Policies were introduced to control commercial banks' online loan businesses and to stop establishment of new online microfinance institutions. The aim is to have a sound and standardized regulation over online finance, reflecting regulators' emphasis on the regulated development of internet finance.

05 Institutional opening-up accelerated and cross-border supervision broke through

The financial sector in 2022 has been showing a "prudently-open" posture. In terms of domestic market and products, the interbank and exchange bond markets are gradually being opened up. *The Announcement on Matters Relating to Further Facilitating Investments in Chinese Bond Market by Overseas Institutional Investors* coordinated and synchronously advanced the opening-up of interbank and exchange bond markets, and explored the establishment and perfection of an inclusive institutional arrangement that is compatible with multi-level custody. The promulgation of *the Amended Administration Measures on Securities Registration and Settlement* and the launch of the "delivery versus payment" (DVP) reform in December helped to boost the confidence of international investors when it comes to efficiency of domestic settlement and security of funds. The futures market is also orderly opening up, underpinned by the issue of the Futures and Derivatives Law, the official launch of the system for QFIIs to invest in domestic futures options in September, and the announcement by CSRC to permit foreign traders to participate in the trading of several specific domestic varieties (including soybean meal, soybean oil options and futures). In August, the PBOC included Deutsche Bank and Société Générale into the list of financial institutions under its carbon emission reduction supporting instruments, indicating that the opening-up of the green finance sector is no less important.

At the institutional level, several foreign investors had their applications accelerated or approved. Schroders BOCOM Wealth and Goldman Sachs ICBC Wealth obtained approval for operation in the first half of 2022, and the preparation for the establishment of the joint venture financial management company by ABC and BNP Paribas obtained approval in October, marking the launch of joint venture financial management business by all the "Big Five Banks". With respect to the fund sector, Manulife TEDA became the first wholly foreign-owned fund management company, by increasing its shareholding. Fidelity and Neuberger Berman finally obtained their business licenses and started operation and the fund distribution company of UBS officially opened and launched its wealth management online platform. There was also considerable progress with respect to the approval procedure of foreign investment in the banking and securities industries.

There has been greater institutional link-up. The domestic and overseas capital markets have become more closely connected. Cross-border investment and financing channels were broadened. A policy framework for banks' overseas loans featuring integration of RMB and foreign currencies was established, bringing the banks' overseas RMB loans and foreign exchange loans under one unified management. The scope of securities involved in the Shanghai-Hong Kong/ Shenzhen-Hong Kong Stock Connect was expanded, and ETF via Shanghai-Hong Kong Stock Connect were officially launched.

Several Chinese listed companies issued Global Depository Receipts (GDR) in Switzerland, the United Kingdom and elsewhere in Europe.

Meanwhile, the integration of China's capital market into the international market was promoted, and China actively and deeply participated in global campaign on governance in respect of financial institutions. On August 26, China and the United States signed a cooperation agreement in relation to the auditing and supervision of cross-border listed companies, empowering the US Public Company Accounting Oversight Board (PCAOB) to inspect and investigate Chinese companies. This means that the long outstanding issue of reviewing the audit working papers of listed China concept stocks has finally been settled, which should make it easier for Chinese companies to avoid being included on the "pre-delisting list" by the SEC and facilitate the future listing of Chinese companies in the US.

Along with these developments, macro prudential regulation on cross-border financial activities has been strengthened. In December, the CSRC issued formal remedial notices to two cross-border securities service providers, Futu and Tiger respectively, reflecting the regulator's official action against cross-border financial services.

Data export remains a major pain point for companies when it comes to compliance: *the Cybersecurity Review Measures (2021)* and *Security Assessment Measures for Outbound Data Transfers* (respectively in February and September), and other applicable rules and guidelines were also published for comment. These indicate the desire by the authorities to refine and improve the regulations surrounding data export. In the offshore listing sector, national network and data security become the top priority. Many companies planning to list abroad have applied for cyber security review to the CAC under the new rules, following the case of one internet company which had wanted to list and been rejected on cyber security grounds by the CAC. The CSRC also again emphasized the "onshore requirements" for working drafts and archives in the offshore listing by domestic enterprises, through the publication of the *Provisions on Strengthening Confidentiality and Archives Management of Overseas Securities Issuance and Listing by Domestic Enterprises (Draft for Comment)*.

06 The digital transformation of the financial sector continues apace, and the strategic position of regulatory technology confirmed

Over the past year, the digital transformation of financial institutions has continued apace. With the clear instruction from *Fintech Development Plan (2022- 2025)* issued by the PBOC at the end of 2021 to "accelerate the digital transformation of financial institutions", *the Guiding Opinions on the Digital Transformation of Banking and Insurance Industries* issued by CBIRC in January 2022 provided constructive guidance on how these institutions should go about their digital transformation and how banks and insurance companies should strengthen financial technology support in the next few years. According to the Guidance, CBIRC's local bureaus put forward requirements for banking and insurance institutions in terms of how they should structure their FinTech operations, how to put in place risk management controls and so on. In February, the CSRC, together with the PBOC, the SAMR and CBIRC, jointly issued *the 14th Five-year Development Plan for Financial Standardization*, and issued several financial industry standards to standardize the internal interface of securities and futures business, unify core business terminology, and improve their data security governance. The CSRC also actively implemented *the 14th Five-Year Plan for the Scientific and Technological Development of the Securities and Futures Industry* released in 2021.

Regulatory technology, which encompasses technology used to monitor and regulate activities in the financial services sector, is another area that has received a lot of attention over the past year. "Improving the basic regulatory system for FinTech, and striving to create innovative FinTech regulatory tools that are inclusive and prudent" and "accelerating the all-round application of regulatory technologies, and enhancing the formation of digital regulatory capacity" were statements made in the *Financial Technology Development Plan (2022-2025)*, which shows an increasingly important role of regulatory technology. Currently regulatory technologies have been applied to fields like anti-money laundering, related-party transactions monitoring, regulatory reporting and the protection of financial consumers' rights and interests, and we can expect more developments along these lines to broaden the activities covered by financial regulation.

The year 2022 also saw greater use of the "regulatory sandbox" (a regulatory tool for financial technology innovation) as local authorities issued announcements one after another on the completion of tests of pilot tools (including some products applicable to online banking) in the previous two years. More pilots were launched, including those for capital markets, which is approved by the CSRC and more challenging. The pilots also expanded to a number of provinces and regions, including Heilongjiang, Hunan and Yunnan. Compared with the previous tools that concentrate on the regulations of financial institutions (e.g. anti-money laundering, risk control, etc.), the new pilot programs have introduced a wider range of matters falling within the ambit of regulations, such as green finance, rural finance and internet finance.

Regulators have demonstrated their tolerance to new innovative technology that may be of value to the financial services sector, including "Web 3", "NFT", "Metaverse" and the like, but still aiming to prevent illegal fundraising. This is in sharp contrast with the straight ban on crypto currencies reflected in a few rules issued in 2021.

07 Platform economy: "rectification campaign" completed, the "normal supervision" era arrived

The "platform economy", by which is meant the online operations offering financial services, is also moving into a new phase. In the past few years, regulators have launched several "rectification campaigns" (meaning requiring companies to improve their operations/compliance/internal control through remedial measures to eliminate bad practices) on the platform economy with respect to financial business, data protection, anti-monopoly and anti-unfair competition. For the purpose of anti-monopoly as well as prevention of "disorderly" (i.e. uncontrolled) capital expansion, the regulators held regulatory talks with 14 leading online platforms in 2021, and imposed the largest ever fine in China on a company for breach of anti-monopoly regulations. Regulators believe that their "rectification" campaigns have helped to eliminate illegal practices. Following that, the Political Bureau of the CPC Central Committee has directed to focus more on regular supervision of the platform economy in future, in a press released on 29 April 2022.

In the past year, there have been many references in national conferences and regulatory policies to the "orderly promotion and healthy development of the platform economy". At the end of 2021, the NDRC and other authorities issued *Several Opinions on Promoting Orderly, Healthy and Sustainable Development of Platform Economy*, which called for establishment and improvement of applicable rules to optimize the environment for the platform economy's development. *The Government Work Report of 2022* also put the "promotion of healthy development of internet finance" in the chapter of "coordinating to promote stable economic growth and economic structure optimization". Throughout the year, the special meeting of the Financial Stability and Development Committee (under the State Council), the State Council executive meeting and the Central Economic Work Conference all encouraged the healthy development of the platform economy.

In December, the CSRC clarified its regulatory policy on overseas listing of platform enterprises – "to promote the implementation of the reform of the overseas listing system of enterprises and to give green light to platform enterprises for overseas listing". Meanwhile, the general principle of "Two Unswerving" (i.e. to support both the public and private sectors) should help to inject confidence into platform enterprises, most of which are private enterprises.

In spite of the above, there are still some clear red lines for platform enterprises. They shall obtain relevant regulatory licenses if they are engaged in all financial activities (including payment services provided by platform enterprises). The intention is for the platform economy to move from innovation of business model to innovation of technology. As regulators require a separation of financial services companies from technology companies, internet companies have rectified and spined-off some of the financial services businesses, including exiting from certain investments in financial businesses. While the CSRC has given the "green light" to some platform companies to obtain an overseas listing, that also suggests that it will issue a "red light" to prevent those not up to standard from overseas listing.

Anti-monopoly legislation and enforcement have also been stepped up through the year. The revised *Anti-Monopoly Law* prohibits monopolistic conduct through the leveraging of data and algorithms, benefiting from capital strength and technological superiority, and imposing restraints on others. This indicates that such regulation has improved to a legislative level.

08 The "third-pillar" pension system in embryonic form

In 2022, there were several significant developments in terms of financial regulations and policies for China's private pension system (a scheme similar to the Individual Retirement Account in U.S.): in March, the *14th Five-Year Plan for the Development of China's Undertakings for the Aged and Elder Care Service System* was released, establishing the general policy of promoting the whole chain of pension finance products (such as payment, savings, wealth management, trust schemes, insurance and mutual funds) to support pension finance and realize a multi-level and multi-pillar pension system over the course of the next five years; and in April, the *Opinions on Promoting the Development of Private Pensions* was released, paving the way for the introduction of the "third-pillar" private pension system.

The *Measures for the Implementation of Private Pensions* jointly issued by five governmental departments in November is deemed as a milestone in the official implementation of China's private pension system. Following this, supporting rules and policies have also been issued: the *Announcements on Individual Income Tax Policies for Private Pensions*, which implements tax-deferral policy for private pensions; the *Interim Administrative Provisions on Private Pensions' Investment in Publicly Offered Securities Investment Funds*, which regulate private pensions' investments in mutual funds and the operation of such funds; and the *Interim Administrative Measures for Private Pension Services of Commercial Banks and Financial Management Companies*, and the *Circular on Matters relating to the Private Pension Business Conducted by Insurance Companies*, which set out requirements for the private pension business and products (e.g. wealth management, savings and insurance) of the financial institutions.

Along with the above rules and policies, the regulatory framework governing private pension-related financial services is starting to take shape. In December, regulators published lists of pension funds products and distributors (i.e. those selling pension schemes), and of commercial banks and wealth management companies, in part to help individuals to take advantage of tax benefits for the tax year of 2022. According to a notice from CBIRC, a pilot program involving four insurance companies was officially launched on 1 January 2023. The private pensions system, supported by its four "pillars", old-age wealth management products, pension target funds, old-age insurance and retirement savings, has taken its shape.

The implementation of this new policy also provides new business opportunities for financial services companies. Commercial banks have boosted their marketing of pension products. A lot of fund management companies have established a department of FOF. Guomin Pension Corporation, founded by 17 companies including several financial institutions, opened for business in March, being the largest of companies offering old-age insurance. With the supporting policies announced by CSRC in December, we expect there to be a flow of funds into individual pensions.

2023 Regulatory Outlook

01 Financial policies will focus on supporting economic recovery

Financial policies in 2023 will be devoted to supporting the real economy. Multiple flexible and targeted financial policies will be rolled out, in the greater cause of economic recovery.

In response to the outstanding issue of "insufficient domestic demand" revealed by the Central Economic Work Conference, expanding consumption will be a top priority for economic recovery in 2023. As regulators in 2022 have taken a number of measures to reduce the cost of consumption for the population so as to boost the economic recovery, we can expect to see more policies that will further support consumption and boost people's spending power through various tools such as consumer loans, credit cards, and payment discounts. In December, the CBIRC circulated an article stating that it will support financial capital to play an important role in residents' expenditure on housing, automobiles and other big-ticket items. This may involve reducing interest rates on automobile credit loans and mortgages.

In addition to boosting consumption, financing support for enterprises engaged in real economy will be maintained. We expect banks to continue to provide medium- and long-term loans to manufacturing, especially advanced manufacturing and strategic emerging industries such as new energy, artificial intelligence, bio-manufacturing, and quantum computing. The next phase may involve a range of measures of the CSRC for key industry chains of manufacturing, technology innovation, and private enterprises, including expanding the "registration-based" IPO system, making greater use of the futures market, and continuing to implement special support plans and tools for private companies to borrow through bond issues. All of this is intended to make greater use of resources. We are also looking out for new policies in the real estate market and investment of insurance fund to better contribute to the economy recovery.

In an article published in December 2022, the CBIRC mentioned that financial policies should be more closely integrated with fiscal and social policies, and we believe that the applicable financial policies in 2023 will reflect this principle. Under the background of increasing certainty of domestic environment, financial policies with strong political and social focus will be well integrated with economic and fiscal policies and offer great help to the economy recovery of China in 2023.

02 Financial rule of law will be strengthened

2023 is expected to be a big year for "the development of the rule of law governing financial services". In 2022, for various reasons, the legislative process of the NPC, the PBOC, the CSRC and the CBIRC fell behind schedule. Unfinished legislative tasks are expected to be gradually completed in 2023.

Many fundamental regulations relating to the top-level design of the financial system are expected to be finalized this year. These include the *Company Law*, the *People's Bank of China Law, the Commercial Bank Law*, the *Anti-Money Laundering Law*, the *Regulations on Local Financial Supervision and Management*, and the *Regulations on Non-Bank Payment Institutions*, which have been under public consultation for more than a year. In addition, according to the previous NPC legislative plan and the PBOC's official website, the *Insurance Law* and the *Trust Law* are also expected to be substantially amended.

In terms of the market and products, the *Measures for Real Estate Investment Trust* are listed in the CSRC's 2022 legislative plan as a "project that needs to be studied urgently and introduced at an opportune time", which should bring real estate investment trusts (REITs) into play.

So far as institutions are concerned, the CBIRC issued a number of regulations regarding non-bank institutions in 2022, including the *Measures for the Capital Management of Financial Asset Investment Companies (for Trial Implementation)*, the *Measures for the Administration of Finance Companies of Enterprise Groups*, the *Notice on Strengthening the Compliance Regulation of the Financial Leasing Business of Financial Leasing Companies*. We can expect regulations governing the businesses of these non-bank institutions to follow in 2023, including auto finance companies, the draft of which has been released to solicit for comments. The management measures for related party transactions, the measures for consolidated management and other rules of financial holding companies (especially the intra-group synergy, which is of great concern to the industry) may also be implemented in an orderly manner to build a complete regulatory framework for financial holding companies. In addition, the *Measures for the Administration of Business Qualifications of Securities Firms* are also expected to be issued to clarify the mismatch between the rules of *Interim Provisions on the Approval of Business Scope of Securities Firms* and the fast development of business qualifications of securities firms after the passing of the *Securities Law*.

In addition to the laws and regulations themselves, the top-level design of regulation is also progressing and developing. In December 2022, the People's Daily published two articles titled *Building a Modern Central Banking System* and *Strengthening and Improving Modern Financial Supervision*, proposing the building of a "modern" central bank and establishing a "modern" financial supervision regime under the centralized leadership of the Party Central Committee, centering on the people, based on China's national conditions, adhering to marketization and legalization, and drawing on the beneficial practical experience of international financial development.. What is exactly meant by "modern" and how to structure "modern" is not really clear, and it remains to be seen how the regulators will provide some more clarification. The reference in the Central Economic Work Conference to "deepening reforms in relevant domestic fields with active reference to relevant rules, regulations, administration and standards" as they relate to opening up to the outside world should be an important signal of approach of "modernization" (a slight hint can be seen in the revision of the *Company Law*). In short, 2023 may bring some profound changes on the supply side of finance, and a financial supervision regime based on the idea of the modern financial supervision can be expected to take shape gradually.

03 Prevention and resolution of financial risks to continue, with greater focus on market and legal solutions to take risk out of economy

There remains an ongoing challenge for regulators to resolve some major risk issues. The PBOC says that there were 316 high-risk institutions as at the fourth quarter of 2021, while the target is to reduce such number under 200 during the 14th Five-Year Plan. Coronavirus added to the numbers of institutions deemed to be at risk. We can expect elimination and reduction of risk to be a core policy for 2023, especially the prevention of "regional and systemic" risks.

How much focus there is on financial risk resolution and prevention depends on the approach being taken by each regulatory authority. The CBIRC is likely to focus on small and medium-sized banks and insurance companies (including small and medium-sized banks, rural banks, and trust companies). In response to the increase of risks in credit assets, more initiatives (including issuance of special bonds) are expected to be introduced in 2023 to support small and medium-sized banks to inject more capital, while there should be greater encouragement of mergers and acquisitions of small and medium-sized banks. In addition, in order to encourage banking institutions to increase their disposal of non-performing assets, the applicable ideas in the *Guidance on Leading Financial Asset Management Companies to Focus on the Main Business and Actively Participate in the Reform of Small and Medium-Sized Financial Institutions to Transform Risks* and the *Notice on Carrying out the Second Batch of Pilot Transfer of Non-Performing Loans* in 2022 are expected to be followed up in 2023. The intention is to further encourage financial asset management companies and financial asset investment companies to participate in the disposal of non-performing loans (including supporting some of the top five financial asset management companies to merge and restructure). Urban and agricultural commercial banks will be gradually involved as participants.

The CSRC will focus more on products and markets. It is looking to set up a sound system for risk identification in the futures market and to expand the powers of emergency measures and contingency disposal measures for futures exchanges. To combat securities crimes, it will take a zero-tolerance approach involving both administrative fines and criminal penalties.

Local governments will come under the spotlight to eliminate hidden risks within local debts and to strengthen their internal controls. There may be special measures to deal with government credit projects and to dispose, where necessary, of city investments.

The *Financial Stability Law* is expected to be formally debuted soon. The introduction of management measures for industry insurance funds of non-bank payment institutions is also worthy of expectation. In addition, the *Financial Infrastructure Supervision and Administration Measures*, released for public comment in late 2022, should provide a clear regulatory framework of license requirements for the financial infrastructures. The *Financial Infrastructure Supervision and Administration Measures* emphasize that foreign investment in such institutions is subject to foreign investment security review and also propose strict controls over the management of cross-border services provided via offshore financial infrastructures, especially for those involving fundamental financial security concern and having a strong spillover effect. In May 2022, the CBIRC issued an article stating that one of the tasks to prevent financial risks is to "actively respond to the spillover effects of macro policies and laws of developed countries", including the impact of financial policies of Western countries, and "long-arm jurisdiction" sanctions. In short, national financial security is included in the scope of supervision as an important component of risk prevention.

04 Institutional opening-up will be promoted at the highest level

The Central Economic Work Conference held at the end of 2022 announced that "greater efforts should be made to attract and utilize foreign capital". Against the background of the gradual recovery of the economy following the adjusted and optimized COVID-19 prevention policy and the significant increase in the certainty of the domestic political and economic environment, we believe that in 2023, China's financial policies will continue to be geared towards greater opening-up.

What we can expect is the introduction of rules, regulations, administration and standards that conform with internationally accepted rules which will lead to achieving the "institutional opening-up strategy" on systemic innovation. A good example can be found in the ESG/green finance area: the International Financial Reporting Standards Foundation (IFRS Foundation) executed a memorandum of understanding (MOU) with the PRC Ministry of Finance at the end of 2022, agreeing to set up an office of the International Sustainability Standards Board (ISSB) in Beijing sometime in mid-2023. The ISSB aspires to promote the promulgation of a set of global standards for ESG reporting. Compared with China's cautious attitude towards collaborating with international organizations in the past, the execution of the MOU signals the desire to incorporate ESG standards in many areas of China's economic and corporate activities. In addition, the project to integrate Greater Bay Area into a financial hub, and the early moves towards establishing the "Carbon Connect", as well as the step-by-step improvement of carbon trading (including carbon allowance trading and carbon credit trading) should help bring about the gradual alignment of China's carbon emission allowance processes with international practice.

We expect to see other more ambitious moves towards opening-up. For example, the SAFE announced that from January 3 2023, the trading hours of the interbank foreign exchange market will be extended to 3:00 am of the next day to cover more trading hours of the markets in Asia, Europe and North America and to further enhance the attractiveness of RMB assets.

The "cross-border connect" regimes will continue to be put in place. Targets (such as expansion of the scope of eligible stocks, optimization of the trading calendar) will be set for the Shanghai-Hong Kong/Shenzhen-Hong Kong Stock Connect and the Swap Connect (i.e. a new interconnection channel between Hong Kong and the Chinese Mainland, allowing international investors to trade and clear onshore RMB interest rate swaps in the Chinese Mainland without changing their existing trading and settlement practices) is also expected to be launched. By contrast with the difficulties faced by foreign-invested financial institutions in 2022 (especially the first three quarters) to access the China market, there should be progress in processing applications through 2023.

With the development of high-quality opening-up, foreign-invested financial institutions can expect to operate under stricter conditions for operation stability, qualifications and professionalism.

Moreover, cross-border regulation/enforcement is tending to be mature, making the opening-up efforts more challenging. We can expect that, as a result of the agreement between China and the US over the auditing of US-listed Chinese companies, the path towards US listings will be revived. However, at the same time, the regulations governing cross-border data transfer may have an impact. Businesses should look out for revisions to the *Provisions on Strengthening the Confidentiality and Archives Management for the Overseas Securities Issuance and Listing of Domestic Enterprises*. The procedures for review and approval of overseas listing of red-chip and variable interest entities (VIEs), which have been under consideration for some time, are expected to be formally clarified.

05 Current financial policies will continue to be implemented with "Stability is the priority"

The goal of financial regulation is to ensure the long-term stability as well as development of China's financial system. We believe that the interim and time-specific measures (mainly the measures to promote economic recovery) to be launched by regulatory authorities in 2023 to serve for social effects and economic planning will not affect the continuous high level of stability and consistency of the major policies on the long-term development of financial system regulation that have been previously established.

Institutional governance is a key priority and will be improved in an orderly manner in 2023. As the last outcome of the *Three-year Action Plan for Improving Corporate Governance in Banking and Insurance Industries (2020-2022)*, the new version of *the Measures for the Regulatory Evaluation of Corporate Governance of Banking and Insurance Institutions* was officially implemented at the end of November, drawing on three years' experience in the regulatory evaluation of corporate governance. The Measures accurately match plenty of governance rules issued in recent years and specify subsequent annual evaluation arrangements, which achieved the effective transition from "policy-based" to "system-based" governance evaluation mechanism. In addition, the Measures include non-banking financial institutions in the evaluation process for the first time, indicating the expansion of the governance scope of the banking and insurance industries in 2023. The CBIRC has also stated that it will continue the previous rectification activities against the cross-regional business operation of financial institutions. It is expected to promote the realization of the classified and hierarchical management of business permits of financial institutions in 2023. Under the securities regulation system, the CSRC will in 2023, as promised, comprehensively carry out a new round of three-year action plan to promote the quality of listed companies.

We can expect more efforts by regulators to ensure that individuals have their consumer rights protected. The protection may have rich meaning in a new era laying more emphasis on the interest of the people. In terms of legislation, the individual consumer protection framework will be further improved and the *Administrative Measures for Protection of Banking and Insurance Institution Consumers' Rights and Interests* will come into force on March 1, 2023, effectively bringing together the specialized legislation for the banking and insurance sectors and the former rules stipulated by the PBOC. We can also expect to see the release of *Measures for Administration of Consumer Suitability of Banking and Insurance Institutions* first for public consultation and then formal promulgation. This should complete the regulatory environment for banking and insurance financial consumer protection. In particular, the CBIRC stated in early 2023 that, under the principle of "taking the interest of people as priority", it is necessary to further establish a "grand consumer protection system" in the future, and it would clarify the division of responsibilities for consumer protection between ministries and departments, strengthening their coordination and cooperation, and continuing to give play to the role of financial regulation as a coordination mechanism for consumer protection. We can expect that in 2023 the PBOC, CSRC and CBIRC will take actions to coordinate regulatory cooperation and even unify the law enforcement in cross-area consumer protection (such as fund distribution by banks).

In addition, some medium to long-term policies based on macro decisions, though not expected to have immediate market effect in the short term, will still be actively implemented. Looking further ahead, watch out for regulations in 2023 governing carbon allowance trading and green finance, through *the Interim Regulations on the Administration of Carbon Emission Allowance Trading*. The China Certified Emission Reduction (CCER) is expected to restart for the first time since its suspension in 2017; and the guidelines for green finance as they apply to different financial institutions may be issued. With respect to elderly care, in addition to the continuous support from the third pillar (personal pensions), the rest of the elderly care infrastructures as well as support for financing of elderly care institutions will also be gradually put in place.

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Banking

2022 Regulatory Milestones

January 10

The China Banking and Insurance Regulatory Commission (CBIRC) published the Administrative Measures on Related-party Transactions of Banking and Insurance Institutions.

