FANGDA PARTNERS
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PRC Financial Regulation 2021

Annual Report

Contents

01 Preamble
02 General
18 Banking
28 Securities
40 Asset Management
53 FinTech
65 Insurance
78 Authors

Preamble

2020 will be remembered as a historic year for many reasons, regrettably and largely for the unprecedented pandemic and the complicated and severe international situation. Despite all these challenges, the Chinese financial sector has undergone huge change over the past year, signaling the determination of China's policy makers and regulators to carry through fundamental financial reform and opening-up.

During the year, a number of laws of major significance to the financial market including the *Securities Law* were amended and implemented or published for public opinion, laws and practice to eliminate "mandatory repayment" continued to progress, the opening-up policy was further implemented, regulation of internet finance were fully incorporated into regulation of the whole financial sector, and the "Yuan You Bao" event, which exposed poor risk management, gave rise to a further crop of new challenges for targeted risk control and regulation.

The year 2021 marks the beginning of China's Fourteenth Five-Year Plan, and heralds deepened regulatory reform and opening-up policies on an expanded scale. 2021 is also the second year for our PRC Financial Regulation: Annual Report series, which examines developments of the previous year and provides a glimpse into the future to help businesses position themselves in China for the forthcoming year.

We have been working in the financial services sector for many years and have in-depth knowledge of the China market, and look forward to understanding the market, embracing the changes, and grasping the future trends with you. To this end, we have prepared this PRC Financial Regulation: Annual Report to provide practical and forward-looking guidance, covering milestone events, main regulatory developments and key trends in the banking, securities, asset management, FinTech and insurance sectors.

Fangda's core mission is to provide effective, creative and timely legal services to meet the commercial needs of our clients. Our Financial Institutions Group comprises 30 top-quality lawyers who have extensive experience. Our lawyers offer a full range of legal services related to financial institutions and China's financial markets. We advise both domestic and overseas clients on the most cutting-edge and complex legal issues in China's financial services sector. We are at the forefront of significant initiatives in the sector, leading on the market's most significant transactions and new product structures. With our deep understanding of the market and our unparalleled experience of advising on groundbreaking transactions, we are able to provide creative solutions in a complex financial regulatory environment. We look forward to sharing with you our observations that we have accumulated over years of practice.

We trust you, as market participants, have your thorough and practical observations on the market and its development. We are always happy to absorb feedback from those working directly in the financial services sector and welcome any comments or suggestions on the contents of this report you may have.

We live in challenging times, but nevertheless we remain optimistic and there is much to look forward to in 2021.

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PRC Financial Regulation: Annual Report (2021) – General

2020 Key Dates

March 1
The amended *PRC Securities Law* took effect.

April 1
The Chinese financial sector was fully opened up, with all main types of financial institutions permitted to be wholly owned by foreign investors.

May 27
The Financial Stability and Development Commission under the State Council issued 11 financial reform measures.

May 28
The National People's Congress (NPC) passed *the Civil Code.*

July 17
The China Banking and Insurance Regulatory Commission (CBIRC) and the China Securities Regulatory Commission (CSRC) took over nine financial institutions controlled by Ming Tian Group.

July 31
The People's Bank of China (PBOC) declared the grace period of *the