April 28

The CBIRC published the *Notice on Regulating and Promoting the Development of Commercial Pension Financial Services*, providing guiding principles on commercial pension financial services. On July 15, the CBIRC and the People's Bank of China (PBOC) published the *Notice on Launching the Pilot Program of Specific Elderly-care Deposits*. On November 17, the CBIRC published the *Interim Management Measures on Individual Pension Businesses of Commercial Banks and Wealth Management Companies*, specifying the scope of and requirements on individual pension business of commercial banks and wealth management companies.

June 1

The CBIRC published the *Guidelines for Green Finance in Banking and Insurance Industries*, introducing ESG requirements in its regulations for the first time.

June 20

The CBIRC and the PBOC published the *Notice on Further Promoting the Standardized and Sound Development of the Credit Card Business*.

July 12

The CBIRC published the *Notice on Strengthening the Administration of the Internet Loan Business of Commercial Banks and Improving the Quality and Efficiency of Financial Services*, further regulating internet loan business (such as adding new rules on utilization of loans) and extending the transitional period.

November 11

The PBOC and the CBIRC revised the *Administrative Measures for Acceptance, Discount and Rediscount of Commercial Drafts*.

November 11

The CBIRC sought public comments on the *Banking Regulation Law (Revised Consultation Paper)*.

November 21

The PBOC and the CBIRC jointly held a symposium on credit businesses with the main commercial banks, providing a loan support scheme of RMB200 billion to six main commercial banks to ensure housing project delivery and other public welfare.

November 28

The CBIRC revised the *Administrative Measures on Risks of Off-balance-sheet Businesses of Commercial Banks*.

December 26

The CBIRC published the *Administrative Measures for Protection of Consumers' Rights and Interests by Banking and Insurance Institutions*.

December 29

The CBIRC sought public comments on the *Administrative Measures for Automobile Finance Companies (Consultation Paper)*.

December 29

The CBIRC sought public comments on the *Administrative Measures for Custody Business of Commercial Banks (Consultation Paper)*.

2022 Regulatory Mainline Review

01 Banking sector instructed to stabilize the economy and as part of policy to protect people's welfare

Protecting people's welfare is a central tenet of government policy, especially during the pandemic of 2022 and as China emerges from the consequences of COVID-19. In particular, regulators have instructed banks and financial institutions to support the freight and logistics sector to make sure that goods continue to be delivered and people can rely on receiving the goods that they need. During lockdown, as freight and logistics companies were adversely affected, banks and financial institutions were encouraged to be lenient in enforcing any loans that were outstanding as well as to extend credit.

On April 15, the CBIRC published the *Notice on Financial Support for Freight Logistics to Ensure Smooth Operation* and on April 18, the PBOC and the State Administration of Foreign Exchange (SAFE) published the *Notice on Strengthening Financial Services for COVID-19 Containment and Socio-Economic Development*. Both of these focused on transportation and logistics companies as well as truck drivers that might have difficulties in repaying loans due to COVID-19 and encouraged financial institutions to extend or renew loans, as appropriate. Financial institutions were also encouraged to make it easier for taxi drivers, truck drivers, e-commerce business owners, and other self-employed individuals to take out loans, in reference to the policies for individual businesses and micro and small businesses. In response, many banks have introduced some measures to assist. The Postal Savings Bank of China has offered credit support enhancement and special repayment policies, as well as the opening of "green channels"; and the China Everbright Bank is providing further financial support and services to freight and logistics industries.

The CBIRC has encouraged banking institutions to support local governments to promote the policies that will "ensure the housing project delivery, people's livelihood, and stability", including but not limited to, policy banks offering special loans for "delivery of buildings". Six state-owned commercial banks are increasing financing to real estate developers. The CBIRC and the PBOC published the *Notice on Strengthening Financial Services for New Urban Residents*, which instructs banks and other financial institutions to help finance employment, entrepreneurship, housing, education, elderly care, and other fields for "new urban residents". All of the above shows that the regulators pay close attention to the financial support in both economy stabilization and people's welfare.

02 Commercial banks playing a growing role in the growth of individual pensions

There have been a number of regulations issued in 2022 to build up the regulatory regime for individual pension, such as the *CBIRC Notice on Regulating and Promoting the Development of Commercial Pension Financial Services*, the *Implementing Measures for Individual Pensions*, and *the Interim Management Measures on Individual Pension Businesses of Commercial Banks and Wealth Management Companies*. These have great impacts on banking industry.

Commercial banks play an important role in China's individual pension regime. A qualified individual may open a dedicated pension fund account with a commercial bank for his/her individual pension. Such account is the source of funds for asset management or wealth management product investments, investment earnings collection as well as any taxes payment in relation to individual pension. Commercial banks can also offer other services linked to the pension fund accounts, including general advisory services and other types of banking accounts services, as well as financial products distribution. Since the services for individual pension funds are increasingly popular, the total levels of pensions deposited in bank accounts can be substantial, offering huge potential for banks but also leading to considerable competition.

Special attention has been paid to the handling of deposits devoted to the care of the elderly. A pilot was launched in November 2022, under which savers of elderly care deposits would earn higher interest than those of common deposits, and can benefit from preferential tax treatment when investing such deposits using individual pension funds.

Following the launch of the regulatory regime of individual pension as well as relevant services and products, how to keep individual pension businesses in good operation and compliance status remains a long-term concern for banking institutions.

03 The risk solution in financial sector promoting resource integration in banking industry, and gradually shifting focus to early risk prevention

China's regulatory environment is shifting from providing solutions in the wake of financial risk outbreak to risk prevention, to try to stop problems from happening in the first place. There was a particular focus in 2022 on the risk management adopted by small and medium-sized banking institutions. There were also some restructurings. For example, in January, the first rural credit cooperatives reform was launched in Zhejiang; in July, the businesses and assets of Liaoyang Rural Commercial Bank (辽阳农村商业银行) and Liaoning Taizihe Rural Bank (辽宁太子河村镇银行) were taken over by Shenyang Rural Commercial Bank (沈阳农村商业银行); and in November, local state-owned funds were injected into Huarong Xiangjiang Bank (华融湘江银行), which then changed its name to Hunan Bank.

Disposal of non-performing loans was another area of focus for regulators. In 2022, regulators turned their attention to asset management companies (AMCs), and provided guidance to AMCs on the acquisition of non-performing loans from small and medium-sized financial institutions. These guidelines included certain supportive policies for AMCs on acquisition of non-performing assets and the issuance of financial bonds. In addition, the guidance encouraged AMCs to offer professional advice to local small and medium-sized financial institutions on how best to dispose non-performing loans. In all, the intention is to promote better coordination within the banking sector and to provide different mechanisms for early financial risk prevention.

One area of concern for the main regulator, the CBIRC, was shareholdings and "related-party" transactions. The *Administrative Measures on Related-party Transactions of Banking and Insurance Institutions* promulgated in January 2022 redefined who "related" parties were, looking at the actual situation (under the principle of "essence is more important than form"). These Measures define bank subsidiaries as "related" parties, to prevent banks from transferring interests improperly through their subsidiaries. In addition, other commercial banks that have affiliated relationships with such bank also fall into the scope of "related" parties of such bank under these Measures, aiming to prevent shareholders from illegally obtaining bank funds through implicit holding of equities in multiple banks.

In November, the CBIRC published the revised *Measures on Supervision and Evaluation of Corporate Governance of Banking and Insurance Institutions*, focusing on typical corporate governance problems such as shareholder manipulation and insider control. More specifically, regulators will pay special attention to banking and insurance institutions rated as D or below (i.e. poor) in terms of corporate governance, instructing them to improve their corporate governance and to stop risky behaviors.

04 Opening-up of banking sector continuing, and cross-border business developing with high-quality

While continuing to open up the banking sector to foreign competition remains a key objective for China's policy makers, a number of changes happened during 2022. In 2022, regulatory policies continued to promote a high level of opening up of the banking sector, and favorable policies continued to be put into practice. Following the principle of having the same regulatory environment for both domestic banks and foreign banks operating in China, the CBIRC amended some provisions of the *Implementation Measures on Administrative Permission Matters for Foreign Banks* to continue the process of convergence with the *Regulations on Administration of Foreign Banks*, continuing the introduction of measures to further open the banking sector. The *Measures for Comprehensive Supervision and Rating of Foreign Bank Branches (for Trial Implementation)* is another step towards standardization of the supervision of foreign banks. It revised the existing rules in the form of a higher-level normative document. The *Measures for the Administration of Finance Companies of Group Companies*, amended for the first time since 2006, confirmed that a multinational group can establish its own foreign finance company in China to provide financial services to its members in China without having to set up such foreign finance company through a specific WFOE.

Foreign investors are responding well. For example, Dah Sing Bank gained approved to establish a new branch in addition to its existing legal subsidiary, becoming the first "dual-licensed" bank in China. Schroder Bank of Communications Financial Management Co., Ltd. also secured approval to open for business.

Legislation on cross-border business facilitation continues to be put in place. In March, the *Regulations on Matters Relating to Overseas Loan Business of Banking Financial Institutions* was officially implemented, offering more scape for domestic banking financial institutions to carry out overseas loan business. In May, the *Notice on Supporting Foreign Trade Enterprises in Improving Foreign Exchange Risk Management Capabilities* was issued, encouraging banks to develop their exchange rate hedging products and make it easier for RMB cross-border settlement. In June, the *Notice on Supporting Cross-border RMB Settlement of New Forms of Foreign Trade* was issued, allowing banks to carry out cross-border RMB settlement either directly or in cooperation with qualified payment institutions and clearing institutions. Following the successful conclusion of a pilot program to allow multinational companies to integrate their Chinese and foreign currencies (called "cash-pooling") in Beijing and Shenzhen, in July, the pilot program was extended to Shanghai and Guangdong province, among others. This provides an opportunity for banks to further optimize and upgrade their relevant services.

In December, the PBOC and the SAFE jointly issued the *Notice on Matters Relating to the Administration of Funds of Foreign Institutions Raised from Bond Issuance in China* to set out the requirements for management of funds arising from domestic issuance of bonds by foreign institutions, which further facilitates the financing of foreign institutions in the domestic bond market and bolstering the two-way opening up of the financial market.

05 Online business and cooperation subject to greater regulation

Regulators have turned their attention to two areas that have caused problems in recent years – internet loans and credit cards. In July, the CBIRC published the *Notice on Strengthening the Administration of the Internet Loan Business of Commercial Banks and Improving the Quality and Efficiency of Financial Services*, providing further requirements on internet loan business of commercial banks, based on which banks shall independently and effectively carry out identity verification and enter into cooperation agreements by business category with third-party institutions. The notice offered a one-year extension of the transitional period of internet loan business rectification.

At the same time, regulators are addressing the issue of "fully disconnection" of credit markets[1], which has received widespread attention because of the time frame for the implementation of corrective measures and relevant plans.

The Notice on Further Promoting the Standardized and Sound Development of the Credit Card Business (the "**New Credit Card Rules**") provides overall regulation of credit card business, strengthening supervision over cooperation agreements and requiring commercial banks to be stricter in their use of cooperation agreements with third party institutions and focusing on their core business, such as implementing the list-based management over cooperating institutions, operating core businesses through its own channels, setting up the concentration ratio for the total number of credit cards and the credit line issued by a bank in cooperation with a single cooperating institution, etc.

Some commercial banks are adjusting their internet loan business and credit card business accordingly.

06 More specific regulations on financial consumer protection promulgated

In December, the CBIRC published the *Administrative Measures for Protection of Consumers' Rights and Interests by Banking and Insurance Institutions* ("**Measures for Consumer Protection**"), laying out the obligations on banking and insurance institutions to protect consumers' rights to property safety, privacy, information and data security, among other rights. The *Measures for Consumer Protection* laid down detailed requirements, covering how banks and other financial institutions can market their products, how much they can charge, collection of loans, and other areas with high risks of consumer rights infringement. There are also strict guidelines on internal management and controls for consumer protection (such as requirements regarding mechanisms of self-review, consumer suitability assessment, and sales traceability management, which are more detailed than relevant requirements under the *Implementation Measures for Protecting Financial Consumers' Rights and Interests* (2020), and will have great impacts on the internal control systems of banks.

The CBIRC has also addressed consumer protection in more specific areas of business (in the *Guiding Opinions on Standardizing the Management of Market-regulated Prices of Banking Services, Notice on Carrying out Special Rectification of Infringement upon Personal Information Rights and Interests by Banking and Insurance Institutions* and the New Credit Card Rules), addressing such matters as arbitrary charges and protecting consumers' rights to information safety.

The regulators have stepped up the levels of fines levied on those consumer finance companies who breach the regulations. Nearly RMB8 million fine were imposed on consumer finance companies in total, with some single penalties exceeding RMB1 million.

1. "Fully disconnection" of credit markets means the financial institutions are not allowed to cooperate with institutions who do not have a credit reporting license to obtain credit data of customers.

07 Green credit business and green bonds taking off as a result of supporting regulation

Green finance regulation took a major step forward in 2022 with the promulgation in June by the CBIRC of the *Guidelines for Green Finance in Banking and Insurance Industries* (the "**Green Finance Guidelines**"). This is the first set of CBIRC regulations which includes in detail the concept of Environmental, Social and Governance (ESG). The Green Finance Guidelines is a comprehensive upgrade over the *Guidelines on Green Credit* of 2012. Under the Green Finance Guidelines, both credit and non-credit business of banks shall be operated under green finance rules, ESG principles shall be incorporated into banks' risk management and business processes, there is much greater emphasis on carbon reduction, and the scope of investments and transaction counterparties under "green"-related management of banks has been expanded. Meanwhile, as we predicted in the last annual report, green finance rules which target niche sectors were published in 2022, such as the *Notice on Encouraging Non-banking Financial Institutions to Support Development of New Energy Vehicles*.

"Green" bonds are also the subject of more standardized regulation. The Green Bond Standard Committee issued the *PRC Green Bonds Principles* in July, providing a clear definition of green bonds with four core characteristics, and requiring that 100% of the funds raised through green bonds shall be invested in green projects.

As the result of policies and regulations that encourage greener practices, as well as deterring polluting practices, there has been an increase in the issue of "green" loans and "green" finance bonds. According to the PBOC, by the end of the third quarter of 2022, the balance of green loans was RMB20.9 trillion, 41.4% higher than a year ago; according to data from Wind, by the end of 2022, policy banks and commercial banks had issued "green" finance bonds of more than RMB350 billion, nearly tripling that of 2021. We expect banks will significantly increase their "green" credit and "green" finance bonds issuances in future.

08 The banking industry insisting on normalizing strict supervision and maintaining the high pressure of administrative punishment

Since addressing market disorders in 2017, regulators have devoted a lot of attention to regulations to impose stricter controls on the banking sector, including imposing administrative penalties. In 2022, administrative penalties have focused on interbank business, management of employees, related party transactions and banks' wealth management business where there have been breaches. Strict supervision continues and the number of administrative penalties increases (the total amount of administrative penalties decreases due to the decrease in the total number of administrative penalties of amount exceeding RMB 10 million). Failure to monitor the activities of employees has continuously led to the imposition of many administrative penalties, and the total amount of fines has been increasing each year. One rural commercial bank was fined over RMB10 million for failure to adequately supervise the conduct of its employees.

In the meantime, 2022 is the last year of the *Three-year Action Plan (2020-2022) for Corporate Governance in the Banking and Insurance Industries*. Regulators have also clamped down on related party transactions, imposing higher levels of fines on those in breach as compared with 2021. The PBOC's anti-money laundering (AML) regulation upgraded in recent years. At the end of 2022, the PBOC published a few penalties imposed on commercial banks and the relevant responsible persons, the total fine of which adds up to about RMB 69 million. This demonstrates that the regulators are determined to promote AML regulation. Moreover, as the grace period of the Asset Management New Rules ends, the wealth management business of banks has progressively shifted into wealth management subsidiaries (WMSs). In May, the WMSs received penalties for the first time. Two WMSs were fined more than RMB 4 million each.

2023 Regulatory Outlook

01 Ensuring people's welfare, consumer protection and enhancing consumer finance will remain core objectives

In 2022 financial regulators have put a strong emphasis on professional standards, the need to create a strong financial environment and concerns for people's welfare in financial development. Following the shift of pandemic prevention policies, we anticipate that in 2023 the CBIRC will play its part in stimulating growth of consumption, and introduce more financial measures to support the development of the real economy. They are likely to support small and micro enterprises of industries that were adversely affected by the pandemic, such as hospitality, culture and tourism. We expect a series of regulations will be promulgated in 2023 to promote financial services to new urban citizens, to increase consumptions of new energy vehicles, green home appliance and housing, and to optimize supervision on consumer finance business. The *Administrative Measures for Automobile Finance Companies* is likely to be released in 2023, which will provide more business growth possibilities for automobile finance companies.

Financial consumer protection will remain a regulatory focus in 2023. Since the *Administrative Measures for Protection of Consumers' Rights and Interests by Banking and Insurance Institutions* have now been published officially, commercial banks are now required to make sure they have proper consumer protection processes in place.

There will be particular attention placed on protection of personal financial information rights. Based on the rectification campaigns against infringement over personal information rights completed in 2022, the CBIRC may promulgate more specific rules on issues such as data collection, storage, transfer, query, usage, deletion and information processing cooperation with third parties. The CBIRC is also likely to step up enforcement against those who breach regulations governing consumers' financial information rights, and may publicize typical cases of infringement to deter others. We also anticipate that there will be new rules on the pricing of services and the management of consumer suitability by banks.

02 Cross-border business will continue to get easier

China will continue to open up, a process that will not be thrown off course by international tensions or the consequences of the pandemic. According to the spirit of the 20th National Congress of the CPC, China will still steadily promote the high-level opening-up of the financial sector and accelerate efforts to foster a new pattern of "dual circulation" development which is designed to foster positive interplay between domestic and international economic flows.

It is expected that the banking sector will maintain and continue to promote high-level opening-up in 2023. There will be more breakthroughs in cross-border business. With the 20th CPC National Congress proposing to promote the high-level two-way opening-up of the financial market and support the sustained prosperity and stability of Hong Kong as the international financial center, Hong Kong features strongly in China's plans. We expect that more products in Hong Kong will be interconnected with the Mainland market, which will both help with the diversified development of the Hong Kong's financial markets and maintain Hong Kong's role as an international financial center. At the same time, we expect the CBIRC to introduce more policies and measures which will further improve the business environment for foreign banks in China, expand international banks' business scope, facilitate cross-border RMB settlement, and continue to increase support for the "One Belt, One Road" project.

03 The fundamental rules of loan business may face changes and rectification results of internet loans business is to be tested

In 2023, the loan business will continue to be the focus of regulators. We expect that the "Three Measures and One Guideline"[2] will be revised and officially released, which are expected to set out more detailed regulations covering, for example, entrusted distribution, loan term, and the pre-loan procedures for working capital loan is expected to be grant more flexibility, to make it easier for small and micro enterprises to borrow money. Under the concept of "20 Data Rules"[3], the CBIRC will in 2023 encourage credit activities

2. "Three Measures and One Guideline" means the *Interim Measures for the Administration of Fixed Asset Loans, the Interim Measures for the Administration of Working Capital Loans*, the *Interim Measures for the Administration of Individual Loans*, and the *Guidelines on the Project Financing Business*.

3. "Data 20" means the "Opinions of the CPC Central Committee and the State Council on Establishing a Data Base System to Maximize a Better Role of Data Elements" issued by the Central Committee of the Communist Party of China and the State Council in December 2022

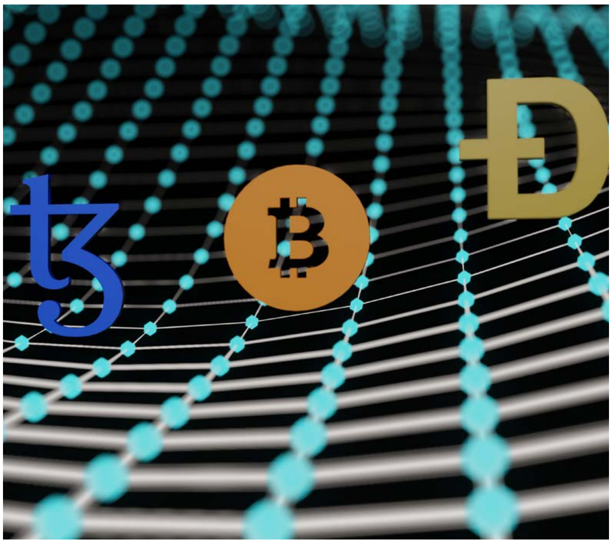
generated based on compliant information sharing and big-data-analysis, ensuring that a responsible internet loan business can help businesses and individuals to relieve difficulties, strengthen financial services for new citizens, optimize financial support for key areas of consumption, and continue to improve the quality and efficiency of financial services for the real economy. In 2023, it is expected that more clear rules and policies will be implemented in this regard. As the transition period of the *Measures for the Credit Business Management* comes to an end, by the second half of 2023, all credit businesses will be required to operate with a license, and non-licensed market players will be "fully disconnected" from financial institutions per the regulatory requirements. All aspects of internet loan operations will have to operate to the high standards laid down by regulations. Commercial banks will no longer be allowed to over-rely on partner institutions when extending loans, which will further improve the supervision system on internet business of commercial banks. However, as the process continues to unfold, not all financial institutions will have put in place the right policies, so we expect there to be more penalties imposed on those who fail to abide by the regulations.

04 Rules on custody business of banks may be issued, filling in the regulatory gap

At the end of 2022, the *Administrative Measures for Custody Business of Commercial Banks (Consultation Paper)* (the "**Custody Business Measures**") was published by the CBIRC to seek public opinion. This is expected to come into force in 2023. Once promulgated, the Custody Business Measures will become the keystone rules for the banking custody business with an asset scale of hundreds of trillions in RMB. This will mark the end of chronic lack of regulation governing banks' custody business, which up to now has relied on self-disciplined rules. The banks will need to respond to the new regulations and change their ways of operating. For example, functions and responsibilities of custodian banks shall be distinguished for "assets under custody" and "other assets". Banks operating custody businesses also need to review their internal and external management systems to check whether they can satisfy applicable requirements under the Custody Business Measures, including, but not limited to, requirements for risk management system and preventing those with whom they have cooperative businesses to market with the custodian bank's brand. As the custody of certain types of financial products may fall within the overall regulation of the CSRC, it remains to be seen how the Custody Business Measures will interact with the CSRC regulations in practice.

05 The digital RMB will be promoted and apps will improve, the regulatory framework is taking shape

Although the two-year pilot of digital RMB has not really taken off with low user activity, we expect there to be continued interest in developing the digital currency, supported by accompanying regulations to fill the current regulatory gap and also boost the application of digital RMB in different scenarios. It is expected that the scope of the digital RMB pilot will continue to expand in 2023 and the digital RMB will extend from its current retail applications to non-retail business. Meanwhile, in order to break the current payment pattern built by bank cards and third-party payments and to explore more application scenarios and business space, the digital RMB currently positioned for retail may transform to non-retail business in the future. Cross-border digital currency may also be explored further, as evidenced by the "m-CBDC Bridge Project"[4] launched by the Digital Currency Institute of the PBOC, together with the Hong Kong Monetary Authority, the Bank of Thailand and the Central Bank of the United Arab Emirates. In addition, the business model and application scenarios widely adopted by the industry may usher in the regulation of independent rules.



4. "m-CBDC Bridge Project" experiments with cross-border payments using a common platform based on distributed ledger technology (DLT) upon which multiple central banks can issue and exchange their respective central bank digital currencies (multi-CBDCs).

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PRC Financial Regulation: Annual Report (2023)

Securities and Futures

2022 Regulatory Milestones

January 1

The China Securities Regulatory Commission (the "CSRC") issued the *Provisions on the Implementation of the Rules of Commitments by Parties to the Administrative Enforcement of the Laws of Securities and Futures* and the *Administrative Measures on the Commitment Funds of Parties to the Administrative Enforcement of the Laws of Securities and Futures*.

January 21

The Supreme People's Court issued the *Several Provisions on the Trial of Tort Compensation Cases regarding False Statement in Securities Market*.

February 18

The CSRC issued the *Measures for the Supervision and Administration of Directors, Supervisors, Senior Management and Practitioners of Securities and Fund Institutions*.

April 29

The CSRC issued the *Guiding Opinions on the Improvement of the Administration of Companies Post-delisting, and* solicited public comments on the *Administrative Measures of Cybersecurity in Securities and Futures Industries (consulting draft)*.

May 12

The CSRC issued the *Pilot Provisions on Market Making Business of Securities Companies for STAR Stocks*.

May 27

The People's Bank of China (the "PBOC"), the CSRC and the State Administration of Foreign Exchange (the "SAFE") issued the *Announcement on Matters Relating to Further Facilitating Investments in Chinese Bond Market by Overseas Institutional Investors*.

June 10

The CSRC issued the *Decision on Amending Several Provisions of the Stock Connect between Mainland and Hong Kong*.

June 24

The CSRC issued the *Announcement on the Arrangements for Including Exchange-Traded Funds on the Mainland-Hong Kong Connect*.

July 27

The CSRC and the Ministry of Finance issued the *Provisions of the Matters on Prioritizing the Use of the Properties of the Persons Violating Securities-related Laws for Civil Liabilities*.

July 28

The depositary receipts business under the mutual market access between China and Switzerland launched.

August 1

The *Futures and Derivative Law of the People's Republic of China* took effect, which was promulgated on April 22 by the Standing Committee of the National People's Congress. The CSRC started to solicit comments on the *Administrative Measures for Futures Exchange (consulting draft)* publicly on September 16.

December 15

The U.S. Public Company Accounting Oversight Board (the "PCAOB") issued a report confirming that it has secured access to inspect and investigate Mainland Chinese and Hong Kong accounting firms in 2022.

December 19

The CSRC and the Securities and Futures Commission of Hong Kong issued a joint announcement regarding the further expansion of the scope of the underlying stocks under the Stock Connect. On the same day, the SSE 50 stock index option was listed on the China Financial Futures Exchange.

December 30

The CSRC solicited public comments on the *Interim Regulations on Position Administration in Futures Market (consulting draft)* and the *Administrative Measures of Stock Options Trading (consulting draft)*.

December 30

The CSRC announced that it will continue to investigate the illegal cross-border business of Futu Holdings and Tiger Brokers.

2022 Regulatory Mainline Review

01 The capital markets broadened financing channels for enterprises and served the real economy

In the report of the 20th CPC National Congress, there is a strong emphasis that economic development should be focused on the real economy, i.e. not on the amorphous financial markets. In 2022, China's capital markets have gone some way to serve the real economy, a long-term and strategic goal, and there have been some significant achievements.

Science and technology innovation enterprises continue to receive strong support. In March 2022, the CSRC issued a document clearly stating that the priority will be given to private enterprises in high-tech and strategic emerging industries to support bond issuances for fund raising. In May, the Shanghai Stock Exchange (the "SSE") and Shenzhen Stock Exchange (the "SZSE") issued the *SSE Guideline No.4 on the Application of the Rules for Reviewing the Listing of Corporate Bonds – Science and Technology Innovation Corporate Bonds* and the *SZSE Guideline No. 6 on Innovative Varieties of Corporate Bonds – Science and Technology Innovation Corporate Bonds* respectively, marking the formal launch of science and technology innovation-focused corporate bonds, which will enable the bond market to provide precise support to the science and technology innovation industry and enterprises in such industry to have access to the fund in the bond market. In November 2022, the CSRC and State-owned Assets Supervision and Administration Commission jointly issued the *Notice on Supporting the Issuance of Science and Technology Innovation Corporate Bonds by Central State-owned Enterprises*, which is aimed at promoting the role of central SOEs in science and technology innovation in support of national strategy.

At the same time, the real estate sector is once again finding it easier to raise finance. The CSRC cited five key areas where financing could assist the sector, including: resuming M&A and restructuring; supporting financing and re-financing of listed real estate enterprises and listed real estate-related enterprises; improving the process for real estate companies to list overseas; promoting the development of real estate investment trusts (REITs); and launching the pilot real estate private investment fund. After an extended period in which real estate companies found it difficult to raise money on the A-share market, the CSRC initiative is a shot in the arm for the real estate enterprises in China and marks the reopening of financing channels for the real estate sector.

The SSE and SZSE stock markets bucked the international trend where most stock indices declined by maintaining IPO and equity raising levels, playing an important role in stabilizing the macro economy and helping the development of the real economy.

02 The Futures and Derivatives Law comes into force, filling the gap in the field of futures and derivatives

The *Futures and Derivatives Law of the People's Republic of China* (the "FDL") was formally approved by the National People's Congress on April 20, 2022 and came into force on August 1, 2022. The formal issuance of the FDL marks the first specialized law in the field of futures and derivatives in China and fills the gap in China's capital markets.

The FDL, described as a "fundamental law", expressly affirms the positive role of futures and derivatives in serving the national economy. It sets out the regulatory framework, provides for the operation of a futures and derivatives market, including futures trading and settlement, establishes the trader protection system, regulates the operation of futures operators, includes over-the-counter derivatives trading, allows for the integration of China's futures and derivatives trading with the international market and provides regulations for cross-border trading.

There were follow-on developments. On August 1, 2022, the International Swaps and Derivatives Association (ISDA) issued a legal opinion, formally endorsing the enforceability of the close-out netting under the PRC law, thereby providing new development opportunities for cross-border trading in the futures and derivatives markets. On December 30, 2022, the CSRC released the *Stock Options Trading Management Measures (Draft for Comments)* and the *Interim Regulations on Position Management in Futures Market (Draft for Comments)* and publicly solicited comments, further implementing the applicable provisions of the FDL.

03 Securities companies' offshore business comes under regulator's scrutiny

On September 25, 2018, the CSRC issued the *Administrative Measures on the Establishment, Acquisition and Equity Participation in Overseas Business Organisations by Securities Companies and Securities Investment Fund Management Companies* (the "Administrative Measures"), which sets out regulatory requirements on securities companies and fund management companies for their overseas business and their establishment and participation in applicable offshore institutions. The Administrative Measures say that overseas subsidiaries can only engage in securities, futures, assets management or other financial business as recognized by the CSRC, and finance-related business as recognized by the regulator such as financial intermediary introductory business and financial information business, and shall not engage in the business unrelated to finance. Under the Administrative Measures, the overseas subsidiaries must have a transparent shareholding structure, be of a size that is consistent with their capital levels within the group, have a proper management, compliance and risk controls in place and comply with all regulations.

Following the issuance of the Administrative Measures, the CSRC required the offshore entities approved by the CSRC to make any necessary adjustments to their operations within three years to make sure they comply with the regulations. On top of that, a number of securities companies were fined for breaches by the CSRC in June 2022. These include one securities company which established an overseas investment company in 2015 but failed to apply to the CSRC for approval and another securities company which had failed to adjust the complicated shareholding structure of its offshore subsidiary within the prescribed time.

The focus on regulating overseas businesses of securities companies has come about because of the growing importance and contribution of such businesses. Statistics show that some securities companies' overseas business revenue accounted for over 20% of their total revenue in 2020. It is important to improve the compliance standard of securities companies' overseas business, to strengthen the management of overseas subsidiaries, and to set up the compliance management, risk management and internal control system to fully cover the overseas subsidiaries.

04 Promoting the "system-based" opening-up of the capital markets

China is taking a holistic approach to the opening up of its capital markets, having issued various rules, measures and notices for opening up in respect of equity, bond and financial derivatives markets – what is known as the "system-based" opening-up.

Stock markets: The mutual market access mechanism between the China mainland and overseas markets has been expanded in various aspects. For the Shanghai/Shenzhen-Hong Kong Stock Connect, from July 2022 qualified exchange-traded funds (ETFs) can be included, and in December 2022, it was decided to further expand the scope of the target securities. For the Shanghai-London Stock Connect, in February, the CSRC issued the *Provisions on the Regulation of the Depositary Receipt Business under the Mutual Market Access Mechanism between Domestic and Overseas Stock Exchanges*, expanding depositary receipt business. At domestic level, the mechanism extended to SZSE; at offshore level, the mechanism extended from UK to the Swiss and German markets. By the end of 2022, five A-share companies had issued the global depositary receipts ("GDRs") in the UK market and nine A-share companies issued GDRs in the Swiss market.

Bond markets: In May 2022, the PBOC, CSRC and SAFE issued the joint announcement on *Matters Relating to Further Facilitating Investments in Chinese Bond Market by Overseas Institutional Investors*, which aims to make China's bond market more "systematic, holistic and synergistic". International investors can in the exchange bond market directly or through one of the mutual market processes and can choose which exchange to use (previously there were restrictions on foreign investors' access to the exchange bond market).

Financial derivatives markets: The newly-promulgated FDL provides clear arrangement regarding the mutual opening of the futures and derivatives markets. In September 2022, the five major domestic futures exchanges announced the expansion of the derivatives investment scope for qualified foreign institutional investors (QFIIs) and RMB-qualified foreign institutional investors (RQFIIs), involving stock index options and the futures and options for a number of important commodities. In October, UBS Futures announced the completion of the first domestic commodity futures transaction by QFII/ RQFII.

The refinement of the regulations is providing opportunities for international participants. The CSRC accepted applications by BNP Paribas to set up a wholly foreign-owned securities company in January 2022 and by Intesa Sanpaolo to set up Sino-foreign joint venture securities company in September 2022. With the further implementation of the policy of "promoting the reform and opening up of the capital market", we expect that CSRC is considering more applications by international financial institutions and will make progress in 2023.

05 China and the U.S. sign the Statement of Protocol, paving the way for solution of delisting of China stocks listed in the U.S.

On August 26, 2022, the CSRC, Ministry of Finance of the PRC and PCAOB signed a Statement of Protocol (the "SOP"), under which the PCAOB obtained the initial permission to conduct inspections and investigations of the registered public accounting firms in China mainland and Hong Kong and access to the audit work paper of public companies in their possession.

The PCAOB has audit requirement on companies listed in the U.S., which becomes sensitive in recent years as the environment changed. In 2020, the U.S. passed the Holding Foreign Company Accountable Act, which provides that if the PCAOB determines that it is unable to conduct the audit on the auditor of a listed company in the U.S. for three consecutive years, the listed company in question may be required to be delisted. As a result, most Chinese companies listed in the U.S. (around 200 of them now) were at risk of being forced to be delisted when the Holding Foreign Company Accountable Act was promulgated.

Although the signing of the SOP eased the nerves of Chinese U.S.-listed companies, there was still some uncertainty as to how the SOP would actually be implemented. On December 15, 2022, the PCAOB said its staff had visited Hong Kong in September 2022 and had conducted the relevant audit work in Hong Kong. It confirmed that the PCAOB was able to secure complete access to inspect and investigate audit firms in China mainland and Hong Kong. The CSRC then held a press conference welcoming the statements made by the U.S. regulator on these issues. The market was generally of the view that this marked substantial progress in the area of audit supervision cooperation between the U.S. and China and the previous risk regarding the delisting of China concept stocks had been eliminated.

06 Reinforcing the responsibilities of intermediaries, constructing the market operation system emphasizing information disclosure

In recent years, the regulators have been constantly dedicated to improve the relevant policies and strengthen the regulatory enforcement, and strictly, timely, and severely conducted investigation and imposed penalties on the intermediaries which failed to perform its duty of care and diligence or had other illegal conduct, which aims to let the market-driven discipline mechanism play a role of survival of the fittest, promote intermediaries' fulfillment of their respective duties and fully control the "entrance" of the market.

Legislation has been introduced requiring sponsors of new issues to practise due diligence, carry out necessary information disclosure and work to high standards. In 2022, the Securities Association of China issued the *Practice Quality Evaluation Measures of Financial Consultancy Business of Securities Companies for Material Asset Restructuring* in 2022, which requires to carry out the practice quality evaluation on financial consultancy business, and strengthen the on-site inspection, regulatory enforcement and accountability pursing of sponsor and underwriting institutions and financial consultants. The *Guiding Opinions on Promoting the Reform of Registration System for Corporate Bond (consulting draft)* promulgated by the CSRC also emphasized the responsibilities of the intermediaries, and urged intermediaries to build sound system in respect of quality and practice risk control in relation to the corporate bond business.

In terms of the enforcement of the law, the CSRC disclosed the information of the cases it handed in 2021. There were 39 investigation cases, twice as many as in 2020, which were initiated against intermediaries in respect of their violation of the law. According to the CSRC, the illegal activities of securities intermediaries mainly include: serious defects in risk identification and appraisal procedures, inadequate and improper implementation of authentication and evaluation procedures, unreasonable professional judgment, and serious violation of professional ethics. In November 2022, the CSRC announced the results of special inspections on the internal controls of eight securities companies. It said it had imposed: (i) administrative measures against a securities company that committed multiple serious non-compliant activities, ordering it to rectify and suspend its sponsorship business and underwriting business for corporate bonds for three months; (ii) measures including administrative penalties and regulatory talks on another securities company that committed multiple serious non-compliant activities; and (iii) administrative measures such as ordering to rectify and issuing the warning letter against five securities companies which had committed relatively minor offences. In the high-profile case of LeTV, one of the underwriters had around RMB 5.6 million confiscated and was fined around RMB 11 million due to its failure to perform its duty of diligence. Another sponsor was ordered by CSRC Shenzhen to suspend its sponsor qualification for three months. The sponsor representatives and the person in charge of the sponsorship business at that time for LeTV's IPO project were also held liable.

With the promotion of the registration-based IPO system, we anticipate that regulators will continue to strengthen the supervision of intermediaries' role of "gatekeepers".

07 Following concluding that Futu and Tiger conducted business without a license, securities cross-border business to be subject to stricter regulation

On December 30, 2022 the CSRC confirmed that Futu Holdings and Tiger Brokers (internet securities companies) had illegally been carrying out cross-border securities business for domestic investors without CSRC's approval.

The CSRC required the two institutions immediately to cease their illegal new business activities and to stop soliciting new domestic clients, while allowing them to continue to serve existing domestic clients so long as they did not transfer "incremental funds in violation of the administration rules of foreign exchange to investors' accounts". Different treatment to new and existing clients shows that the regulatory authority has adopted a relatively mild approach to maintain the stability of the market.

As early as 2021, the CSRC has, through media statements, regulatory talks and other forms, expressed its attitude towards the illegal cross-border securities business conducted by foreign securities institutions, and pointed the compliance issue regarding the cross-border personal information transmission arising out of the said cross-border securities business. On February 8, 2022, Sun Tianqi, the director of the Financial Stability Bureau of the PBOC also stated that engaging in financial business that is not opened up to foreign investors or conducting business in China only with overseas licenses by foreign institutions is illegal.

Now that the two internet securities companies have been officially identified as "driving without a license", cross-border securities business without a domestic license will be subject to closer scrutiny by the regulator, and cross-border financial activities with similar nature may be subject to stricter regulation as well.

08 Formal launch of market-making for stocks on the Science and Technology Innovation Board (the "STAR Board")

On May 12, 2022, the CSRC promulgated the *Provisions on the Pilot Program of Market Making Business of Securities Companies for Stocks on the STAR Board*, stipulating the qualification requirements and approval procedures, internal control requirements, risk monitoring and control requirements for market makers, regulation and law enforcement and other aspects, which provides top-level legal basis for the introduction of the market maker mechanism into the STAR Board.

On October 31, 2022, the market making for stocks on the STAR Board was officially launched. By December 31, 2022, the first batch of 14 market makers for the STAR Board approved by the CSRC had completed the filing of a total of 116 stocks, reduced to 92 after the elimination of "repeat subjects, accounting to nearly 18% of the total number of stocks on the STAR Board.

The formal launch of market making for stocks on the STAR Board means that the original single-market bidding trading mechanism on the STAR Board has been transformed to mixed trading mechanism including market making and bidding, which is an important transformation of China's capital market. The amended Securities Law in 2020 has officially included "securities market making" into one of the seven basic business scopes of securities companies. However, market making has long been limited to certain products (such as market making for ETFs listed on exchanges and stock options) and has not really been fully implemented on the A-share market. The launch of the market making business on the STAR Board is a pilot, allowing some securities companies who are viewed as having sound corporate governance and internal controls, stable operation and strong risk resistance capability to carry out the market making business. Such pilot approach is good for the steady promotion of the relevant work and prevention and control of various risks. The CSRC and the SSE will evaluate the pilot and, if all goes well, it is expected that market making will be expanded to other stock boards. The relevant regulatory rules on market making are also expected to be developed.

2023 Regulatory Outlook

01 Capital markets will contribute to the development of the real economy

According to the Central Economic Work Conference at the end of 2022, stabilizing the economic growth and promoting the development of the real economy will become one of the primary tasks of development of the securities market in 2023. To this end, the CSRC clarified multiple priorities in work in December 2022.

In terms of the reform orientation of the capital markets, the CSRC emphasized that it would focus on key areas and weak spots such as major manufacturers, scientific and technological innovation, private enterprises, and strengthening the role of the capital markets in providing investment and financing to the real economy. The futures market will play an increasing role in supporting the risk management needs of enterprises engaging in the "real" economy.

There will be a continued focus on supporting the real estate sector, with a number of priority focuses, including resumption of mergers, acquisitions and restructuring, the financing or refinancing of listed real estate enterprises and listed companies related to real estate industry, improving the policies for the listing of real estate enterprises in overseas markets, supporting plans for strengthening the balance sheets of high-quality real estate enterprises, continuing the implementation of special support plans and instruments for bond financing by private enterprises, and promoting the credit enhancement cooperation between the central and local governments to jointly support the issuance of bonds by private real estate enterprises.

In short, China' capital markets will play a greater role in supporting the continued development of China's economy.

02 Supporting rules and regulations of the Futures and Derivatives Law will be further refined, and the futures market will embrace new development opportunities

On August 26, 2022, Fang Xinghai, vice-chairman of the CSRC, said in his speech at the 19th Shanghai Derivatives Market Forum that it is necessary to improve the "promulgation, amendment and abolition" of supporting rules and regulations of *the Futures and Derivatives Law.*

Among the supporting rules, the amended version of the *Administrative Measures for Futures Exchanges* was released to the public for comments on September 16, 2022, aiming to implement the provisions of *the Futures and Derivatives Law* relating to futures exchanges, while regulations such as the *Measures for the Supervision and Administration of Futures Companies* are also expected to be amended in 2023.

In 2023, it is expected that applicable rules in relation to the listing and registration of futures varieties, position management, industrial customer cultivation, over-the-counter derivatives trading, the business scope of futures companies and other important matters will be further revised, so as to implement the relevant requirements under *the Futures and Derivatives Law* and further improve and complete the legislation system in respect of the futures and derivatives.

There are still many matters in the *Futures and Derivatives Law*, such as cross-border transactions, cross-border regulatory coordination, the marketing of foreign institutions in the domestic market, and the filing of master agreements, which are currently only stipulated in principle, and it remains to be seen how they will be implemented in the future.

03 The securities dispute resolution mechanism is expected to continue the diversified development trend, and relevant rules and practices will continue to improve

The amended *Securities Law* provides different ways for resolving securities disputes, including administrative settlement, dispute mediation, advance compensation, and representative litigation. In 2022, there have been new developments in the legislation and practice of securities dispute resolution, as follows:

<u>Administrative settlement</u>: A number of new rules came into effect in 2022, including the *Measures for the Implementation of the Rules for the Undertakings Made by the Parties to Securities and Futures Administrative Law Enforcement*, the *Provisions on the Implementation of the Rules for the Undertakings Made by the Parties to Securities and Futures Administrative Law Enforcement*, and *Measures for the Administration of Funds Paid for the Undertakings Made by the Parties to Securities and Futures Administrative Law Enforcement*, pursuant to which securities investigations may be terminated if the party involved has undertaken to rectify the alleged breach of laws, to compensate investors for their losses, to eliminate negative impact, and such undertakings have been accomplished. This mechanism is not new, but the latest legislation in this regard has a number of changes, including: (1) extending the application time, deleting the requirements that the relevant arrangements may only be applied

after the case has been filed; (2) expanding the scope of application; (3) optimizing the initial procedures; (4) clarifying the factors that should be considered when determining the settlement amount; and (5) clarifying decision-making procedures for deciding whether to apply the settlement scheme. The above new rules reflect regulators' clear attitude to actively promoting the settlement arrangement in the administrative enforcement process. We expect that there will be more examples of securities investigations settled in 2023. The relevant arrangements will help to protect the legitimate rights and interests of investors, to maintain market order, and to improve the efficiency of administrative law enforcement.

Misrepresentation: In January 2022, the Supreme People's Court issued *Several Provisions on the Trial of Civil Compensation Cases Involving Misrepresentation in the Securities Market* (the "**Interpretation of Misrepresentation**"), addressing some problems that had occurred in the past due to market developments, legislation and other reasons. The Interpretation of Misrepresentation provides more detailed requirements on the determination of causation of losses and expands the scope of application of misrepresentation. The newly released Interpretation of Misrepresentation responds to the concerns expressed by market and the judiciary in connection with misrepresentations to some extent, and is conducive to deepening all-round reform of the capital market and forming a good ecology of the capital market. However, there is still much left to be clarified, and so we can expect some more legislative and regulatory developments in 2023.

The priority of civil liabilities: The CSRC and the Ministry of Finance issued the *Provisions on Matters Related to the Priority Use of Property of Securities Offenders to Bear Civil Liability* in 2022. The principle of priority of civil compensation has long been established but it has been difficult to put into practice, largely because of lack of effective connection with the Ministry of Finance at institutional level. This regulation, jointly issued by the CSRC and the Ministry of Finance, should enable civil compensation priority to work. In September 2022, the Shanghai Financial Court rendered a first-instance judgment and publicly pronounced its judgment in the investor's lawsuit against Xian Yan for manipulating the securities trading market, ordering the defendant Xian Yan to compensate the plaintiff for losses totaling more than RMB4.7 million, becoming the first securities tort case to apply the principle of priority of civil liability and compensate investors' losses in priority.

In view of the development of relevant mechanisms and practices in 2022, we expect that more rules governing securities disputes and cases will happen in 2023. Dispute resolution mechanisms such as administrative settlement, arbitration and mediation in the securities and futures industry are also expected to play an important role in further optimizing investor protection options and improving efficiency for dispute resolution.

04 Stock issuance registration system is expected to be extended to the main board in 2023

After the development in the past few years, the pilot systems used for registration of stocks on the STAR Market, ChiNext and the Beijing Stock Exchange have all worked satisfactorily. According to public information, more than 300 enterprises have been listed through the registration system in 2022, raising more than RMB400 billion in aggregate. The implementation of the registration system has effectively lowered the threshold for enterprises to go public and, in so doing, made the market more efficient, weakened the government review and approval, led to better pricing of stocks and generally improved the market's ability to discover value. The development in the past few years has accumulated experience and created conditions for the fully implementation of the registration system. Currently only the main board has not applied the registration system.

In the 2022 government work report, the goal of "fully implementing the stock issuance registration system" was put forward again, and in the CSRC work conference, the slogan of further promoting capital market reform with the fully implementation of the stock issuance registration system was emphasized. The scale of main board market is large in terms of the number of listed companies, the number of investors as well as investment products, and its impact on iconic indices is significant, which increases the difficulty of fully implementing the registration system on the main board.

Based on the practical experience accumulated in the past few years in the areas of rule formulation, listing review, market-oriented pricing issuance, secondary market trading by implementing information disclosure-oriented registration system, together with the gradual attempts of regulatory transformation and the continuous enhancement of "gatekeeper" responsibility of the intermediary agencies, a good market ecology to fully implement the registration system has gradually formed. We believe that there will be moves towards instituting registration on the main board in 2023. In the future, market vitality will be further stimulated, and the capital market will serve the real economy better with the fully implementation of the registration system.

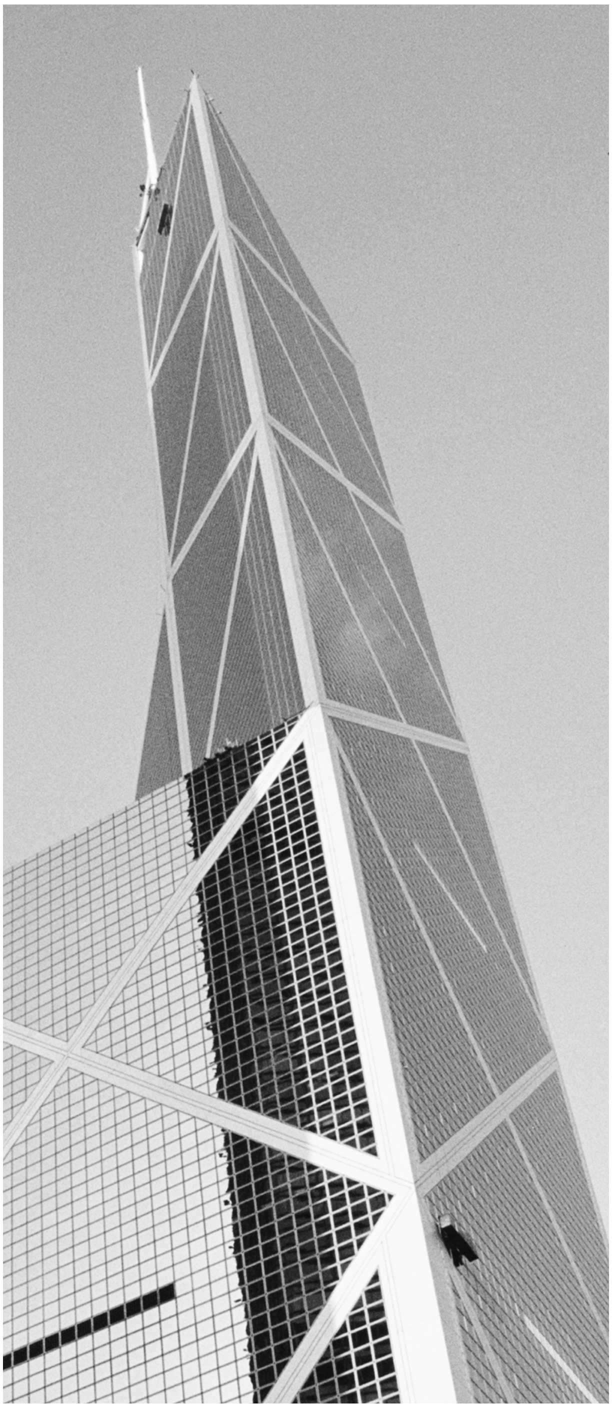
05 China's capital markets will continue to open up, attracting more foreign investors

Since 2022, regulators have made positive statements on the opening up of China's capital market. In September, Fang Xinghai, vice-chairman of the CSRC, said that the SFC and Hong Kong would launch three new initiatives to expand the connectivity of the Mainland and Hong Kong capital markets. Of these, the expansion of eligible stocks for Stock Connect was launched in December 2022 and is expected to be officially implemented in 2023. Other initiatives are also expected to be implemented in the near future, including introduction of Renminbi stock trading counters in Hong Kong and support for the issuance of Mainland government bond futures in Hong Kong. In November, Fang Xinghai further clarified at the Global Financial Leaders' Investment Summit that in order to develop China's high-quality capital markets, China will continue to open up in the future, welcome the world's top institutions, and share the fruits of mainland economic growth with the world.

In terms of system construction, there will be more favorable policies in the capital market for opening up in 2023. In October 2022, the CSRC indicated that it was studying and formulating policies on the application of specific "short-swing" trading rules for foreign investors, allowing eligible overseas public funds to calculate the number of securities held separately for each product with reference to domestic public funds, while exempting Hong Kong Securities Clearing Company Limited as a nominal holder of A-shares from applying short-swing trading rules. If the policy is finally implemented, this should dispel the concerns of overseas investors about triggering information disclosure requirements or short-swing trading rules due to the total position exceeding the threshold, thereby increasing the A-shares proportion in their asset allocation.

The development of some cross-border transaction processes is also expected to attract more overseas funds. With the upgrade of Shanghai-London Stock Connect to China-Europe Connect in 2022, the policies and procedures for A-share listed companies to issue GDRs overseas have been settled, allowing more domestic listed companies to seek overseas financing by issuing GDRs. In addition, in November and December 2022, the Singapore Exchange and the Shenzhen Stock Exchange each listed one China-Singapore ETF cross-listing product, marking the beginning of China-Singapore ETF mutual connection, and it is expected that more ETF products jointly developed by the two countries will be launched in the future, providing foreign investors with convenient channels to invest in A-share ETFs and enhancing the international influence of China's capital market.

In terms of institution access, in 2022, a number of conversion applications (from foreign-funded public fund joint ventures to wholly foreign-owned enterprises) and greenfield applications were approved, reflecting the regulators' continuously open attitude to foreign capital entering China's capital market. Driven by this trend, we believe that more foreign securities companies and futures companies will apply for licenses and there will be progress in the approval process in 2023.



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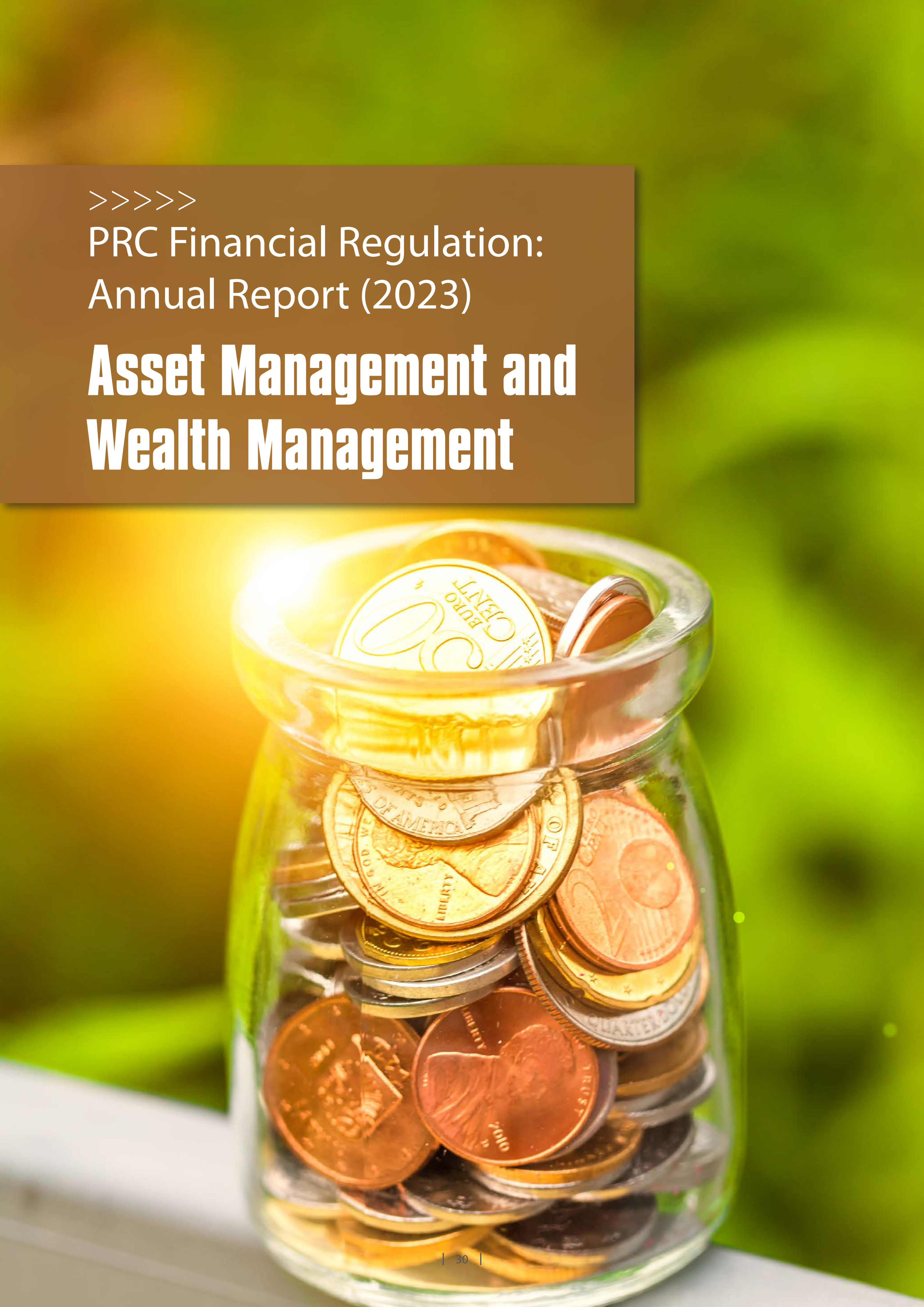
Asset Management and Wealth Management



2022 Regulatory Milestones

February 18

The China Securities Regulatory Commission ("**CSRC**") published the *Measures for the Supervision and Administration of the Directors, Supervisors, Senior Management and Practitioners of Securities and Fund Institutions*, the application of which is extended to relevant personnel of the subsidiaries of fund management companies and fund service institutions.

April 26

The CSRC published the *Opinions on Accelerating and Promoting the High-quality Development of the Public Fund Industry*, some of which have already been implemented in the new regulations published in 2022.

May 20

The CSRC published the *Measures for Administration and Supervision on Publicly-raised Securities Investment Fund Managers*, which optimizes the policies regarding market access, corporate governance and market exit for the managers of public fund (i.e. "mutual funds" in Western terminology).

June 16

The China Banking and Insurance Regulatory Commission ("CBIRC") approved the application for Xinhua Trust to enter into bankruptcy.

June 24

The CSRC issued the *Announcement on the Arrangements for Including Exchange-traded Funds ("ETFs") into the Mainland-Hong Kong Mutual Market Access Mechanism*, and ETFs was officially included in the Stock Connect regime.

Early July

The CSRC announced the launch of a pilot scheme for private equity ("PE")/venture capital ("VC") funds to distribute shares in kind to fund investors, and in October 2022 approved Shanghai Pro-rationale Investment Partnership LLP to carry out the first pilot.

August 5

The CBIRC issued the *Provisions on the Administration of Insurance Asset Management Companies.*

August 22

The CBIRC issued the *Measures for the Administration of the Internal Control of Wealth Management Companies.*

September 2

The domestic commodity exchanges and the China Financial Futures Exchange promulgated circulars allowing QFIIs and RQFIIs to invest into commodity futures, commodity options and stock index options.

October 13

The CBIRC approved the preparation for the establishment of the fifth foreign-controlled wealth management company (the joint venture between BNPP and the wealth management subsidiary of Agricultural Bank of China).

November 2

The CBIRC and the CSRC promulgated relevant provisions on personal pension, which implement the *Opinions on Promoting the Development of Personal Pensions* promulgated by the General Office of the State Council in April 2022 and serve as the implementation rules for the *Implementation Measures for Personal Pensions* effective on October 26, 2022.

December 30

The CBIRC promulgated the *Notice on Regulating the Classification of Trust Businesses of Trust Companies (Consultation Draft)*, which clarifies the boundaries and service scopes of various types of trust businesses and directs trust companies to increase the supply of trust products which conform to the original purpose of trusts.

2022 Regulatory Mainline Review

01 Aimed at high-quality development, public fund industry embraces new policies

The *Opinions on Accelerating the Promotion of High-quality Development of the Public Fund Industry* ("**Opinions on Public Fund Industry**") published by the CSRC on April 26, 2022 aims to encourage the public fund industry to operate to high standards. This would be done by having professional asset management institutions, strengthening the professional capacities and promoting the transformation of top-level regulation. On May 20, 2022, the CSRC amended the *Measures for the Administration of Securities Investment Fund Management Companies* (published in 2004) and renamed it as the *Measures for Administration and Supervision on Publicly-raised Securities Investment Fund Managers* (together with its implementing rules, "**New Measures on Public Funds**"), some measures of which reflect the *Opinions on Public Fund Industry*.

The *New Measures on Public Funds* have brought both public fund management companies ("**FMCs**") and other financial institutions engaged in public fund management business under one unified set of regulatory rules, which includes raising higher requirements for license application, broadening the scope of financial institutions which can apply for public fund management licenses. Even if there is already a FMC within the group, the CSRC allows affiliated financial institutions to simultaneously hold public fund management licenses, which was not explicitly allowed due to the "One Participation, One Control" principle previously (meaning, affiliated institutions were not allowed to invest in more than two FMCs and shall only control up to one of such two FMCs). Guotai Junan Securities became the first securities company to operate two separate licensed public fund managers after the release of the *New Measures on Public Funds*, taking a controlling stake in HuaAn FMC by acquiring additional 8% equity interest in HuaAn FMC. Other financial institutions such as CICC, CITIC Securities and China Securities also set up asset management subsidiaries in 2022. What this trend indicates is the asset management businesses of securities companies will probably focus more on public fund management businesses.

The *Opinions on Public Fund Industry* and the *New Measures on Public Funds* allow FMCs to set up subsidiaries that specialize in publicly offered real estate investment trusts ("**REITs**"), private equity investment, fund investment consultancy, pension financial services and other innovative businesses. There are new concepts of "comprehensive wealth management institutions" and "boutique asset managers" proposed by the CSRC.

One of the key developments of 2022 is the rapid development of REITs. The General Office of the State Council, the National Development and Reform Commission, the CSRC and the exchanges have all adopted policies to promote REITs business. The preferential tax policies on infrastructure REITs issued by the Ministry of Finance and the State Taxation Administration have taken the first step towards providing preferential policies for REITs in China, which also gave a strong boost to the high-quality development of the REITs sector. The SASAC has also unified the approval procedures of state-owned assets related to REITs.

02 Trust business returns to its roots with the key words of "transformation and innovation" and "risk disposal"

After the introduction of the *Asset Management New Rules*, the CBIRC and the CSRC have issued follow-on implementation rules for relevant asset management products and the management institutions, but these exclude trust and trust companies. The *Interim Measures for the Management of Fund Trusts by Trust Companies (Consultation Draft)* (《信托公司资金信托管理暂行办法（征求意见稿）》) published on May 8, 2020 have not yet been officially promulgated. Trust companies are waiting to see what the final version will look like.

On December 30, 2022, the CBIRC promulgated the *Notice on Regulating the Classification of Trust Businesses of Trust Companies (Consultation Draft)* (《关于规范信托公司信托业务分类有关事项的通知（征求意见稿）》) ("**Draft of Classification of Trust Business**"), *based on the Circular on Issues Concerning the Adjustment of the Classification of Trust Business (Consultation Draft)* 《关于调整信托业务分类有关事项的通知（征求意见稿）》 promulgated in April and the version issued by the regulator to certain trust companies in private in October. The *Draft of Classification of Trust Business* classifies the trust business into three major categories (i.e. asset management trust, service trust and charity trust) which are further broken down into subdivisions. Specifically, single-client trusts no longer fall within the category of asset management trusts, but are classified as wealth management trusts (in itself one subdivision of service trust). This classification is different from the provisions of the *Interim Measures for the Management of Fund Trusts by Trust Companies (Consultation Draft)* (《信托公司资金信托管理暂行办法（征求意见稿）》), and reflects the CBIRC's new approach on the regulation and development of trust business.

The *Draft of Classification of Trust Business* requires trust businesses to return to their original purpose and not to carry out any forbidden activities, such as carrying out illegal entrusted capital pooling business, provision of channel services for illegal activities and shadow banking. A three-year grace period has been granted for any adjustment that is required for existing businesses. All existing businesses must operate only to the scale and size that they had on December 31, 2022. Although the *Draft of Classification of Trust Business* has not been promulgated in its official version, trust companies already need to adapt their businesses accordingly.

At the same time, trust companies are also being encouraged to innovate and to enrich their scope of services. Some of these have happened, such as the offering of China's first special needs trust by China Foreign Economy and Trade Trust Co., Ltd. in August and the offering of China's first art asset management and heritage trust by Minmetals International Trust Co., Ltd. in September.

Faced with the challenges of risk disposal in the trust industry in recent years, the CBIRC, in consultation with the Ministry of Finance, revised the *Measures for the Administration of Protection Fund in the Trust Industry* and promulgated the *Measures for the Administration of Protection Fund in the Trust Industry and Liquidity Support Funds (Consultation Draft)* (《信托业保障基金和流动性互助基金管理办法（征求意见稿）》) on February 11, 2022, which clarifies the positioning and use of the protection fund in the trust industry ("**Trust Protection Fund**") (the capital of which is paid in by trust companies and used for the disposal of systematic risks and other major risks recognized by the CBIRC) and the liquidity support funds (the capital of which is raised by market participants in the trust industry and mainly used for dealing with liquidity issues). This consultation paper aims to optimize the functions of both the Trust Protection Fund and the liquidity support funds, so as to resolve the risks in the trust industry, ensure the stability of the financial market and protect the legitimate rights and interests of the trust clients/ investors.

During 2022, Trust Protection Fund reached a debt settlement with Anxin Trust, accepted all of Huarong Trust's equity interest held by China Huarong, and participated in the risk disposal of Sichuan Trust. In addition, the disposal of risks of Huaxin Trust and New Times Trust is proceeding. Risk disposal involves a variety of solutions, including share restructuring plus debt settlement, company liquidations and trusteeship.

03 Favorable policies are introduced for PE/VC funds

By comparison with previous years when PE/VC funds were held on a tight leash, 2022 witnessed a number of pilot policies being introduced. These included the Shenzhen Financial Service Office officially launching the pilot program for registration of contractual-type PE/VC funds (which means the PE/VC funds are purely contractually-based and not wrapped up in a form of limited liability partnership or limited liability company). Where a contractual-type PE/VC fund invests in a limited liability company or a partnership, it is permitted to be registered as a shareholder or partner of the target in the form of "the name of the PE/VC fund manager (representing the "name of the PE/VC fund")". Whether such a model will solve the issues of "three types of special shareholders" during IPO of the target is yet to be further clarified by the applicable regulatory authorities (FYI - three types of special shareholders referring to contractual funds, asset management schemes issued by financial institutions and trusts). Introducing such types of shareholders (no matter having interests in the IPO applicant directly or indirectly) might been seen as introducing a non-transparent shareholding structure in the IPO applicant and may either be required to be unwound or otherwise reorganized to other structures).

So far as exit channels are concerned, in July 2022, the CSRC launched the pilot program of in-kind distribution by PE/VC funds to investors, and conducted the first pilot program in October. In September 2022, the Shanghai Financial Service Office and other departments issued the *Several Opinions on Supporting the Shanghai Equity Exchange to Carry Out the Pilot Program for the Transfer of Private Equity and Venture Capital Shares*, which proposed the launch of preferential policies for shares transfer of PE/VC funds (including state-owned assets and fiscal funds, QFLP funds and other types of PE/VC funds), one-stop services for information sharing and shares transfer among different authorities, and the establishment of secondary market funds, among others. The Shanghai Equity Exchange became the second pilot platform for the transaction of PE/VC fund shares approved by the CSRC after the Beijing Equity Trading Center. These pilot programs took into account the specific needs of different types of investors and made the PE/VC fund market more liquid.

Although pilot programs for registration of pledging shares of limited liability partnerships have taken place in some cities, the *Several Provisions on the Development of Green Finance in Shanghai Pudong New Area* in Shanghai is the first local legislation in China that explicitly allows the registration of pledged PE/VC fund shares in regional equity markets, solving the practical problem of the effectiveness of pledge of shares of limited liability partnerships (note: share pledge will not become effective upon registration with the competent authority under PRC law. Previously, there was no means for a partner of a limited liability partnership to apply for registration if the shares were pledged).

In November 2022, the CSRC issued a circular announcing that it would launch a pilot program for real estate investment funds, allowing qualified PE fund managers to set up real estate investment funds to invest in residential real estate, commercial real estate and infrastructure. The aim of the CSRC is to promote the use of capital markets in the cause of a stable development of the real estate sector. However, the connection between such policies and the existing rules of the Asset Management Association of China ("**AMAC**") (especially the *Administrative Rules No.4 for Filing of Private Assets Management Plans by Securities and Futures Institutions - Private Assets Management Plans Investing in Real Estate Development Enterprises & Projects* which also applies to PE fund managers) still needs to be clarified.

04 Asset management outsourcing services to be made more professional

At the beginning of 2022, the CSRC issued a circular to securities companies, highlighting the major risks associated with the financial products distribution business (e.g. marketing, sales or promotion of financial products), clarifying the subsequent regulatory focus, and informing them that the on-site inspection of financial product distribution would be strengthened. During the year the CSRC increased its efforts to clamp down on those in breach of regulations and some of distributors had their distribution businesses suspended. The year of 2022 also witnessed the fund distribution license of some distributors being revoked, brought about by the implementation of the *Measures for the Supervision and Administration of Distributors of Publicly Offered Securities Investment Funds* (《公开募集证券投资基金销售机构监督管理办法》) and the competition in the market. On the one hand, some distributors were unable to maintain their licenses due to failure to meet the minimum requirements for carrying out their businesses or their failure to rectify compliance issues on time. On the other hand, due to the increased competition in the fund distribution industry, small institutions were unable to renew their licenses because they failed to meet the minimum levels of average daily distribution volume. Under the *Measures for the Supervision and Administration of Distributors of Publicly Offered Securities Investment Funds*, fund distribution licenses are only effective for three years, which is bringing pressure on these distributors to get their businesses in order and to make sure they are complying with the regulations. This is leading to some reorganization in the industry.

In terms of custody businesses, the circular issued by the CSRC to securities companies in early 2022 also summarized the major risks of the custody business of securities companies and mentioned that on-site inspection of their operations of the custody businesses would also be strengthened. The CSRC specifically mentions that some custodians have failed to make adequate investments in the HR and IT systems for their custody businesses. This may pose significant challenges for small-sized custodians which used to run the custody business with only the most basic operating infrastructures.

In addition, the CBIRC promulgated the *Measures for the Supervision and Administration of Custody Services of Commercial Banks (Consultation Draft))* (《商业银行托管业务监督管理办法（征求意见稿）》) ("**Draft of Custody Services of Commercial Banks**") by the end of 2022. Prior to the *Draft of Custody Services of Commercial Banks, there was no unified legislation for banks*' custody services other than one self-disciplinary rule, the *Guidelines for Asset Custody Services of Commercial Banks* (《商业银行资产托管业务指引》) issued by the China Banking Association, while the other requirements were scattered in specific provisions for different products. The *Draft of Custody Services of Commercial Banks* clarifies: (1) the segregated custodial assets should not be included as the assets of the bank in the event of bank dissolution, or bankruptcy, (2) the division of the assets of products under custody into custodial assets and other assets, based on whether the bank can achieve actual control over such assets, and (3) for other assets that do not constitute custodial assets (e.g. private equity), the bank does not assume the duties of asset safekeeping, asset valuation, investment supervision and other duties, but may only provide purely administrative services in connection with these assets. To some extent these rules constitute a formal statement by the CBIRC on the scope of duties of PE/VC fund custodians. However, it remains to be seen how they will be coordinated with the existing rules of the CSRC and the AMAC. In addition, the *Draft of Custody Services of Commercial Banks* reiterates the requirements of the independence of the custody business under the *Asset Management New Rules*. We note that the CBIRC penalized a number of banks whose custody business was deemed as lack of independence and not segregated from other businesses during 2022.

The professionalism of outsourcing service providers should also be enhanced by the announcement of a series of new policies in the financial services sector during 2022. As well as providing personal pension services directly to customers, financial institutions can also provide services to personal pension service providers by providing services such as product distribution and custody. The *New Measures on Public Funds* provides that FMCs may establish dedicated subsidiaries to provide services such as fund administration and transfer agent ("**FATA**"). In addition, FMCs are allowed to entrust qualified service providers to handle outsourcing services, including FATA and consulting services. By taking reference to international experience, as asset management companies become more specialized, we can expect the outsourcing in public fund management business may become the first choice for those boutique asset managers and small and medium -sized FMCs.

05 Greater financial consumer protection and regulators taking joint actions to protect investors

On December 31, 2021, the PBOC and other authorities issued the *Administrative Measures for the Online Marketing of Financial Products (Consultation Draft)* ("**Draft of Financial Marketing**"), on which they sought public comments by January 2022. The aim was to bring about unitary requirements of online marketing of all kinds of financial products. If and when the *Draft of Financial Marketing* is finally implemented, it will have a material impact on the current regulatory system and lead to greater protection for consumers as well as acknowledging the rights of investors.

The CBIRC issued the *Administrative Measures for Protection of Consumers' Rights and Interests of Banking and Insurance Institutions (Consultation Draft)* in May 2022, and an official version at the end of the year. These measures apply to banking institutions, insurance institutions and wealth management companies (collectively, "**banking and insurance institutions**"). The new rules lay down procedures for banking and insurance institutions to ensure their consumers are properly protected, and put forward the principal requirements for suitability management, record keeping of distribution activities, protection of personal information, management of cooperative institutions, complaint and dispute resolution mechanism, etc. These measures also require banking and insurance institutions to make sure that they adhere to high standards when implementing the protection of consumers' rights and interests in the design and development, pricing management, formulation of agreements, marketing and publicity of their products or services, and to protect legitimate rights of financial consumers. The regulations relating to the protection of financial consumers' rights and interests have been frequently issued in recent years, and the new measures should bring about greater protection for consumers of banking and insurance institutions.

The CBIRC and the CSRC were also more active in taking enforcement action against asset management institutions found to have been in breach of regulations, including in relation to information disclosure, provision of false or misleading information to investors, failure to properly conducting suitability management on investors, and compliance failures. For some transgressors, the regulators adopted what is called the "dual-punishment system" which means that punishments are applied to both the institutions and the relevant responsible persons. Such cases reflect the regulatory authorities' concerns on the greater protection for investors.

The judiciary has also contributed to the protection of financial consumers. On October 11, 2022, Shanghai Pudong New Area People' s Court issued the *White Paper on the Trial of Financial Asset Management Cases from 2021 to 2022* (the "**White Paper**"), which summarizes the trials involving asset management disputes and typical cases from August 2021 to July 2022. The *White Paper* covers disputes relating to investor protection such as the performance of suitability obligations, fiduciary duties and investor education by asset management institutions. To some extent it shows that these issues are quite common in the judicial field, and also provides judicial guidance for investors to enforce their rights.

06 Online business of wealth management booms, and regulatory policies support the digital transformation of wealth management sector

With the development of the Internet and the increased demand for online services as a result of COVID-19 lockdowns, more and more domestic customers have become accustomed to receiving financial services through online channels. For the wealth management sector, adapting the wealth management services to the online age has become both a challenge and an opportunity.

There are different approaches by wealth management companies to bring about digital transformation including putting in place strategies for digitalization of the wealth management business, or leveraging FinTech, such as artificial intelligence, to precisely analyze investors' needs and preferences. Some foreign businesses, including UBS and HSBC, have also started developing online platforms to sell their services in China.

As quickly as wealth management companies have adapted to the digital transformation, the regulatory authorities have also followed. In January 2022, the General Office of the CBIRC issued the *Guiding Opinions on the Digital Transformation of Banking and*

Insurance Industries, proposing the goal of achieving notable results in digital transformation of the banking and insurance industry by 2025. Related to wealth management business, the CBIRC proposed the use of FinTech to carry out marketing and services for personal financial products, expanding online channels, and promoting online marketing, transactions, services, and risk control. In particular, the CBIRC proposed enhancing the accessibility of financial products and services for special customer groups, including the elderly. Similarly, the CSRC and various institutions including China Securities Information Technology Service Co., Ltd, securities companies, fund management companies, futures companies, and information technology service providers jointly drafted the *Design Specification of Mobile Internet Application for Securities and Futures Industry for the Elderly* and the *Design Testing Specification of Mobile Internet Application for Securities and Futures Industry for the Elderly* to clarify the requirements related to App designs to make it easier for the elderly to use. In addition, the AMAC issued the *Administrative Measures for Electronic Contract Business of Private Investment Funds (for Trial Implementation)*, which sets out how private investment funds need to have proper internal controls, operation and data management when it comes to online contracts.

07 Personal pensions receives much attention as policies are developing and brings new opportunities for the wealth management industry

In 2022, many new policies relating to personal pensions were issued, including the *Opinions on Promoting the Development of Personal Pensions* issued by the General Office of the State Council, the *Implementation Measures for Personal pensions* issued by the Ministry of Human Resources and Social Security and other regulatory authorities, the *Announcement on Relevant Individual Income Tax Policies Regarding Personal pensions* jointly issued by the Ministry of Finance and the State Taxation Administration, the *Notice of Launching the Pilot Program of Specific Retirement Savings* issued by the CBIRC and the PBOC, the *Notice of Expanding the Scope of the Pilot Program of Pension Wealth Management Products*, the *Notice of Regulating and Promoting the Development of Commercial Pension Financial Services*, the *Interim Administration of Personal Pension Business of Commercial Banks and Wealth Management Companies*, and the *Notice of Launching the Pilot Program of Commercial Pension Business of Pension Insurance Companies* issued by the CBIRC, and the *Interim Provisions on the Administration of the Business of Personal pensions' Investing in Publicly Offered Securities Investment Funds* issued by the CSRC. What all that means is that there is now an overall regulatory structure covering personal pensions. How China's personal pensions markets develop will be a good indicator of the progress of China's wealth management sector overall.

Financial institutions are allowed or permitted to offer personal pension services relying on their capabilities in asset management and other wealth management services, by offering personal pension accounts, personal pension consulting services and issuing pension financial products. There are already several rules issued in respect of personal pension public funds, pension wealth management products, commercial pension insurance products and pension saving products. The model of provision of professional personal pension investment consulting and advisory service remains to be further explored. With reference to the development experience of developed countries, personal pension investment advisory service is an integral part of personal pension financial services.

08 Strengthening personnel management and introducing unified rules in the fund industry

With the development of the fund industry in China, there needs to be a focus on making sure that the practitioners in the fund industry are well managed and suitably qualified. Several regulations were issued in 2022 to govern the management of practitioners and to bring about improved internal governance of institutions in the fund industry.

In February 2022, the CSRC published the *Measures for the Supervision and Administration of the Directors, Supervisors, Senior Management and Practitioners of Securities and Fund Institutions*, covering procedures for the appointment and practice of directors, supervisors, senior management and practitioners in securities and fund institutions by unified rules, which also included the relevant personnel of FMCs, their subsidiaries and outsourcing service providers in the scope of supervision. Subsequently, the AMAC published the *Administrative Rules for Fund Practitioners* and the implementing rules applicable to institutions in the public fund and private fund industry, as well as their respective practitioners, which proposed more specific requirements for qualification application, management responsibilities of the employers, code of conduct and other aspects. The *New Measures on Public Funds* published in 2022 also specifies the professional standards and requirements for relevant personnel to safeguard the interests of clients, work honestly and so on.

The *Opinions on Public Fund Industry* and the *New Measures on Public Funds* stipulate that public fund managers shall establish and refine long-term incentive and control processes, have greater internal control over the payment of salaries and remuneration, and ensure that the interests of practitioners and fund investors are aligned. In June 2022, the AMAC published the *Guidelines for Performance Appraisal and Remuneration Management of Fund Management Companies*, regulating the performance appraisal and remuneration management of fund managers from the perspectives of optimizing remuneration structure and payment, as well as improving performance appraisal.

2023 Regulatory Outlook

01 Promising future for the wealth management sector with strong policy support

With the support of regulatory policies, the wealth management sector in China has a promising future. Currently, key regulations (or their consultation drafts) have been issued one after another. We expect that in addition to the official version of the consultation drafts, the regulatory authorities will continue to issue further implementation regulations.

Now that the *Asset Management New Rules* has raised requirements such as eliminating "mandatory repayment" and carrying out net value management, there is a recognition that wealth management services can greatly assist people's personal finances. Given that buy-side investment advisory services are the core of wealth management services, we can expect regulators to put in place rules and regulations governing how those services are delivered. There is a consultation draft written by the CSRC on securities, futures and fund investment advisory businesses. In addition, the model of professional personal pension investment consultation and advisory services, including providing professional advice and guidance on pension account management, asset allocation, tax treatment and so on will be guided and encouraged by applicable policies.

The advantages of trust business in the wealth management sector will be further explored, and trust companies can provide tailored wealth management services through wealth management service trusts (including family trusts, testamentary trusts, individual/legal person/unincorporated organization wealth management trusts, special needs trusts and others). Trusts serve many people well, including high net worth individuals, who need their privacy protected and assets ring-fenced. We anticipate that regulatory authorities will pay increasing attention to wealth management as a new direction for the transformation of trust companies, and launch regulatory guidance and implementation policies accordingly.

In 2022, many local governments, including Beijing, Guangzhou and Shenzhen, proposed to become the wealth management/wealth and asset management centers. Whether the local governments will introduce more specific implementation advice or preferential policies, we will just have to wait and see.

02 China's financial sector will continue to open up and international financial institutions need to sort out a more practical approach to make the most of their group advantages while adhering to the PRC regulatory requirements

We expect that in 2023 the regulatory authorities will continue to open up the financial sector, and provide more choices of financial products and services for domestic financial consumers by allowing more foreign institutions to enter the market and exploring more channels for cross-border investments.

The *Provisions on the Administration of Insurance Asset Management Companies* published in 2022 had already removed the restriction that foreign investors cannot hold more than 25% of equity interest in an insurance asset management company, and specified that insurance asset management companies may establish dedicated subsidiaries engaging in asset management business or asset management-related business. We shall have to wait to see how the market responds. In addition, we expect the launch of Swap Connect in 2023, which will be another landmark of the mutual connection between the financial markets of Mainland China and Hong Kong, promoting the development of the domestic derivatives market and providing more diversified investment and risk management instruments for both domestic and overseas investors.

To enter the Chinese market, foreign institutions need to adapt to the Chinese market, working towards localization while bringing their advanced international experience. Although foreign institutions have more experience in innovative and complex financial products, and have stricter group compliance and risk control requirements, foreign institutions still need to take into account local regulatory requirements and the environment of the domestic market, and reach a balance between the requirements of group collaboration and independent operation.

In our view, against the background of tightening financial regulation and increasing regulatory attention to network and data security, it remains for all parties concerned to work together to devise feasible and risk-controlling work solutions on how to achieve rapid business implementation and stable commercial operations, to maintain necessary cross-border data transmission and to adhere to global risk control requirements, which will ensure compliance with all local regulations but at the same time take advantage of international resources and experience.

03 Unified regulations should help to benefit the industry generally

The promulgation of unified regulatory standards covering asset management and supporting rules applicable to different types of asset management institutions is likely to lead to more competition, largely because banks and trust companies can no longer offer guaranteed returns on their asset management products and the gap between regulations of the CSRC and those of the CBIRC narrow to prevent companies taking advantage of different regulations. At the same time, we can expect more cooperation between different types of financial institutions, including distribution and custody. For example, professional asset managers may provide investment advisory services to banks (which are less competitive in investment research), and the new trend of outsourcing by public funds will bring more opportunities for the banks or securities companies.

The trend towards issuing unified regulations by regulators for different institutions to build a healthy industry ecosystem and the greater cooperation including supervision cooperation and information sharing between regulators should serve the asset management sector and wealth management sector well.

04 Improvements to internal governance and risk control and multi-pronged strategy to resolve financial risks

In 2022, China's financial regulatory authorities, including the CBIRC and the CSRC, made it clear the importance they attached to financial institutions' governance and risk control. The *Opinions on Public Fund Industry* points out that high-quality development shall be premised on compliant operation and risk prevention, and propose four specific requirements. The *New Measures on Public Funds* set up a special chapter on internal control, in which various requirements are stipulated with an aim to strengthen the internal control and risk management of FMCs. The *Measures for the Administration of the Internal Control of Wealth Management Companies* puts forward comprehensive requirements on the internal control of wealth management companies. Chairman of the CBIRC Guo Shuqing pointed out key measures for strengthening corporate governance and internal control of financial institutions and urging financial institutions to refine and improve their internal controls in an article, "*Strengthening and Improving Modern Financial Supervision*".

We expect that in 2023 regulatory authorities will continue to emphasize financial institutions' internal governance and risk control. This could take a number of forms, including (1) risk plans and disposal plans such as "living wills" to implement the capital replenishment responsibilities of major shareholders and actual controllers of asset management institutions, (2) strengthening verification of shareholders' qualification and license application requirements, (3) strengthening the regulation of shareholders' conduct, as well as the supervision of conducts of directors and senior management personnel, and paying special attention to long-term incentive mechanisms, and (4) improving and enhancing the construction of internal control, improving the overall risk management system, (5) fully implementing the *Asset Management New Rules*, reducing shadow banking, and stopping guaranteed returns. Although these measures have already been implemented for banking and insurance institutions, we expect China's regulatory authorities will improve and use a wide range of mechanisms to optimize the implementation. Requirements such as "living wills" will be further introduced to CSRC-regulated public and private fund managers in 2023. In addition, regulatory authorities will use diversified risk disposal methods to properly deal with risky institutions and prevent systemic financial risks.

05 Policies will guide the asset management sector to serve the real economy with an aim at the economic recovery

With a focus on economic recovery, the financial policies in 2023 will be geared to ensure that the asset management sector will serve the real economy and contribute to the disposal of non-performing assets. There will be more pilot schemes covering a greater range of asset management products.

Given the advantages of insurance funds in long-term investments and diversified investments, the CBIRC will further explore how insurance funds can be put to good use and will encourage innovation of insurance asset management products to promote the development of emerging and innovative industries. According to the *Draft of Classification of Trust Business*, trust companies are prohibited from carrying out any trust business which aims at providing investment banking service for the benefit of the lenders in essence, and they need to reduce the trust business with prominent shadow banking risks. In the meantime, trust companies will be expected to explore new business models. In the process of serving the real economy, it is particularly urgent for trust companies to reduce the scale of existing non-compliant businesses and explore new business models, and they need to break the single role of financing provider and better support the development of the real economy from the perspective of equity investment and other aspects. Banks are also being asked to adapt their wealth management businesses. We believe that the CBIRC will assist in the business transformation and development of bank wealth management and trust business, optimize the relevant business regulatory system, and provide the policy basis for them to serve the real economy.

The CSRC is giving special attention to the normalized issuance and expansion of infrastructure REITs and government-subsidized rental housing REITs projects to better serve the real economy. In addition, the pilot scheme of PE/VC funds to make in-kind distributions to investors initiated by the CSRC and the pilot real estate private investment fund to be introduced by the CSRC should demonstrate the role of private equity funds in the real economy. We believe that the CSRC will give full play to the investment research advantages of asset managers and will continue to explore and implement pilot programs to serve the real economy.

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FinTech

2022 Regulatory Milestones

January 10

The China Banking and Insurance Regulatory Commission (CBIRC) issued the *Guiding Opinions on the Digital Transformation of the Banking and Insurance Industry*.

January 21

The People's Bank of China (PBOC) released the *Fintech Development Plan (2022-2025)*.

April 13

The National Internet Finance Association of China (NIFA), the China Banking Association (CBA) and the Securities Association of China (SAC), jointly issued the *Initiative to Prevent Relevant Financial Risks of Non-Fungible Tokens*.

April 29

The China Securities Regulatory Commission (CSRC) issued the *Measures for the Management of Cybersecurity in the Securities and Futures Industry (Consultation Draft)*.

June-July

The Cyberspace Administration of China (CAC) promulgated the *Provisions on Standard Contracts for Outbound Transfer of Personal Information (Consultation Draft)* and the *Measures for Security Assessment of Outbound Data Transfer*.

July 12

The CBIRC issued the *Notice on Strengthening the Management of Internet Loan Business of Commercial Banks and Improving the Quality and Efficiency of Financial Services*.

July 19

The CBIRC solicited public opinion on the *Administrative Measures on Insurance Sales Practices*.

September 12

The CAC solicited public opinion on proposed *Amendment to the Cybersecurity Law*.

December 1

The Secretariat of the CAC and the General Office of the CSRC jointly issued the *Work Plan for the Governance of Online Information Content involving Illegal Securities Activities*.

December 11

The CAC, the Ministry of Industry and Information Technology (MIIT) and the Ministry of Public Security jointly issued the *Provisions on the Administration of Deep Synthesis of Internet-based Information Services*.

December 26

The CBIRC issued the *Administrative Measures for Protection of Consumer Rights and Interests by Banking and Insurance Institutions*.

December 30

The CSRC announced initiation of inspection and "rectification" work against online brokerage firms Futu Holdings and Tiger Brokers.

2022 Regulatory Mainline Review

01 Financial regulators reinforce licensing requirements for financial business, and initiate regulatory measures on cross-border securities services

Following the issuance of a series of rules requiring financial business (such as banking, securities, insurance, and credit reporting) to operate with a license in 2021, on January 1, 2022, a number of developments occurred to reinforce the licensing requirements and to draw clearer delineations between the financial and technology sectors. These included:

(i) the expiration of the "rectification period" (which involves businesses putting right processes and practices to comply with new regulations) under the *Notice on Further Regulating the Internet Life Insurance Business of Insurance Institutions*;

(ii) the formal implementation of regulatory requirements on the minimum funding proportion by each participating bank in a joint loan and the cross-regional operations under the *Notice on Further Regulating the Internet Loan Business of Commercial Banks*; and

(iii) the formal implementation of the *Measures for the Administration of the Credit Reporting Business*.

On January 24, 2022, the CBIRC emphasized in its working meeting the need to crack down on unlicensed financial businesses.

On December 1, 2022, the Secretariat of the CAC and the General Office of the CSRC issued *the Work Plan for the Governance of Online Information Content involving Illegal Securities Activities* (the "**Work Plan**"). The Work Plan calls for a prompt clean-up of information and accounts (i) used in illegal stock recommendation activities by unlicensed institutions or individuals, (ii) counterfeiting the information and accounts of licensed securities and fund institutions or their staff, or (iii) of stock market "black mouth" spreading fake or misleading information and deceiving investors into trading. The Work Plan also requires strict implementation of "licensing operation" by securities businesses, as well as proper guidance for website platforms and mobile app stores to set the verification of securities service qualifications as a prerequisite for carrying out securities-related business cooperation.

Licensing requirement has also extended to online cross-border securities services. On December 30, 2022, the CSRC announced that it planned to order Futu Holdings and Tiger Brokers to stop providing cross-border securities services to domestic investors without proper approval and to address regulatory non-compliance under PRC law.

02 Promoting the digital transformation and innovative development of the financial sector

Driven by the development of the digital economy, the financial sector experienced a new wave of digitalization and innovation in 2022.

In early 2022, the PBOC issued the *Fintech Development Plan (2022-2025)*, defining "Fintech" as a "technology-driven financial innovation", emphasizing "driven by digitalization" as the principle of Fintech development, and setting "deepening the digital transformation of the financial industry", "further releasing the potential of data elements" and "advanced digital infrastructure construction" as development goals of Fintech for the years 2022-2025.

On October 28, 2022, the *Report of the State Council on the Development of the Digital Economy* restated the working arrangement of "vigorously promoting the innovation and development of the digital industry" and "accelerating deep transformation of industrial digitalization", and listed "speeding up the digitalization of the financial industry" as one of the tasks of "accelerating deep transformation of industrial digitalization".

In terms of specific policies and measures,

(1) On January 10, 2022, the CBIRC issued the *Guiding Opinions on the Digital Transformation of the Banking and Insurance Industry* (the "**Guidance on Digital Transformation**"). As the first CBIRC document dedicated to the digital transformation of the banking and insurance sectors, the *Guidance on Digital Transformation* provided guidance on how banks and insurance companies should develop digital finance, with the goal of actively developing industrial digital finance, digitalizing personal financial services, increasing digital financial market transactions and creating a safe and efficient financial services sector. The *Guidance on Digital Transformation* set a deadline for the banking and insurance sectors to obtain significant achievements in their digital transformations by 2025.

(2) On November 18, 2022, the PBOC, the National Development and Reform Commission (NDRC), the Ministry of Science and Technology, the MIIT, the Ministry of Finance, the CBIRC, the CSRC and the State Administration of Foreign Exchange (SAFE) jointly issued the *Overall Plan for the Construction of Pilot Zones for Sci-Tech Innovation Finance Reform in Shanghai, Nanjing, Hangzhou, Hefei and Jiaxing*. The plan laid out 19 specific policies ranging from promoting the innovation of science and technology financial

products to improving the Fintech ecosystem, with the goal of better linking finance, technology and manufacturing industries to facilitate high-quality development.

03 Regulators move towards establishing technology to support financial regulatory supervision, but challenges remain

As compared with the *Fintech Development Plan (2019-2021)* in 2019, the *Fintech Development Plan (2022-2025)* has upgraded the development strategy of "regulatory technology (Regtech)", changing description from "strengthening the application of regulatory technology and establishing a sound rule base for digital regulation" to "accelerating the all-round application of regulatory technology" and "strengthening capacity development of digital regulation". The point is to highlight the importance of the use of technology as an efficient way to regulate and properly guide the development of the Fintech sector. "Improving the use of regulatory tools for Fintech innovation" was also set as one of the key tasks of the Financial Technology Committee of the PBOC in 2022, according to a committee meeting held in March 2022.

On November 18, 2022, PBOC, together with other seven regulatory bodies, jointly issued the *Overall Plan for the Construction of Pilot Zones for Sci-Tech Innovation Finance Reform in Shanghai, Nanjing, Hangzhou, Hefei and Jiaxing*, proposing a work plan to "improve the level of financial regulatory technology", expressly supporting the setting up of provincial digitalized financial regulatory platforms, encouraging Nanjing, Hefei and Jiaxing to promote the implementation of Fintech innovation regulatory tools, and calling for exploration of innovative application of data sharing and data intelligence in technology-based regulation, as well as "inclusive and prudent" Regtech practice.

Whilst Regtech has been applied in the financial sector to regulate such activities as anti-money laundering, related party transactions, regulatory reporting, consumer protection and securities market supervision, there is still a lack of supporting rules. The development of Regtech is also hampered by restrictions on the use of data and technical difficulties. Guo Shuqing, chairman of the CBIRC, wrote in an article *Strengthening and Improving Modern Financial Supervision (Conscientiously Study, Publicize and Implement the Spirit of the 20th CPC Congress)* published on December 14, 2022, that "the gap between the means of regulatory technology and the digital level of the industry is prominent", indicating that there remains much room for the development and application of Regtech.

04 Cybersecurity legislation and law enforcement in the financial industry further strengthened; supporting insurance mechanisms begin to emerge

Following the *Regulations on the Security Protection of Critical Information Infrastructure*, the *Regulations on the Management of Network Product Security Vulnerabilities* and the *Measures for Cybersecurity Review* in 2021, cybersecurity legislation continued to be refined in 2022.

On June 27, 2022, the CAC promulgated the *Provisions on the Management of Internet User Account Information* to further refine the requirements of the "Internet real-name system".

On September 12, 2022, the CAC publicly solicited comments on the proposed *Amendments to the Cybersecurity Law*. The completed amendments further strengthen the legal responsibilities of (i) critical information infrastructure operator, (ii) network operators, and (iii) providers of critical network equipment and cybersecurity products; and greatly increase the scope of punishments and levels of fines for those in breach.

On April 29, 2022, the CSRC solicited public opinions on the *Measures for the Management of Cybersecurity in the Securities and Futures Industry (Consultation Draft)*, requiring securities institutions to establish and improve sound cybersecurity management system and mechanism, and enhance security assurance capabilities for network operation.

On November 7, 2022, the MIIT published the *Opinions on Promoting the Standardized and Healthy Development of Cybersecurity Insurance (Consultation Draft)*, providing guidance for the development and operation management of "cybersecurity insurance", and laying down the foundation for subsequent development and implementation of regulatory rules for cybersecurity insurance.

Meanwhile, regulators have continued to bolster law enforcement in the cybersecurity sector. In July 2022, due to a system failure, a brokerage firm was punished for being in breach of the *Measures for the Administration of Information Security Protection in the Securities and Futures Industry*, the *Measures for the Information Technology Management of Securities and Fund Operators*, and the *Measures for the Reporting, Investigation and Handling of Information Security Incidents in the Securities and Futures Industry*. Also in July, the CAC announced its decision to impose administrative penalties on a well-known Internet travel platform (as well as its executives) for its violation of the *Cybersecurity Law*, the *Data Security Law* and the *Personal Information Protection Law*, imposing a fine of more than RMB 8 billion.

05 Management rules for outbound data transfer by financial institutions further improved; permitted routes for personal information export become clear

"Outbound data transfer", i.e., the transmission of data from within the mainland area of China outside the jurisdiction, continued to be the subject of regulatory attention.

On July 7, 2022, the CAC issued the *Measures for Security Assessment of Outbound Data Transfer* (the "**Outbound Transfer Assessment Measures**"), which, on the basis of the *Personal Information Protection Law* and the *Data Security Law*, further clarifies the scope, conditions and procedures of outbound data transfer security assessment, and provides general guidance for the assessment.

So far as outbound personal information transfer is concerned, according to the *Outbound Transfer Assessment Measures* and related official comments[1], currently only outbound personal information transfer by (i) operators of critical information infrastructures, (ii) data handlers that handle personal information of more than 1 million people, and (iii) data handlers that have cross-border transferred personal information of more than 100,000 individuals or sensitive personal information of more than 10,000 individuals cumulatively as of January 1 of the previous year, are subject to the security assessment requirement. Other types of outbound personal information transfer arrangements can be carried out by signing a standard contract or obtaining a personal information protection certification. With the subsequent promulgation of the *Provisions on Standard Contracts for Outbound Transfer of Personal Information (Consultation Draft)* and the *Announcement on the Implementation of Personal Information Protection Certification*, the implementation rules for the three "permitted routes" of outbound personal information transfer identified under the *Personal Information Protection Law* (i.e., the route of security assessment, protection certification and signing of standard contracts) are essentially all in place.

Meanwhile, outbound data transfer by banks is subject to heightened rules of "data localization". On November 11, 2022, the CBIRC publicly solicited comments on the *Banking Supervision Law of the PRC (Draft Revision for Consultation)*. Compared with the current *Banking Supervision Law*, the consultation draft adds new provisions on outbound data transfer by banking financial institutions by reference to the regulatory rules in the securities sector, providing that "banking financial institutions shall not provide relevant documents, information and data related to their business outside of China without authorization".

06 Financial institutions accelerate Metaverse opportunities; financial compliance risks emerged for Metaverse innovation

Driven by the rapid development of Metaverse economy, Metaverse exploration has expanded from gaming and entertainment to other sectors. According to public statistics, as of August 15, 2022, the concept of "Metaverse" had been mentioned in a total of 39 official policy documents and work reports across the country. In November 2022, five regulatory departments including the MIIT, the Ministry of Education, the Ministry of Culture and Tourism, the State Administration of Radio and Television and the State Administration of Sports, jointly issued the *Action Plan for the Integration and Development of Virtual Reality and Industry Applications (2022 - 2026)*, noting that "virtual reality (including augmented reality and mixed reality)" is "a major forward-looking field of the digital economy", and putting forward a five-year goal of "achieving large-scale application of virtual reality in important economic and social industries".

In this context, aiming to open up a new digital market, the financial sector has initiated active exploration of Metaverse, including:

- in January 2022, WeBank launched a digital collection of the Year of the Tiger "Fuhu", and Bank of Jiangsu announced that it would start to actively deploy financial Metaverse; and

- in February 2022, Xiangcai Securities announced the launch of three series of digital collections for investment education, and JPMorgan Chase opened Onyx Lounge in Decentraland (the first fully decentralized virtual world), becoming the first commercial bank to enter the Metaverse.

The rapid development of Metaverse economy also brings compliance concerns. On February 18, 2022, the Office of the Inter-Ministerial Joint Conference issued the *Risk Alert on Preventing Illegal Fund Raising in the Name of Metaverse*, drawing the public's attention on illegal fund raising, fraud and other illegal and criminal

1. Press Conference for the *Measures for Security Assessment of Outbound Data Transfer*, http://politics.people.com.cn/n1/2022/0707/c1001-32469307.html

activities under the disguise of Metaverse. On April 13, the NIFA, the CBA and the SAC jointly issued the *Initiative to Prevent Relevant Financial Risks of Non-Fungible Token*, proposing to curb the move towards NFTs (non-fungible tokens) securitization, and advocating that there should be (i) no financial product embedded in the underlying commodities of NFTs, (ii) no disguised issuance and trading of financial products, token Issuance financing or centralized trading via NFTs, (iii) no use of virtual currency as a valuation, pricing or settlement tool for NFT issuances and transactions, and (iv) no investment in, or provision of financing services for the investment in NFTs.

On December 11, the CAC, the MIIT, and the Ministry of Public Security jointly issued the *Provisions on the Administration of Deep Synthesis of Internet-based Information Services*, including "deep synthesis technology"[2], which is considered as one of the key technologies for the development of Metaverse, into the scope of administration. These Provisions provide general regulatory rules for the operation of deep synthesis service, requiring service providers to undertake responsibility for information security, to establish and operate robust internal management, including having in place processes and risk management protocols to enhance content management and deal with rumors and complaints, and to carry out real-name identity check on users.

07 Third-party payment market undergoes deepen restructuring; cross-border RMB policy reinstates supports to cross-border RMB payment business

In 2022, the PRC non-bank payment sector (i.e., the third-party payment sector) undergoes another round of reshuffle. On June 26, 2022, the PBOC announced the license renewal results of the fourth-batch third-party payment institutions. The result revealed that among all the seventy-nine (79) payment institutions, only fifty-two (52) had had their licenses renewed, eight (8) had applied for suspension, ten (10) failed to submit renewal applications, one (1) was rejected, and eight (8) withdrew their applications. Compared to the previous three batches, the proportion of successful renewals of the fourth batch is the lowest. Meanwhile, affected by the directional opinions (such as the "two participations and two controls" principle) under the *Regulations for Non-Bank Payment Institutions (Consultation Draft)*, voluntary clearing and withdrawal by third-party payment institutions are also accelerated. According to unofficial statistics, as of December 21, 2022, there have been 7 equity transfer deals in the third-party payment sector in 2022. While, according to the PBOC, as of December 31, 2022, the total number of licensed third-party payment service providers stands at 201. Cumulatively, 70 third-party payments providers have ceased business, of which 23 were terminated during 2022.

In terms of regulatory policies, with the introduction of a series of new regulations in 2022, such as the *Self-regulatory Code for Acquiring Outsourcing Service Organizations (For Trial Implementation)*, the *Anti-Telecommunication Network Fraud Law of the PRC* and the *Notice on Further Promoting the Standardized and Healthy Development of Credit Card Business*, compliance requirements for third-party payment industry have been further upgraded and strengthened, the cost of violations has increased significantly, and the gray profit margin has been further compressed.

Meanwhile, cross-border RMB payment services continued to be encouraged by the regulators. On June 16, 2022, the PBOC issued the *Notice on Supporting Cross-border RMB Settlement of New Forms of Foreign Trade Businesses*, which expands the cross-border RMB policy support for new forms of foreign trades and, on the basis of the *Notice on Further Optimizing Cross-border RMB Policies to Support Stable Foreign Trade and Foreign Investment (Yinfa [2020] No. 330)*, explicitly expands the cross-border RMB payment business scope of third-party payment institutions from goods and service trade led by cross-border e-commerce, to cross-border e-commerce, market-purchase-trade, overseas warehouses and comprehensive foreign trade service, among other new types of foreign trade business. Domestic banks are encouraged to cooperate with licensed third-party payment institutions and qualified clearing institutions to provide cross-border RMB settlement services for market entities and individuals on current account.

We expect that the "reshuffling" in the third-party payment sector will continue through 2023. At the same time, the legislative progress of the *Regulations for Non-Bank Payment Institutions* is also worth attention. The formal implementation of the Regulations is likely to help further consolidate and facilitate the development of the third-party payment service market.

2. "Deep synthesis technology" is a new application of AI technology, covering face synthesis, human voice synthesis, immersive scene generation and editing and other technical types and services.

08 Financial consumer protection measures continue to be strengthened; rules of Internet information service further improved

In 2022, financial consumer protection remained a top priority of regulators. In July 2022, the CBIRC issued in succession the *Notice on Strengthening the Management of Internet Loan Business of Commercial Banks and Improving the Quality and Efficiency of Financial Services* and the *Administrative Measures on Insurance Sales Practices (Draft for Consultation)*, which introduced more regulations covering the sales of financial products and strengthened the protection of consumers' rights and interests. On December 26, 2022, the *Administrative Measures for Protection of Consumer Rights and Interests by Banking and Insurance Institutions* were officially promulgated, expressly prohibiting banking and insurance institutions from allowing third-party institutions to promote or sell financial products and services in the name of banking and insurance institutions through business outlets or self-operated online platforms.

Internet regulation is also undergoing revision. On June 14, 2022, the CAC issued the updated *Provisions on the Administration of Mobile Internet Application Information Services*, strengthening the requirements for the protection of the rights and interests of application users, prohibiting service providers from inducing users to download applications via false advertising, bundled downloading, brushing, comments control or spreading illegal and harmful information. On September 9, 2022, the CAC, the MIIT and the State Administration for Market Regulation (SAMR) jointly issued the *Provisions on the Administration of Internet Pop-up Information Push Service*, proposing specific compliance requirements for issues such as using pop-up windows to illegally push news information, online advertisements that cannot be closed with one click, malicious hype about entertainment gossip, and other malevolent features.

2023 Regulatory Outlook

01 Big Tech "rectification" enters its final phase; Internet finance steps in a stage of "normalized" supervision

After three years of regulatory attention, the process of regulating Internet finance companies entered its final stage during 2022.

On March 2, 2022, Guo Shuqing, chairman of the CBIRC, disclosed at a press conference that the major 14 Internet platform enterprises had done much on self-inspection but were still in the progress of completing necessary internal reforms (i.e., the "rectification") to bring their businesses in line with regulations. The innovative financial services of the 14 platforms were also being gradually brought under supervision, he said.

Later on September 20, 2022, the PBOC convened a forum with the 14 platforms, revealing an intention to quickly complete the rectification process and initiate normalized supervision on Internet platform companies. In November 2022, the *Report of the State Council on the Financial Work* reiterated the intention of "prudently processing and expeditiously completing the rectification of the financial business of platform enterprises, and implementing normalized supervision". In the same month, 360 DigiTech, one of the 14 platform enterprises, said that it had basically completed rectification and upon general regulatory review, moved into the phase of "normalized supervision".

The concept of "normalized supervision" embraces both the strict supervision of financial services and the coordinated regulation on "platform economy" (such as antitrust and anti-unfair competition regulation). Going alongside that, as part of the country's overall economy strategy, the development of platform economy remains strongly supported and encouraged in China. It was pointed out during the Central Economic Work Conference held in December 2022 that it is necessary to "vigorously develop digital economy and improve the level of normalized supervision, support platform enterprises to lead the economy development, create employment and play their role in international competition."

It is foreseeable that, in 2023, with the conclusion of the rectification work on leading Internet platforms, Internet financial services will gradually step into the phase of "normalized supervision". Whilst, driven by economic development needs, supporting regulation policies and rules on Internet finance will continue to evolve.

02 Implementation rules for outbound data transfer pending for further improvement; "data capitalization" to be expected

With the release of the *Outbound Transfer Assessment Measures* and other documents on outbound data transfer, the routes and supporting regulatory requirements for transferring data out of China have become clearer.

However, as the *Provisions on Standard Contracts for Outbound Transfer of Personal Information* is not finalized, and the detailed operational rules and guidance for security assessment and personal information protection certification are yet to be unveiled, there is still a lack of clear implementation guidelines and reference cases for outbound personal information transfer. Meanwhile, in terms of the implementation of the security assessment requirement for outbound data transfer involving "important data", the scope of "important data" is not clearly defined either. Although some industries have initiated pilot work to formulate industrial important data catalogs, so far no draft catalog has been issued; and the draft national standards *Information Security Technology Important Data Identification Guide*[3], after several modifications, is still waiting to be finalized. Since the scope of "important data" is clearly important when it comes to the outbound data transfer security assessment, as well as the formulation of the "data classification and categorization management mechanism" proposed by the *Data Security Law*, it is imperative to introduce clear identification rules and instructive catalogue of "important data".

We expect that, in the coming months, the legislative work on data security will focus on the finalization of the *Provisions on Standard Contracts for Outbound Transfer of Personal Information*, the release of operating standards for the security assessment and personal information protection certification, and the final versions of industry-wide important data identification guidelines. It is also expected that, with the further introduction of the outbound data transfer rules and greater clarity on the scope of "important data" in the financial sector, the regulatory compliance boundary for outbound financial data transfer, will become clearer.

Meantime, with the heating up of the exploration work in the data element market[4], the concept of "data assets" has been further highlighted. On October 28, 2022, the *Report of the State Council on the Development of the Digital Economy* expressly calls for establishing systems and rules for data property rights, data circulation and trading, income distribution and security governance, and promoting the "national data element market system". On December 19, 2022, the Central Committee of the Communist Party of China (CPC) issued the *Opinions on the Construction of Data Basic System to Better Play the Role of Data Elements* (the "**20 Data Measures**"), putting forward 20 measures covering such matters as data property rights, data transfer and transaction, distribution of income, and safety management. The *20 Data Measures* proposed a data property rights framework which divides data property rights into three kinds: ownership, the right to use and process data, and the right to operate data products. The *20 Data Measures* proposed improving the life-cycle data compliance and regulatory rules system, having standardized and efficient data trading venues, and building safe, compliant and well-organized cross-border data transfer systems.

Whilst data capitalization has become a key focus as the government promotes the digital economy, data trading remains a hazy area and is not well regulated due to varied unresolved issues such as unclear property rights and lacking of fair pricing. There are only a few data trading venues and platforms that are able to ensure continuous operation, and important services thereof such as data registration, value estimation, liquidation, delivery and asset management are far from standardization. Compliance risks also exist in terms of the qualification of data providers and the legality of data sources. As such, to promote "effective" and "compliant" data capitalization, formulating legislation on data capitalization is likely another legislative focus in the near future.

3. This document has purportedly changed its name to the *Information Security Technology Important Data Identification Rules*.

4. On May 27, 2022, Guiyang Big Data Exchange released the first set of data trading rules in China, providing guidance on data ownership, evaluation and pricing of digital assets, trading process and other matters. Later in July, September and November 2022, Fujian, Guangzhou and Shenzhen respectively opened their local data exchanges. As of August 2022, 44 data trading institutions had been established nationwide, with most of the platforms' registered capital ranging from RMB50 million to RMB100 million, according to the *2022 White Paper on the Development of Data Trading Platforms* released by the State Industrial Information Security Development Research Center.

03 Steady development of e-CNY, with expected supporting laws and regulations

In 2022, the domestic e-CNY pilot project moved further forward. As of October 2022, PBOC has identified some areas in 15 provinces and cities to carry out e-CNY pilot projects and designated 10 operating institutions upon evaluation. Meanwhile, PBOC continues to actively promote multilateral and bilateral exchanges and cooperation for the internationalization of e-CNY. PBOC has participated in the multilateral central bank digital currency bridge project advocated by the Bank for International Settlements, exploring the possibility of multilateral cooperation for cross-border payments; and accelerated cross-border payment technology testing between the Mainland and Hong Kong, seeking to establish interconnection between the e-CNY system and Hong Kong fast payment system (FPS) to facilitate settlement by HK residents. According to the Hong Kong Monetary Authority (HKMA), in September 2022, Hong Kong, being the first city outside of the mainland area of China to conduct a cross-border pilot technology test for e-CNY, has entered the second phase of testing. Also according to *The Currency Bridge Project: Central Bank Digital Currency Helps Economies Converge and Interoperate* - jointly published by the Bank for International Settlements and others - the multilateral central bank digital currency bridge has successfully completed the first real transaction pilot test based on four central bank digital currencies. In a six-week period, 20 commercial banks from four different jurisdictions have completed a total of 164 cross-border remittance and foreign currency exchange transactions, totaling more than RMB150 million equivalent.

We expect there to be more regulations governing the use of e-CNY both domestically and internationally. Meanwhile, the prohibition on the issuance of virtual currencies and related financial services is not expected to change in 2023.

04 Gradual improvement of legislative and enforcement measures for anti-monopoly and anti-unfair competition in the digital economy

On June 24, 2022, the 35th Meeting of the Standing Committee of the 13th People's Congress considered and adopted the *Decision on Amending the Anti-Monopoly Law of the PRC*. The new version of *the Anti-Monopoly Law* came into force on August 1, 2022. A major revision by the new *Anti-Monopoly Law* is to further clarify the rules of application of the anti-monopoly related system in the digital economy and to confirm the regulatory principles stipulated in the *Anti-Monopoly Guidelines on the Platform Economy* at the level of "law". On June 27, 2022, the SAMR issued the *Regulations of the State Council on Standards for Declaration of Concentration of Business Operators(Revised Draft for Consultation)*, *Regulations on the Review of Concentration of Business Operators (Consultation Draft), Regulations on Prohibiting Abuse of Dominant Position in the Workplace (Consultation Draft)*, *Regulations on the Prohibition of Monopoly Agreements (Consultation Draft)*, *Regulations on Suppressing Abuse of Administrative Power to Exclude and Restrict Competition (Consultation Draft)* and *Provisions on Prohibiting Abuse of Intellectual Property Rights to Exclude and Restrict Competition (Consultation Draft)*, all open for public comments. These documents adjust and refine the provisions on safe harbor, concentration of business operators and determination of dominant market position in the platform economy.

On November 22, 2022, the SAMR issued for public comment the draft revision of *the Anti-Unfair Competition Law of the PRC*. The draft puts forward the principal requirement that "business operators shall not use data and algorithms, technology, capital advantages and platform rules to engage in unfair competition", and targets unfair competition in data acquisition and use, or via the use of algorithms, as well as new types of unfair competition on Internet such as prevention of open sharing.

With the clarification of the rules applicable to the "digital economy" under the new *Anti-Monopoly Law* and the *Anti-Unfair Competition Law*, as well as the introduction and updating of the subsequent supporting rules, the anti-monopoly and anti-unfair competition enforcement in the digital economy will be stepped up. As the economy recovers, we expect there will be more regulatory enforcement in 2023 to stamp out monopolistic behavior in the platform economy, including the Internet finance sector.

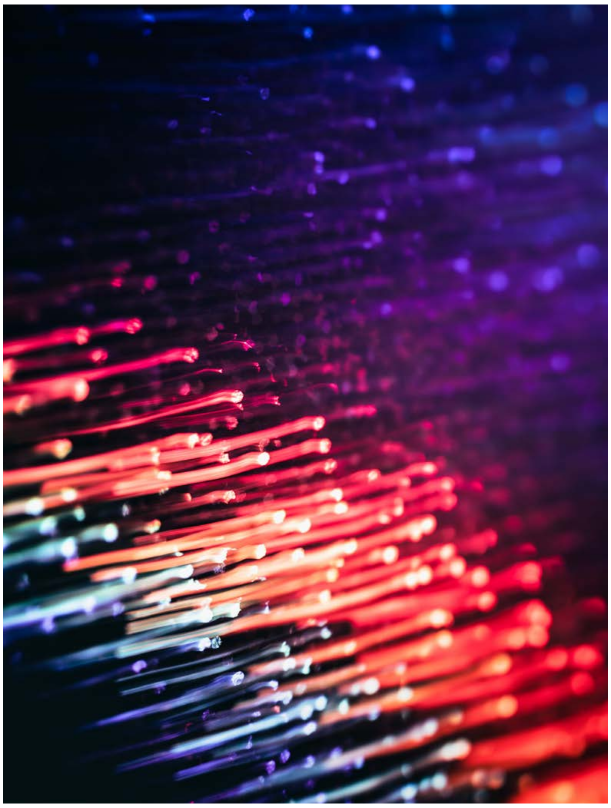
05 Supervision of financial science and technology ethics is expected to be established, top-level legislation on financial consumer protection may be introduced in the future

In early 2022, the General Office of the Central Committee of the CPC and the General Office of the State Council issued the *Opinions on Strengthening the Ethical Governance of Science and Technology*, pointing out that "the ethics of science and technology is the value and norms of conduct that need to be observed in scientific research, technological development and other scientific and technological activities, and it is an important guarantee to promote the healthy development of science and technology", and proposing five governance principles including (i) respecting the right to life, (ii) adhering to fairness and justice, and (iii) keeping openness and transparency. The *Fintech Development Plan* (2022 to 2025) also listed "strengthening the construction of financial science and technology ethics" as one of the important tasks of improving the governance system of financial science and technology. The objective is, primarily, to prevent in advance and effectively solve the ethical risks of Fintech activities, and to prohibit the misuse of technology.

On October 9, 2022, PBOC officially issued the *Guidelines for Science and Technology Ethics in the Financial Sector* (JR/T0258-2022)[5], which defined "Fintech" as "technology-driven financial innovation", and put forward major requirements for financial institutions, including the responsibility of performing ethical governance, implementing the requirements of "licensing operation", fulfilling the mission of serving the real economy, upholding the position of "technology empowering finance", adhering to the code of conduct in good faith, and effectively safeguarding the legitimate rights and interests of all parties. It is therefore clear that ethics governance has been formally incorporated into the regulatory framework of Fintech, and may become one of the soft requirements for sci-tech compliance in the future, echoing and bring into line with existing regulatory requirements such as consumer protection, data security, and network security

In terms of consumer protection legislation, at present, apart from the *Guiding Opinions of the General Office of the State Council on Strengthening Financial Consumer Protection*, there has been no unified special legislative document on financial consumer protection. The regulatory requirements issued by the PBOC, the CBIRC and the CSRC are yet to be properly aligned, and the "top-down" regulatory system for financial consumer protection is not complete. In view of this, in March 2022, the deputy governor of the PBOC expressed in an interview with the media, that "it is necessary to speed up the formulation of the law on the protection of financial consumers' rights and interests"; in July 2022, Sun Tianqi, director of the Financial Stability Bureau of the PBOC, published opinions in *Chinese Finance*, stating that "efforts should be made to strengthen the protection of the rights and interests of consumers and investors, and to promote the introduction of the financial consumer protection law". We therefore believe that top-level legislation in the field of financial consumer protection is likely to be introduced in the future.

In 2022, regulators continued to strengthen financial consumer protection through greater law enforcement. Among the issued penalties, most were imposed on both the organizations and the people in charge, and several were in an amount exceeding RMB 1 million. Meanwhile, with the formal implementation of the *Administrative Measures for Protection of Consumer Rights and Interests by Banking and Insurance Institutions*, the compliance requirements and the level of penalties for financial consumer protection have once again increased. We expect there will be more financial customer protection related law enforcement action in the future.



5. https://finance.sina.com.cn/money/bank/bank_yhfg/2022-10-25/doc-imqqsmrp3670382.shtml

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Insurance

2022 Regulatory Milestones

January 10

The *Administrative Measures on Related Party Transactions of Banking and Insurance Institutions* was issued, preventing improper transfer of interests by related parties in a "look-through" way.

March 21

National Pension Insurance Company received approval to open for business, becoming the 10th professional pension insurer, boosting the "third pillar" of pension insurance.

April 24

The *Notice on the Investment in Relevant Financial Products with Insurance Funds* was issued, expending the scope of financial products available for investment by insurance funds.

May 9

The *Administrative Measures on Entrusted Investment of Insurance Funds* was issued, reshaping the regulatory system for the "entrusted" investment of insurance funds.

June 1

The *Guidelines for Green Finance in Banking and Insurance Sectors* was issued, laying out the strategic arrangement for the development of green finance in the insurance sector.

July 15

Bankruptcy of Yi'an Insurance was accepted by the court, becoming the first insurer of China to enter into the bankruptcy and restructuring procedure.

July 28

The *Administrative Provisions on Insurance Asset Management Companies* was issued, removing the shareholding limit for foreign investors.

October 25

The *Administrative Measures for the Insurance Security Fund* was issued, which was the first revision since its formulation 14 years ago, optimizing risk prevention measures of the insurance sector.

November 21

The *Matters Concerning the Private Pension Business of Insurance Companies* was issued, boosting the "third pillar" of pension insurance with support from the insurance sector.

November 24

The Pilot Program of Commercial Pension was launched, four pension insurer and 10 provinces and cities being selected.

November 28

The *Regulatory Assessment Measures for the Corporate Governance of Banking and Insurance Institutions* was amended, promoting the classification-based regulation of corporate governance of banking and insurance companies.

December 26

The *Administrative Measures for the Protection of Consumers' Rights and Interests by Banking and Insurance Institutions* was issued by CBIRC, strengthening protection of rights and interests of financial consumers.

2022 Regulatory Mainline Review

01 Integrated regulations on the related party transactions applicable to banks and insurance companies; new standards balancing severity with leniency

Financial reform was continuously deepened in 2022. The mid-2022 saw more regulations governing banking and insurance though not as many as had been introduced in 2021. Nevertheless, they are still important in terms of its importance and influence, with the *Administrative Measures on Related Party Transactions of Banking and Insurance Institutions* (the "**No. 1 Decree**") being a typical example.

There is still a long way to go before the financial security defense line and risk emergency response mechanism are well established. Based on numerous experiences and lessons, particular risks stem from related party transactions, which are difficult for regulators to monitor but can be prohibited or controlled by insurance institutions' effective daily management. The No.1 Decree replaced the *Administrative Measures on Interested Party Transactions of Insurance Companies* that had been in force for many years, and integrated the related party transactions of banks, insurance companies and other non-bank financial institutions into the same regulatory regime. While coordinating the basic definitions of terms such as "related party" and "related party transaction", as well as the regulations setting out prohibited activity, the No.1 Decree also formulated the regulations on transaction classifications that are more applicable to the business models of different types of licensed institutions.

The No. 1 Decree is based on the principles of "substance over form" and "look-through", replacing the previous quantitative standards such as "significant influence". "Related party" is also broadened in its scope of definition to include concepts such as "persons acting in concert", "ultimate beneficiaries", "important branches" and personnel with the power to approve or make decisions on core businesses. The No.1 Decree added a new chapter providing rules on prohibited actions such as transaction splitting and multi-layer nesting, which also enriched the contents of "substance over form" and "look-through" principles.

The No.1 Decree reflects a stricter regulatory attitude. The expansion of the scope of related party requires better management of information and better information system. Also, the maximum proportion allowed for the balance of related party transactions involving application of funds has been reduced. Together with the *Notice on the Special Inspection of Related Party Transactions for the Use of Insurance Funds* and *Notice on Strengthening the Supervision of Related Party Transactions for the Use of Funds by Insurance Institutions* issued in the mid-2022, many financial institutions have done some internal checks and have disposed of some assets.

The regulators have carried out inspections on financial holding platforms or hidden financial holding platforms which have capital operation as their main business, as well as on small and medium-sized insurance institutions which have diversely developed and aggressively expanded shareholders.

Regulators are being lenient in some regards. The related party transactions of subsidiaries that are controlled are no longer required to be managed as if done by the insurance institution itself. More flexibility is allowed for insurance institutions in the scope of related party and their methods to identify related party. These changes are part of the drive by regulators to streamline financial companies' obligations.

Certain practical problems remain unsolved, for example, on how "related party" transactions can be accurately identified and how to calculate investment in private equity investment funds and financial products, as well as the standard for calculating accrued amount. Other areas that have been left for discussion include the deletion of "co-investment" and exemption from review/disclosure for subsequent transactions. The market expects the regulator to provide more detailed guidance on these issues, while the regulator expects to gain some feedback on market experience when implementing the No.1 Decree. We expect to see more guidance and opinions in the future, though they may not be comparable with the No.1 Decree in terms of hierarchy and effectiveness.

02 Insurance sector participating in the private pension market, promoting establishment of a multi-tiered and multi-pillar old-age pension system

After a long preparation, the private pension plan was rolled out in 2022. The *Opinions on Promoting the Development of Private Pensions* was issued by General Office of the State Council in April, disclosing the complete system regime for the first time. In late 2022, the Ministry of Human Resources and Social Security together with other ministries issued the *Measures for the Implementation of Private Pensions*. Following that, the Ministry of Finance, State Taxation Administration, People's Bank of China, China Banking and Insurance Regulatory Commission ("**CBIRC**"), and China Securities Regulatory Commission ("**CSRC**") issued supporting pilot rules to fill in the gaps of industry rules in respect of income tax policies, pension savings, wealth management products for pension savings, public funds for pension savings, and endowment insurance products. The supporting rules for insurance industry sought public opinion in the late September and were officially issued in November.

The private pension plan is based on the personal account, deposits which can be used by the participant to invest in financial products. The private pension plan can help expand the coverage of the "third pillar" pension, but exposes pension insurance products to competition with bank savings and asset management products on the basis of united account, exploring the trillion-dollar blue ocean market. In fact, the insurance institutions have the first mover advantage in the pension market as their annuity and endowment insurance products in essence have the function and nature of pension security. Also, by making use of its specific advantage, insurance funds can be invested in building communities for the elderly and elderly-care operation institutions, laying out an industrial chains of the elderly care sector.

Although the previous attempt to launch tax-deferred pension insurance failed to achieve the desired result, the pilot program of exclusive commercial pension insurance, launched in 2021, has made good progress. The pilot program was further expanded in March 2022, with 10 more pension insurance companies added to the initial six companies. Success achieved in the pilot program has also laid a solid foundation for insurance institutions to participate in the competition for private pensions and help them quickly enter into the market. The first batch of private pension insurance products consists of seven products provided by six companies, all of which are exclusive commercial pension insurance products. With the expansion and normalized promotion of the pilot program of exclusive commercial pension insurance, more insurers and products are expected to enter the private pension market as time goes on.

Apart from the exclusive pension insurance and private pension plan, there is also a pilot program covering commercial pensions. CBIRC issued the *Notice of Launching the Pilot Program of Commercial Pension Business of Pension Insurance Companies* in December, allowing four pension insurers to launch the pilot business in Beijing and other nine provinces (cities). Although the pilot products are not eligible for tax benefits available to private pensions, the pension insurers can provide one-stop services to clients, which includes account management, pension planning, fund management and risk management. The professional pension insurers, after playing an important role in the investment management of the "first pillar" and "second pillar" for a long time, has gradually obtained attention during the prosperous development of the third pillar. As requested by the regulators, pension insurers have commenced with removal of asset management and similar wealth management businesses, and turned to focus on strengthening its function of elderly care.

03 Reshaping the investment model of insurance funds, expanding the range of financial products in which insurance funds can invest

In 2022, regulators have been reshaping the significant rules relating to insurance funds utilization, compared with the effort to emphasize "delegating power, streamlining administration and optimizing government services" in 2021.

The *Notice on the Investment in Relevant Financial Products with Insurance Funds* ("**No. 7 Decree**") issued by CBIRC in April has expanded the scope of financial products available for investment by insurance funds. The wealth management products provided by wealth management companies and the convertible debt investment plans which had been regulated by a special regulation, together with single asset management plans, have all been included in the "white list" of permitted investments, so as to satisfy the needs of diversified investment. Single asset management plans issued by securities companies, securities asset management companies, and securities investment fund management companies had previously been regulated as a form of trusted investment by insurance funds, meaning that the investing institution would conduct the investment as a trustee of the insurance funds. The No. 7 Decree classified this kind of investment plan as a financial product, which reflected the regulator's intention to distinguish between an trusted investment within the insurance sector and investment outside the insurance sector, and clarify the difference between an engagement relationship and a trust relationship. Also, based on the previous experience and lessons, the new rule emphasizes the "look-through" principle of regulation. In principle, to invest in financial products, the insurance institutions shall be equipped with adequate investment management ability comparable to the products' underlying assets, apply the corresponding limits on the proportion of investment in financial products, so as to reflect the true risk of the invested assets and effectively reduce the proportion of investment in non-standardized products.

The *Administrative Measures on Entrusted Investment of Insurance Funds* ("**No. 9 Decree**") is aligned with the No. 7 Decree in a number of ways. Under the regulatory regime established by No. 7 Decree and No. 9 Decree, the "entrusted investment" of insurance funds specifically refers to the circumstance where the insurance asset management company acts as the trustee. Insurance companies are allowed to entrust insurance asset management companies to invest in financial products, excluding the single asset management plans and private wealth management products issued to a single investor. Also, the No.9 Decree has specified that the insurance group companies and insurance companies without the ability to manage investment in equities and real assets are allowed to indirectly invest in equities and real assets financial products through entrusted investment.

The *Administrative Provisions on Insurance Asset Management Companies* issued in July further allowed insurance asset management companies to establish subsidiaries engaged in asset management or asset-management-related business in the wealth management, mutual funds, private funds, real estate and infrastructure. It is undoubted that the insurance asset management companies will take on a more important role in the investment by insurance funds, and it has encountered a good opportunity to enhance professional development and in-depth reform of its business.

04 Lackluster domestic investment in insurance license business, while foreign investors remain enthusiastic, brokerages offer greater appeal

The impact of the pandemic and other factors meant that there were fewer M&A transactions and less domestic investment in 2022. There was also reduced activity in the insurance sector, i.e. equity investment and license application. In the first half of the year, the National Pension Insurance Co., Ltd. and China Rongtong Property Insurance Co., Ltd. were approved to open for business, and the latter broke the record that there were no new property insurance companies in the past four years. Several institutions listed their shares, but without attracting much public interest.

While the domestic market showed little signs of activity, several foreign companies demonstrated their confidence in the Chinese market. International insurance giants, including Allianz, Prudential, Chubb, and AIA, have all increased their domestic insurance licenses through equity acquisitions and capital increases, or anchored their controlling stakes. Institutions such as HSBC that have acquired controlling stakes have shifted their focus to the establishment of domestic branches. In terms of reinsurance, Spain's Mamfort Reinsurance Company prepared to establish a Beijing branch, and Hannover Reinsurance further increased its capital in its Shanghai branch. At the policy level, the *Regulations on the Administration of Insurance Asset Management Companies* officially abolished the restriction on the proportion of ownership that foreign companies can hold in insurance asset management companies, marking that among the all the 34 opening-up measures for the insurance industry introduced since 2018 have been implemented. Looking ahead, we can expect to see the introduction of health insurance, pension insurance with greater use of advanced technology and management expertise generally.

Another phenomenon worthy of attention is the increase in interests to secure insurance intermediary licenses. Since Tesla registered an insurance brokerage, car companies such as BMW, BYD, Li Auto and NIO have all registered or acquired insurance brokerage companies. In view of the requirement of "registration business license before governmental approval" for insurance brokerage licenses, some of them have not yet obtained the qualifications to carry out the business, but the trend for brokerages in the auto industry will provide extra impetus.

The policy to establish brokerages has been in place since 2021, but there remains a lack of necessary detailed regulations to delineate the boundaries of intermediary/agency business development. In addition, the Internet platform sideline insurance agency qualifications, the business compliance role of the recent MGA (managed insurance professional intermediary agency) business and other old and new issues that have previously been talked about but have not yet come to pass.

05 Risk prevention and disposal continues, financial stability showed top-level design ideas

In 2022, the insurance sector continued on its consolidation to deal with the high-risk companies. The workout of Mingtian Xi's four insurance companies was completed: Tianan Property & Casualty Insurance's assets were sold at rock-bottom prices; Yi'an Property & Casualty Insurance became the first domestic company to enter bankruptcy and reorganization process; and the two life insurance companies were taken over by trustee members with the follow-up disposal plan still in the works.

Risk prevention, resolution, and disposal of financial institutions have all become an important part of regulatory work in recent years, but these procedures are scattered among the specific regulations of various financial sub-sectors, and some are less effective than others. In 2022, the draft version of the *Financial Stability Law* was released and public opinions were solicited, which generated much discussion. In particular, the establishment of the financial stability guaranty fund, the sequence of use of risk disposal funds, disposal measures and tools, and the "three terminations" and other judicial interface issues all revealed the thinking of the regulators. If the *Financial Stability Law* is promulgated in the future, it should parallel existing laws such as the *Insurance Law* and the *Enterprise Bankruptcy Law*. How the specific systems regulated therein are connected is also an important prerequisite for determining whether relevant measures can be effectively implemented.

The disposal of AnBang and other institutions required significant dipping into industry guaranty funds. According to the draft version of the *Financial Stability Law*, industry guaranty funds should only be called upon as a last resort as a means of supporting distressed insurance companies, but how to effectively use and manage the funds is still an area that needs to be considered.

In December 2022, after a lapse of 14 years, the *Insurance Security Fund Management Measures* was revised to optimize the use and management of insurance guaranty funds and give insurance guaranty fund companies "the right to participate in risk disposal plans and the making of the methods".

06 Internal controls and compliance management given added weight, shift of regulators from rectifying chaos to building a thorough and workable overall and compliance system

In the past few years, China's regulators have been focusing on making sure that banks and insurance companies have effective internal corporate governance, and with some success. On the basis of ensuring effective corporate governance, business compliance is an important factor that determines how far an organization can go. There has been a shift by regulators from requiring errant companies to "rectify" (i.e. remediate) their poor governance to putting in place effective, robust governance processes that prevent violations of the law and regulations from happening. Regulators have struggled to keep up with innovations that have seen companies conducting all manner of illegal activities, including falsifying reports, the granting of interests outside the insurance contract to policyholders, and illegal transfer of interests between related parties. In 2021, the CBIRC launched the "Internal Control and Compliance Management Construction Year" campaign in the banking and insurance industries to guide institutions from "passive compliance" to "active compliance" and to firmly establish the concept of "internal control first and compliance as the basis". Combined with the new regulations promulgated in 2022, compliance will be the main focus of regulators in the next few years.

In January, the CBIRC issued the *Interim Measures for the Off-site Supervision of Insurance Companies*, aiming to set a unified standard for off-site supervision. In the future, it will also study and formulate the specific assessment guidelines of the risk monitoring and off-site supervision of property insurance companies, personal insurance companies and reinsurance companies. Concurrently, the CBIRC issued measures including the *Negative List of Personal Insurance Products (2022 Edition)* and the *Notice of the Personal Insurance Department of the China Banking and Insurance Regulatory Commission on Recent Issues* with Personal Insurance Products. It also issued the *Measures on Information Disclosure on Personal Insurance Products* in November to increase the transparency of information in the entire process of product sales. The next phase will be to see whether the regulation covering life insurance will be extended to other types of insurance products.

So far as penalties are concerned, the trend is for an increase. In 2022, the number of administrative fines imposed on insurance institutions and their personnel all increased compared with the same period. More attention has been paid to protecting personal data held by insurance companies. In August, the *Notice on Carrying out Special Rectification of the Infringement of Personal Information Rights by Banking and Insurance Institutions* was issued. Following that, the local Banking and Insurance Regulatory Bureau targeted employees of insurance institutions for violating citizens' personal information. Some were barred from working in the insurance sector for five years. There has also been heightened supervision of insurance intermediaries, and many institutions have been penalized for management failings, including losing their licenses. In June, the "CBIRC" issued the *Notice on Printing and Distributing the Work Plan for the "Scattered" Problems of Insurance Intermediaries* within the industry, clearing out insurance intermediaries that did not meet regulatory requirements, as well as requiring others to rectify many violations of laws and regulations.

07 Green insurance and agricultural insurance move into next phase

Green finance (i.e., providing finance for environmental projects) and green insurance are fast-growing sectors. In 2022, the CBIRC issued in succession the *Guidelines for Green Finance in the Banking and Insurance Industry and the Notice on the Statistics System for Green Insurance Business*, which for the first time at the policy level clarified the definition of "green insurance". The regulations require insurance institutions to incorporate and integrate environmental, social and governance (ESG) factors into their systems and management, investment and financings, and information disclosure, and innovatively propose that ESG assessment results be used as an important basis for cost management and investment decisions. We can expect insurance companies to devote more resources to greenfield projects, once ESG factors are fully incorporated into their decision-making and costs.

Agricultural insurance has also been the subject of policy making. The 19th Central No. 1 Decree to guide the work of the "Three-Agriculture", the *Central Committee of the Communist Party of China and the State Council on Promoting the Key Work of Rural Revitalization in 2022*, was issued as scheduled in February. The decree requires commercial agricultural insurance and innovative agricultural insurance to keep in line with policy developments. The CBIRC on the basis of the *Interim Measures for the Management of Agricultural Insurance Underwriting and Claims* and the *Agricultural Insurance Regulations*, the CBIRC issued the *Agricultural Insurance Underwriting and Claims Management Measures* in February to further regulate underwriting claims management of agricultural insurance, detailed agricultural insurance co-management system, unified forest insurance into the scope of adjustment, and further clarified the content and requirements of agricultural insurance, differentiated the inspection content of the underwriting subject into different insurance categories, and unified the time limit for loss determination and explicit prohibition of arbitrage of premium subsidies, etc. At the end of the year, the China Insurance Association released the underwriting and claim settlement specifications for arable, husbandry and forest insurance, which is the first time to standardize and unify this at the level of industry self-discipline.

08 Digital transformation receives top-level support, opportunities and challenges coexist in digital transformation, insurance and technology are two-way empowerment

At the beginning of 2022, the CBIRC issued the *Guiding Opinions on the Digital Transformation of the Banking and Insurance Industry*, requiring banking and insurance institutions to digitize their business operations and management, actively develop digital finance and "vigorously" promote the digital transformation of personal financial services. Many insurance companies have proposed digital transformation development strategies, seeking to use digital technology to empower the high-quality development of the insurance sector. These institutions are investing in digital technology research and development, both for internal management and to make them more efficient. However, digital transformation also throws up challenges that need to be confronted, such as data governance, network security, data security, and privacy protection. Many regulatory decrees issued in recent years have encouraged insurance institutions to make good use of data, while at the same time requiring them to fully protect customer privacy and data security in accordance with laws and administrative regulations.

"Digital transformation" cannot be separated from the discussion of "technology empowerment". More and more insurance institutions are applying digital technology, life technology and environmental technology to daily governance, internal control compliance, and product and insurance innovation to improve work quality and efficiency. From another perspective, at the policy level insurance funds are also being encouraged to support industrial development and empower the technology industry. In July, the CBIRC and the Shanghai Municipal Peoples Government issued the *Work Plan for the Leading Area of Science and Technology Insurance Innovation in the Lingang New Area of China (Shanghai) Pilot Free Trade Zone*, supporting the development of the leading area of technology insurance innovation in Lingang New Area into a model for innovation.

With encouragement of policy makers, insurance institutions will be able to participate in the investment and financing of cutting-edge manufacturing, major industrial projects, and key technology companies through a variety of capital utilization methods. However, what cannot be ignored is that considering the high technical threshold of the technology industry, the work of pre-investment due diligence, investment decision-making and post-investment management all puts forward higher requirements for insurance institutions.

2023 Regulatory Outlook

01 The discussion on the amendment of the *Insurance Law* will continue to heat up

The current *Insurance Law* has been amended four times since it was promulgated and implemented in 1995, and the latest version was amended in 2015. In recent years, with the accelerated development of the insurance market and the entry of various emerging institutions and products, new risks and challenges are accompanied by opportunities. The priority of the insurance sector has gradually shifted from accelerating development to the original function of insurance and serving the real economy. The current *Insurance Law* has gradually lagged behind changes on the ground, and there has also been a call for amendment in the market. Such amendment of the *Insurance Law* has been in the legislative work plan of the Standing Committee of the National People's Congress since 2020, and it has remained on the list of items for preliminary deliberation in 2021 and 2022.

During the NPC and CPPCC sessions in 2022, some representatives proposed a motion to amend the *Insurance Law*, suggesting that the amendment and improvement should be made from the aspects of improving business operation rules, strengthening the protection of the rights and interests of insurance consumers, and improving risk prevention and disposal mechanisms of the insurance sector to meet the industry development and regulatory requirements. The regulators have listened to the feedback both from the sector and from society at large. There has been heated discussion in academia and in the sector about how to improve the rules relating to risk disposal and the modification of standard terms and conditions.

Given that recently the *Civil Code* has been promulgated and the *Financial Stability Law*, *Company Law* and *Civil Procedure Law* have all been revised, there is pressure on law makers to harmonize the *Insurance Law* with other laws. We can expect more discussion over the coming year.

02 Antitrust compliance awareness in the insurance sector will be strengthened

After nearly two years of discussion and revision of the draft, the *Anti-monopoly Law (2022 amended)* was finally approved at the 35th session of the Standing Committee of the 13th National People's Congress in June 2022 and was implemented on August 1. This is the first amendment since the *Anti-monopoly Law* took effect in 2008.

Over recent years, we have seen the rise of anti-monopoly cases in the insurance sector and more examples of financial institutions being penalized for breaching anti-monopoly rules. Companies have been penalized for, among other violations, the horizontal monopoly organized by the industry association, the vicious competition at the business end and failure to conduct merger control filings. This has caused a number of insurance companies to review their internal controls and compliance processes.

The amendment of the *Anti-monopoly Law* paid special attention to the financial sector, including insurance institutions. The law added Article 37 - "the classification-based and hierarchy-based examination system for merger control." Although the specific content of the system is not clear, it is widely believed that this is a signal to strengthen the merger control filing review in key sectors such as finance. We can expect to see stricter supervision of insurance companies, as has happened in other financial services sectors. Insurance institutions should, in turn, strengthen their internal and compliance processes and be more vigilant when it comes to anti-monopoly regulations.

03 Classification-based and hierarchy-based regulatory system of insurance institutions will be put in place

The idea of the classification-based and hierarchy-based regulatory system has been widely used in the insurance sector. This helps regulator to effectively manage the daily affairs of institutions and allocate supervision resources more efficiently when it comes to regulating business scope, branches, corporate governance, solvency risk assessment, and so on. In 2021, the regulator made an attempt on the management of insurance asset management companies by launching the *Interim Measures for the Regulatory Rating of Insurance Asset Management Companies*. This provided a comprehensive rating system for insurance asset management companies with five key indicators: corporate governance and internal controls; asset management capability; comprehensive risk management; transaction and operation security; and information disclosure. For institutions of different classifications, regulators will apply differentiated regulatory measures in terms of market access, business scope and allocation of resources they apply to supervision.

In terms of the management of insurance companies, in the past few years, the regulator has launched a similar classification mechanism from the perspective of corporate governance, and further improved the *Measures for the Supervision and Evaluation of Corporate Governance of Banking and Insurance Institutions (the "**Measures**")* in November 2022. According to the Measures, those institutions rated as grade B or above will not be supervised as often as those deemed to be of higher risk.

With the implementation of territory-based policies in recent years, and the implementation of on-site inspection and off-site inspection rules, there is a certain basis for promoting the classification-based and hierarchy-based regulatory system for insurance institutions in a larger scope. It may be regulator's next step to coordinate the existing classification-based and hierarchy-based regulatory system with a view to having a holistic approach to regulation.

04 The regulatory standards of financial sub-sectors in specific fields will gradually converge

The gradual unification of the regulatory framework of the banking and insurance sector was one of the main themes in 2021. The consolidation of the regulatory framework slowed down in 2022, but, as we anticipated last year, the regulator still issued many important regulations, including the *Measures for the Affiliated Transactions of Banking and Insurance Institutions*, the *Measures for the Banking or Insurance Institutions' Protection of Consumer Rights and Interests*, and the *Guidelines for the Green Finance of the Banking and Insurance Sector*, and coordinated management of the banking and insurance sectors as laid out in a number of policy measures. We expect that the process of bringing about uniform supervision will continue to be implemented in 2023, and regulations such as compliance management and information disclosure are expected to be put on the agenda.

The CBIRC issued the "*Fourteenth Five-Year Plan" for the Standardization of the Insurance Sector* in May 2022, proposing the promotion of unified standards for the asset management business of banking, securities, insurance and other sectors. In addition to the *Measures for Online Marketing of Financial Products (Consultation Draft)* issued at the end of 2021, the trend of uniform regulatory standards in the banking, insurance and securities sectors in special areas has been conspicuous. Considering the current top-level design of separate supervision and the relatively mature existing regulations of various sectors, it is not easy to regulate across many financial sub-sectors. However, if the uniformed regulation has achieved good results in asset management, Internet promotion and other sectors, it is worth expecting more along these lines in the coming year.

05 Supporting systems for vehicle-related insurance will gradually be put in place

The long-planned "equivalent pre-recognition" policy for cross-border vehicle-related insurance in the Great Bay Area is expected to be implemented early on in 2023. What this means is that the scope of liability for cross-border vehicles to be insured by Hong Kong and Macao insurance companies will be extended to the third-party liability insurance on the Mainland. Based on our experience, there are a number of complexities associated with this type of insurance, including issues such as cross-border payments, tax management and regulatory coordination in different areas, so it will not be easy to see final implementation. With the loosening of the lockdown policy, the pilot policy is expected to be widely applied in the Greater Bay Area, laying a good foundation for broader cross-border "insurance connect" cooperation.

In addition to cross-border vehicle-related insurance, some insurance companies have already moved into the new energy vehicle-related insurance market. In August 2022, the Ministry of Transport issued the *Autonomous Vehicle Transport Safety Service Guide (Trial) (Consultation Draft) (the "**Guide**")*. According to the Guide, the insurance coverage of self-driving vehicles has significantly improved as compared with traditional vehicle-related insurance. The insurance coverage of traditional three-party insurance is RMB1 million to RMB2 million, while the same product for self-driving vehicles is at least RMB5 million. Compared with traditional vehicle-related insurance, self-driving vehicle-related insurance products can superimpose liability insurance according to different scenarios and purposes. As far as we know, some institutions have developed and launched supporting insurance products, but the scale and quality of services are still limited according to the technology of the vehicles. With the active participation of more insurance institutions and more self-driving enterprises, the development of self-driving vehicle-related insurance is worth expecting, and its supporting policies will gradually take shape.

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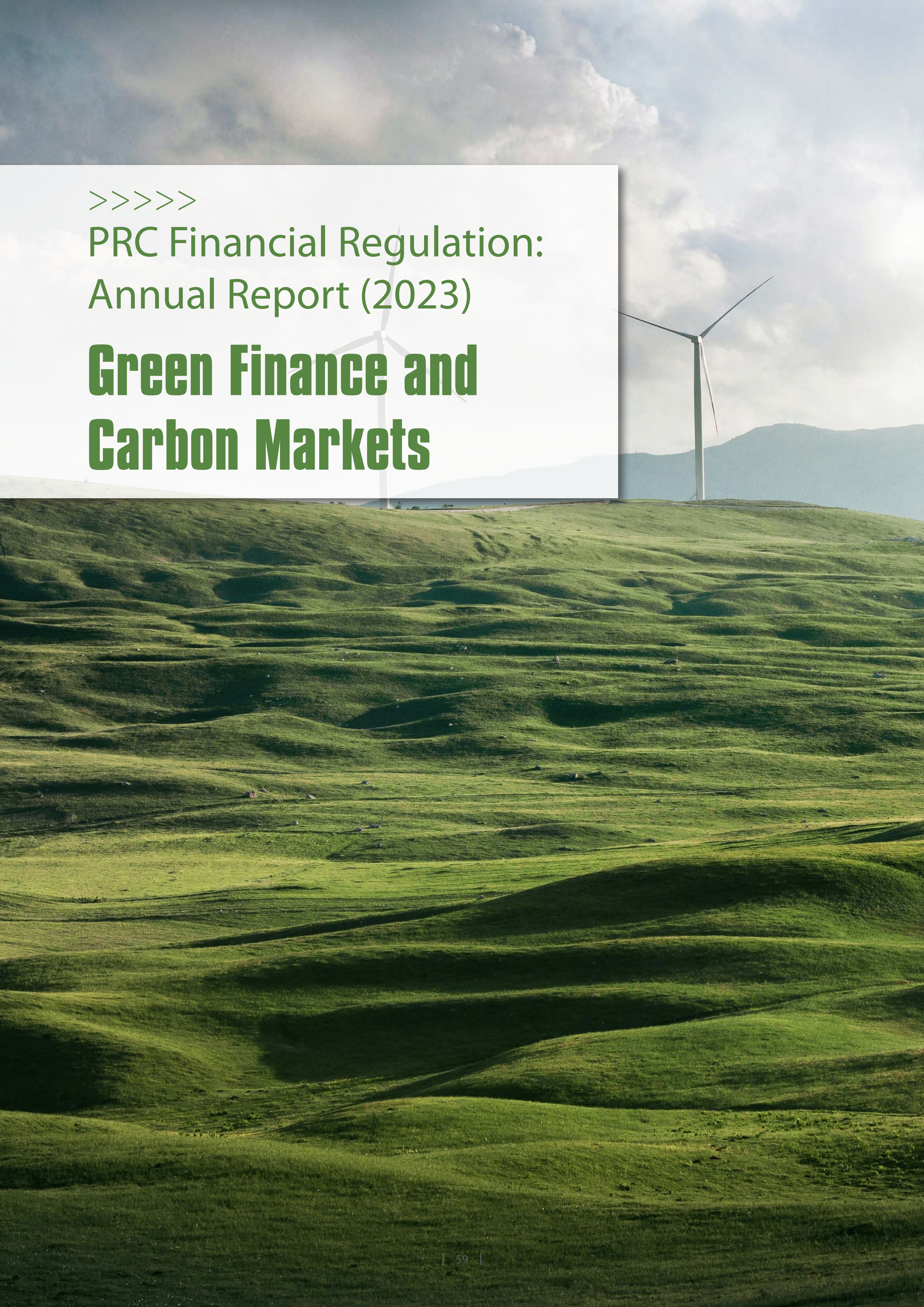
Green Finance and Carbon Markets



2022 Regulatory Milestones

January 24

The Ministry of Ecology and Environment ("**MEE**") announced that the first compliance cycle of the National Carbon Emissions Trading Market ("**National Carbon Market**") had been successfully completed, and the framework for the operation of the national carbon market had been established.

April 12

The China Securities Regulatory Commission ("**CSRC**") released the *Carbon Financial Products National Standard*, the first national industry standard in the field of carbon finance.

June 1

The China Banking and Insurance Regulatory Commission ("**CBIRC**") issued the *Guidelines on Green Finance for the Banking Industry and the Insurance Industry*, setting out comprehensive requirements covering environment, social and governance ("**ESG**") for the first time in its regulatory specifications.

July 14

The Supreme People's Court issued the *Opinions on Providing Judicial Services and Protection to Accelerate the Construction of a Unified National Market*, providing judicial support in the process of achieving "Carbon Peaking and Carbon Neutrality".

July 25

Hainan International Carbon Emission Trading Center ("**Hainan Carbon Center**") officially established.

July 29

Green Bond Standard Committee issued self-regulatory rules - the *China Green Bond Principles*.

August 4

The MEE announced the list of pilot cities/areas for climate investment and financing, containing 23 cities/areas.

August 31

14th Five-Year Plan of Guangzhou Ecological Civilization Construction was released, announcing that Guangzhou will explore the establishment of the Guangdong-Hong Kong-Macao Bay Area ("**GBA**") carbon emission rights exchange.

October 28

Hong Kong Exchange launched Core Climate, a new international carbon market, dedicated to building an international voluntary carbon market.

November 3

The MEE published the *Implementation Plan for the Setting and Allocation of Total National Carbon Emissions Trading Quotas for the Years 2021 and 2022* for solicitation of public comments.

November 11

The CBIRC issued the *Notice on the Issuance of the Statistical System for Green Insurance Business.*

December 12

The first carbon asset bond linked to carbon quota trading proceeds in China was successfully issued on the interbank market.

2022 Regulatory Mainline Review

01 The "Five Pillars" to the green finance development have been optimized with the green finance regulatory framework being perfected

Since the top-level framework of green finance was established in 2016 in the *Guiding Opinions on Building a Green Finance System*, China's green finance regulatory framework has been gradually put in place and refined. The People's Bank of China ("**PBOC**") has proposed "Five Pillars" of green finance development as the key breakthrough and basic focus for financial institutions to achieve "Carbon Peaking and Carbon Neutrality", namely, (i) improving the standards of green finance, (ii) strengthening the supervision and information disclosure requirements of financial institutions, (iii) gradually improving incentives and constraint mechanism, (iv) continuing to refine and improve products and market of green finance , and (v) actively expanding international cooperation in green finance. By now, policies and standards in furtherance of the "Five Pillars" have been gradually put in place.

China's 14th Five-Year Plan for National Economic and Social Development (2021-2025) and Vision 2035 outlines the requirement to "build a green development policy system and strengthen legal and policy safeguards for green development", and the *14th Five-Year Plan for Financial Standardization* also proposes to "improve the top-level design and planning of green finance and improve the green finance policy framework and incentive and constraint mechanisms". 2022 is the second year of the implementation of the 14th Five-Year Plan, and regulators continue to introduce measures aimed at improving green finance generally:

- In April, the CSRC issued the *Carbon Financial Products National Standard*, the first national industry standard in the field of carbon finance;

- In June, the CBIRC issued the *Guidelines on Green Finance for the Banking Industry and the Insurance Industry* to strengthen ESG compliance requirements (including, without limitation, disclosure requirements) for financial institutions, providing guidance for banks and insurance institutions to support green development and low-carbon transition projects, and improving incentives and strengthening restraints in relation to green finance;

- In July, the Interbank Market Dealers Association led the Green Bond Standard Committee to issue the *China Green Bond Principles*, which primarily unified domestic green bond standards and brought these standards in line with international standards;

- In August, the PBOC included several foreign banks into the list of financial institutions permitted to issue carbon emission reduction support instruments, again with the goal of encouraging more financial resources to be invested in green and low-carbon fields and improving incentives and strengthening restraints;

- In November, the CBIRC issued the *Notice on Issuing Green Insurance Business Statistics System*, further emphasizing the significance of green insurance and establishing the importance of green insurance from the perspective of business statistics ;

- In December, the Ministry of Finance and the International Financial Reporting Standards Foundation (IFRS Foundation) signed a memorandum of understanding and decided to establish an office of the International Sustainability Standards Board (ISSB) in Beijing, which is expected to complete by mid-2023. It is generally believed that this implies China's intention to introduce ESG standards that are in line with international standards.

Since China proposed the goal of "Carbon Peaking and Carbon Neutrality", green finance legislation has been introduced and it is likely that in the coming years more legislation will follow.

02 Climate finance pilot established; transition finance policies have built momentum

One of the main challenges hindering the achievement of "Carbon Peaking and Carbon Neutrality" target is the huge funding gap, which requires market and financial instruments to encourage capital investment into related areas, in addition to the financial assistance provided by the state. To this end, China continues to actively promote climate finance and transition finance.

The MEE and other regulatory authorities issued the *Notice on Piloting Climate Finance* at the end of 2021. In August 2022, the MEE announced the list of climate finance pilots, with a total of 23 approved locations. These pilot cities or areas will aim to address climate change and, according to the characteristics of each pilot site, curb investments into local high-carbon emitters and, instead, guide funds to be invested in climate-friendly projects, develop carbon finance, strengthen carbon accounting and information disclosure, enhance innovation in business model and financial instruments, strengthen supporting policy, and build a national climate finance project bank. The MEE also stated in its *2022 Annual*

Report on China's Policies and Actions to Address Climate Change that it will further strengthen its work on climate finance, including building a platform to match funds to projects, strengthening information disclosure, encouraging innovative financial instruments and services, supporting the participation of financial institutions and enterprises, and developing international cooperation.

The current green and sustainable finance framework, including climate finance, supports economic activities that meet the criteria of being "green" and "low-carbon", and currently does not really support the financing of enterprises that are in the process of transitioning from high-carbon to low-carbon operations. At the end of 2022, China took the lead in promoting the launch of the *G20 Transition Finance Framework*, which guides G20 members to formulate specific policies for transition finance that are compatible with their own circumstances. While the international consensus on the framework of transition finance is broadly in place, China is framing its own program to encourage practice under transition finance scheme: the National Association of Financial Market Institutional Investors and the Shanghai Stock Exchange have released standards and specifications related to "transition finance bonds"; several financial institutions have released their guidelines on transition finance bonds and studied on innovative products of transition finance; and Huzhou City, Zhejiang Province has issued the first local supportive policies and catalogs. In response to the regulatory trend of standardization in financial sector, we expect that relevant authorities will introduce transition finance policies and implementation plans that are in line with the principles of the *G20 Transition Finance Framework*, which are similar to climate investment and financing policies, to develop innovations on financial products and service on top of building financial infrastructure.

03 Rules relating to green finance products got refined; carbon finance products to be developed

Under the background of developing green finance and achieving the goal of "Carbon Peaking and Carbon Neutrality", in China, there is a growing number of green finance products, including green credit, green bonds, green insurance, green funds, green trusts and carbon financial products, all of which are providing diversified investment and financing tools for the market. Of these, green credits are the most prominent, having been the first and now the most extensive. The rules relating to green credits have been developing since 2007. In 2022, the *Guidelines on Green Finance for the Banking and Insurance Industries* ("***Guidelines on Green Finance***") promulgated by CBIRC refines the relevant requirements for the business of banks and insurance institutions on the basis of the *Green Credit Guidelines*. In addition, the China Green Bond Standard Committee under the National Association of Financial Market Institutional Investors has released the *China Green Bond Principles* and the CBIRC has issued *Circular on Issuing the Statistical System for Green Insurance Business*, both of which provide policy support for the further development of green finance products. Financial institutions are also constantly trying to innovate green finance products. For example, in April 2022, CPIC worked with commercial banks and local government to develop an insurance product covering China's first ecological value insurance for wetland carbon in Ningbo, combining green credit with green insurance; and in November 2022, Pacific Property Insurance Shanghai Branch developed the first carbon asset repurchase performance guarantee insurance in China.

For carbon finance products, more policies have been introduced to support carbon finance pilots and carbon finance innovations. The *Circular on Launching the Pilot Program of Climate Investment and Financing* encourages pilot regions to develop carbon finance; 23 such pilot regions were identified in 2022. The *Carbon Finance Products*, promulgated by CSRC in April, as the first national industry standard in carbon finance, provides guidelines for the implementation of carbon finance products. The CBIRC gave a clear signal in 2021 that it would support the development of carbon emission quota mortgage and pledge loans[1], and many provinces and cities have been issuing regulations related to these rights. Several financial institutions have launched innovative carbon asset loan products. For example, Shanghai Rural Commercial Bank issued the China's first loan which the lender pledged its China Certified Emission Reductions ("**CCERs**") future income right at the end of 2021.

However, the above-mentioned carbon financial products and derivatives are in the early stage of development, and carbon financial products trading is yet not lunched in the National Carbon Market. Some regions have introduced carbon-related financial products, such as carbon bonds, carbon forwards, carbon options, carbon funds, cross-border carbon asset repurchases, and carbon emission allowance mortgage and pledge loans, but the market participation is limited and the development is uneven between regions. Guangzhou Futures Exchange has dedicated itself to the

1. On 24 June 2021, the CBIRC website published the speech delivered by CBIRC Vice Chairman Zhou Liang at the promotion conference titled *Focusing on "Carbon Peaking and Carbon Neutrality" and Accelerating the Development of Green Finance*, in which Zhou mentioned the development of carbon emission quota mortgage and pledge loans. http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=992372&itemId=915&generaltype=0

development of carbon futures products, but none have so far been launched. The trading rules governing the trading of carbon financial products have still to be released. Added to that, the legal nature of carbon assets is not yet clear which to some extent restricts the development of carbon financial products. International practice has shown that the carbon financial market and carbon trading market are interdependent. Refining the trading rules of carbon financial products, clarifying the attributes of carbon assets, and the promotion of carbon financial products will enhance China's carbon emissions trading market to become more developed and sophisticated.

04 Financial institutions' ESG compliance requirements are tightened, incorporating Governance (G) factors for the first time

In 2022, the CSRC and the CBIRC issued documents to urge financial institutions to fulfill their ESG responsibilities. The *Opinions of the China Securities Regulatory Commission on Accelerating the Promotion of High-Quality Development of the Industry of Publicly Offered Funds* provides guidance to the public fund sector on how they can best serve the development of the green economy, including supporting green finance, ensuring responsible investing, making sure that environmental impacts are included in investment projects and summarizing the ESG investment rules. The *Guidelines on Green Finance* are issued on the basis of the *Green Credit Guidelines* but expanded the scope of application to insurance institutions as well. The amended *Measures for the Regulatory Assessment of Corporate Governance of Banking and Insurance Institutions* aims to assist banking and insurance institutions improve the effectiveness of their corporate governance.

The *Guidelines on Green Finance* incorporate "governance" factors into green finance evaluation criteria, and for the first time proposes comprehensive "Environmental, Social and Governance" requirements, that is, banks and insurance institutions should incorporate environmental, social and governance requirements into their business management process and risk management system in their financing and investment business. They are also instructed to continuously improve applicable policies, regimes and processes. In particular, bank and insurance institutions should develop ESG assessment standards and set up risk lists (assessing differential risk rates for different risks). They must incorporate ESG factors in risk assessment, due diligence, compliance, credit management and post-investment management, and include governance factors in internal control inspections, evaluation assessments and information disclosure. The *Guidelines on Green Finance* also require banks and insurance companies to disclose green finance-related content and to improve information disclosure by reference to international practices, guidelines or good practices.

The *Guidelines on Green Finance* do not apply to non-banking financial institutions under the supervision of the CBIRC. In respect of the CSRC, it has issued rules mainly to do with the governance and disclosure of listed companies and green financial products such as green bonds, but the CSRC has not yet provided comprehensive guidelines for compliance governance and disclosure of ESG for securities companies, futures companies, fund companies and other institutions. Given that the *"14th Five-Year" Development Plan for Finance Standardization* has laid down requirements for the financial sector in China to develop green finance policies, include incentives and limitations covering green finance and generally have the financial sector play an important role in developing green development, we expect this aspect of China's financial sector to develop strongly over the coming years.

05 First "performance period" of the National Carbon Market finishes, and regulations are progressing steadily

On 16 July 2021, the National Carbon Market was officially launched. On 31 December 2021, the first performance period of the National Carbon Market was officially finishing, with an overall performance rate of carbon allowance in the National Carbon Market reaching 99.5%. Upon the completion of operation in the first performance period, the operational framework of the National Carbon Market is essentially in place. In 2022, regulators continued to address the shortcomings revealed during the operation of the National Carbon Market by introducing more regulations while the sufficient policy continuity and stability of the regulations are maintained.

The regulators continued to strengthen their management on data quality of carbon emissions and environmental information disclosure in 2022. Following the release of the *Notice on the Supervision and Management of Data Quality in the National Carbon Emissions Trading Market* in October 2021, the MEE made public in March 2022 typical cases of falsification of carbon emission data by some institutions.

- In April, the National Development and Reform Commission ("**NDRC**"), the National Bureau of Statistics, the MEE and other departments jointly issued the *Implementation Plan on Accelerating the Establishment of a Unified and Standardized Carbon Emissions Statistics and Accounting System* to accelerate the establishment of a unified and standardized carbon emissions statistics and accounting system.

- In December, the MEE issued the *Guidelines for Accounting and Reporting of Greenhouse Gas Emissions by Enterprises (Power Generation Facilities)* to continue to improve the management of data quality in relation to carbon emissions.

- In terms of environmental information disclosure, according to the *Measures for the Administration of Law-based Disclosure of Environmental Information by Enterprises*, which came into effect in February 2022, various enterprises are required to disclose environmental information in accordance with the regulation, including key pollutant discharging entities, enterprises subject to compulsory cleaner production examination, eligible listed companies and bond-issuing enterprises. The regulation specifies detailed requirements on the content and time limits of disclosure and corresponding penalties for non-disclosure, untrue or inaccurate disclosure or disclosure in violation of regulations.

To better advance the work in next performance period, the MEE launched a *Consultation Paper on the Implementation Plan for Setting and Allocating the Total Amount of National Carbon Emission Trading Allowance for 2021 and 2022* in November 2022 ("**Implementation Plan**"). This Implementation Plan, compared with the *Implementation Plan for Setting and Allocating the Total Amount of National Carbon Emission Trading Allowance (Power Generation Sector) for 2019 and 2020*, keeps the same policy, continues the process of free carbon allowance allocation and allowance allocation based on intensity control of carbon emission, and sets the corresponding carbon emission benchmark according to different institutional categories. In the meantime, based on a comprehensive summary of the practical experience of the first performance period, the Implementation Plan has optimized the annual division of allowance allocation, correction factors, benchmark, and operation methods. We expect that the regulators will further amend and optimize the rules in the second performance period. An orderly and effective regulatory system will provide strong support and assurance for the further expansion and development of the carbon market.

Meanwhile, it is expected that the National Carbon Market will continue to expand. In October 2022, the MEE announced that it would gradually expand the coverage of the National Carbon Market, meaning more trading entities, products and trading methods will be covered. The cement, chemical, electrolytic aluminum and paper industries will be included in the National Carbon Market during the "14th Five-Year Plan period", and the cement industry is expected to be formally included in the carbon trading system in 2023 at the earliest.

06 National and regional carbon markets develop differently; integration of carbon markets to be watched

Prior to the establishment of the National Carbon Market, there have been regional carbon emissions trading markets since 2011 in Beijing, Tianjin, Shanghai, Chongqing, Guangdong, Hubei, Shenzhen and Fujian, covering nearly 3,000 "key emission entities" in more than 20 industries, including electricity, steel and cement. According to data from the Guangzhou Emissions Exchange, as of 16 December 2022, the cumulative turnover of carbon emission allowances in the secondary markets of China's eight regional carbon markets was 530 million tones, amounting to a turnover of RMB13.7 billion. The regional carbon markets have their own special features:

- the National Carbon Market focuses on power generation industry, while the regional carbon markets cover other industries such as steel and cement, as well as power;

- the National Carbon Market only has spot trading, while the regional carbon markets also offer derivatives trading such as carbon options, carbon forwards and carbon swaps;

- the products traded in the National Carbon Market are only national carbon emission allowances, while the products traded in the regional carbon markets include regional carbon emission allowances, CCERs, while local versions of certified emission reduction projects have been launched in the regional carbon market, such as Fujian FFCER's and Guangdong PHCERs.

After the National Carbon Market went live, the regional carbon markets continued to operate with relatively high trading volumes, which means that they play an independent and indispensable role in reducing greenhouse gas emissions at the regional level.

The *Interim Regulations on the Management of Carbon Emissions Trading (Draft Amendment)* issued by the MEE in 2021 ("**Interim Regulations**") provides that "local carbon markets that existed before the implementation of this regulation shall be gradually incorporated into the National Carbon Market." However, given the differences and independent value of regional carbon markets and the National Carbon Market, as well as the price differences between products in different carbon markets, the integration of regional carbon markets into the National Carbon Market will be an extremely complex issue that will require long-term planning and arrangements. How the finalized Interim Regulations deal with this remains to be seen.

07 Carbon footprint standards gradually established; carbon financial inclusion schemes have become the trend

The concept of carbon footprint has now become well-established in the international market and is the subject of regulatory control in many jurisdictions. In China, carbon footprint is now listed as a key construction target under China's "Carbon Peaking and Carbon Neutrality" policy framework. In terms of product carbon footprint, the State Council has proposed the development of a product carbon footprint standard in the *National Standardization System Development Plan (2016-2020)*, and also explicitly proposed to explore the establishment of a whole-life carbon footprint standard for key products in the *Action Plan for Carbon Peaking by 2030*. In the past two years, the Ministry of Industry and Information Technology and the Ministry of Commerce have encouraged key industries such as photovoltaic and foreign trade to explore carbon footprint certification mechanism, and the MEE guided various industry associations to issue group standards for carbon footprint assessment of products, including LED lighting, TV sets and microcomputers. There are, as yet, no national standards affecting the operations of enterprises and lives of individuals, but some such standards have been set at the local level. For example, Suzhou's Green Powers Carbon Neutral Promotion Center has taken the lead in implementing a "digital carbon ledger" of emission reduction behaviors based on carbon footprint data from the production and consumption activities of individuals and enterprises in the region. There are plans to apply the digital carbon ledger for individuals to obtain social welfare, business and policy incentives, to create a model of carbon financial inclusion program in Suzhou and the Yangtze River Delta region.

As an important innovation of carbon finance, carbon financial inclusion has been implemented in many places in China. It enables both corporate entities and the general public to establish their own carbon accounts, where behaviors reducing carbon emission reflected by the carbon footprint record can accumulate verifiable carbon credit points. Verifiable carbon credit points can be exchanged for goods, services or policy rights and interests, or even be traded as carbon assets. The idea is to establish incentives across society to reduce carbon emission. In 2022, the first market-based carbon financial inclusion system for voluntary emission reduction has been launched in Suzhou Industrial Park, and Shanghai, Shandong and other provinces and cities are also intending to launch their own local carbon financial inclusion schemes.

In addition to exploring emission reduction scenarios and developing related methodologies, the implement and improvement of carbon financial inclusion scheme also relies on the setting-up of enterprises and individuals carbon footprint standards to provide data basis. In the context of actively launching carbon inclusion system across the country this year, we understand that follow-up policies and regulations in the field of carbon print will be further introduced and modified, covering issues such as local and national standards of enterprises and individual carbon footprint, the carbon footprint assessment and certification system, the standard, frameworks and methods for environmental information disclosure.

08 Judicial innovations guide the dispute resolution of green finance to facilitate the achievement of the goal of "Carbon Peaking and Carbon Neutrality"

In July 2022, the Supreme People’s Court issued the *Opinions on Providing Judicial Services and Protection to Accelerate the Construction of a Unified National Market* ("**Opinions**"), supporting the establishment of a unified national energy and ecological environment market. The Opinions proposed to research and issue judicial policies on how the courts could assist in achieving the goal of "Carbon Peaking and Carbon Neutrality"; proposed to properly adjudicate in cases involving trading of carbon emission allowances and certified emission reductions, corporate environmental information disclosure, and disputes over green credit and green finance involving carbon elements, and help improve the mechanism of trading carbon emission rights; proposed to improve the rules for adjudicating disputes involving carbon emission rights, water use rights, pollutant discharging rights and energy use rights trading. In addition, the Supreme People’s Court has explicitly supported the secured creditor’ right in security created over forest carbon sink in accordance with the *Interpretation of Several Issues Concerning the Application of Law to the Trial of Civil Disputes over Forest Resources*, and has permitted the subscription of certified forest carbon sinks by an obligor as an alternative for the obligor’s liability for damage to the forest ecology and environment.

In Fujian Province, for example, where forest carbon sink projects are booming, the Fujian Provincial High People's Court issued working guidelines in September 2022 on the compensation for damages in relation to forest carbon sinks in ecological and environmental criminal cases, establishing a mechanism for measuring damages due to decrease of forest carbon sink and compensating on the same, the first of its kind in China, with the aim of solving the key issues in the identification of forest carbon sink damages in local environmental criminal cases in recent years. As green finance practices continue to boom, it will be increasingly important to clarify the rules for dispute resolution in judicial practice, and it is expected that more green finance-related cases and rules will emerge in 2023 to provide further clarity for green finance-related disputes.

2023 Regulatory Outlook

01 ESG disclosure standards for financial institutions are expected to be unified, and international standards and experiences are likely to be adopted in due time

At present, the only standards of information disclosure applicable to financial institutions are set out in the *Guidelines for the Environmental Information Disclosure of Financial Institutions* published by the PBOC in July 2021, which is not a mandatory regulation financial institutions have to follow. There are no other guidelines on information disclosure for financial institutions in terms of S (social) and G (governance) factors. With the growth of green finance and the increased obligations on financial institutions for ESG governance, we expect that the regulator and industry associations will introduce more comprehensive ESG disclosure guidelines or standards. Although the *Guidelines on Green Finance* do not yet require bank and insurance institutions to make ESG information disclosure, regulators have strongly indicated that they will draw on international standards and experiences in the sorts of information disclosure that they will expect of banks and financial institutions. We expect that in time, both the regulatory standards and financial institutions' practices will gradually develop into a unified ESG reporting standard for all financial services institutions.

Added to this, the International Financial Reporting Standards Foundation (IFRS Foundation) signed a memorandum of understanding with the Ministry of Finance at the end of 2022 to establish an office of the International Sustainability Standards Board (ISSB) in Beijing, which is expected to be completed by mid-2023. The ISSB aspires to promote the emergence of a set of global standards for ESG reporting. This is a clear indication that China intends to follow international standards when it comes to ESG reporting and governance.

02 "Green Washing" is capturing regulatory authorities' attention; green finance standards need to be refined

"Green Washing", the term given to activities of businesses such as promoting false information and other camouflaged conducts to pretend they are achieving green and sustainable developments, poses significant risks to both financial institutions and investors. Regulators in various countries are stepping up their efforts to curb such practices, and there have been several cases of financial institutions being investigated for "Green Washing".

In China, "Green Washing" in practice is considered as false advertising or misleading statements. Laws and regulations including the *Securities Investment Fund Law, the Interim Measures for Supervision and Administration of Private Investment Funds*, *the Anti-Unfair Competition Law* and *the Advertising Law* provide legal basis for regulatory authorities to impose punishment on "Green Washing". However, there is no specific regulation focusing "Green Washing" in green financial products. What will be required is an overall system of green finance to include what are and what are not green financial products and, therefore, provides clear restrictions on "Green Washing".

Such a system is taking shape. Standards covering green financial products are gradually being introduced, following the launch of the *"14th Five-Year" Plan for Financial Standardization* in February 2022. It is likely that more regulations will be issued to govern risk management of green financial products.

03 Interim administrative regulations on carbon emissions trading are likely to be issued to fill in the gap of high-level legislation

In March 2021, the MEE issued the Interim Regulations for public consultation, which focuses on building a scientific, standardized and orderly carbon emissions trading management system to promote the goal of "Carbon Peaking and Carbon Neutrality". The draft provides provisions on the coverage of the carbon emission trading market, the identification of key emission units, the allocation of allowances, the supervision of carbon emission data quality, the clearance of allowances and the mechanism of trading operation. In July 2022, the State Council has included the Interim Regulations in its annual legislative work plan, but the formal regulation has not yet been issued. At present, the *Measures for the Administration of Carbon Emission Trading (for trial implementation)*, the *Rules for the Administration of Carbon Emission Registration (for trial implementation)*, and the *Rules for the Administration of Carbon Emission Settlement (for trial implementation)*, which mainly regulate the activities related to carbon emission trading, are all departmental rules with lower hierarchy of legal authority compared to laws and administrative regulations. The Interim Regulations, an administrative regulation once promulgated by the State Council, should fill a long-standing gap in high-level legislation and provide stronger institutional support for regulating carbon emissions trading and related activities.

According to the MEE's statement in the second half of 2022, the Interim Regulations is expected to be formally introduced in 2023. At the same time, relevant supporting policies and technical specifications will also be issued to further improve the system of cooperative supervision and better prevent the risks of market operation, so as to promote the standardized and orderly operation and healthy and sustainable development of the national carbon emission trading market and provide strong legal protection for the realization of China's "Carbon Peaking and Carbon Neutrality" goal.

04 CCER filings are expected to restart as signals emerged

The CCER trading was previously a key complement to the carbon market. However, since 2017, the NDRC has held off on accepting filing applications for CCER projects both because of "irregularities" in some CCER projects and low overall trading volumes. Despite frequent signals of the reopening of CCER project filing applications in 2022, there have been no applications for new CCER projects as yet.

CCERs can be used to offset a portion of the clearance amount in the performance of carbon allowance clearance, and approximately 32.7 million tones CCERs were used as carbon offsets in the first performance period of the National Carbon Market. However, there is very little current stock of CCERs in the market. As the expiry date of the second performance period of the National Carbon Market approaches, the need to restart the filing of CCER projects will become increasingly urgent. On October 2022, the MEE stated that it would accelerate the establishment of a voluntary greenhouse gas emissions trading market and strive to launch a market that conforms to China's actual circumstances and reflects China's special features as soon as possible. This was widely interpreted as a signal that the CCER would soon be restarted. In preparation for the re-launch, the regulators are revising the *Interim Measures for the Management of Voluntary Greenhouse Gas Emission Reduction Trading* (originally issued in 2012) to set up how the voluntary emission reduction trading market would work and the rights and responsibilities of the participating parties, and to coordinate the carbon emission trading market and the voluntary emission reduction trading market. At the same time, they are also working on the regulations and rules that will support the Interim Measures, including important supporting management systems and technical specifications such as project development guidelines, validation and verification rules, registration and trading rules, and methodologies. In addition, work is nearing completion on the establishment of the voluntary emission reduction registration system and trading system.

05 The development of cross-border carbon trading platform has attracted much attention, with positive progress in the GBA and the Hainan Carbon Center

Although the Guangzhou Carbon Emissions Trading Center was briefly connected to the EU carbon emissions trading system in 2019, the relevant business has been suspended, and there is currently no market practice of direct connection for carbon allowance swap trading between China and overseas carbon emissions trading markets. Foreign investors can open accounts for carbon allowance trading in a few regional carbon emission rights exchanges that accept foreign entities to open accounts, but they cannot participate in national carbon market trading, and the direct participation of foreign entities in the carbon market on-court trading is restricted.

The GBA has been attracting attention as a potential region that can link domestic and international carbon markets. In March 2022, the Guangzhou Carbon Exchange and the Hong Kong Exchange announced that they would jointly explore the possibility of creating a voluntary emission reduction system applicable to the GBA. On October 28, 2022 the Hong Kong Exchange announced the launch of Core Climate, a new international carbon market platform for internationally certified carbon credit products. The platform is dedicated to connecting the international capital markets with climate-related products and opportunities in Hong Kong, the Mainland, Asia and the rest of the world. Following the launch of the foreign exchange pilot for carbon emissions trading in Shenzhen in 2014, Guangzhou also announced in 2022 that it will explore a foreign exchange pilot to allow foreign investors to participate in carbon emissions trading in the GBA in foreign exchange or RMB, if they meet the conditions set by the GBA carbon emissions trading center.

There is also a proposal to build a new carbon market trading system in the GBA, to be called Carbon Connect, to open up cross-border carbon trading channels and allow global investors to participate in the Mainland carbon market.

Outside the GBA, Hainan emphasizes differentiated development and focuses on the international market route to explore the voluntary carbon emission reduction market serving the Belt and Road. In February 2022, the Hainan Carbon Center was approved and formally established in Sanya in July. In December, the first cross-border carbon transaction was successfully concluded in Hainan Carbon Center, the underlying product is international voluntary carbon emission reduction, the buyer and seller were an enterprise in Nanjing and an overseas institution, and Hainan

Carbon Center provided trade matching and witnessing services for the transaction.

Cross-border carbon trading can supplement resource and give further impetus to carbon trading market. Promoting the interconnection between China's carbon trading market and the international carbon trading market is also the development trend of carbon trading. Based on the existing development, we expect more institutional and practical exploration in cross-border carbon trading in 2023.

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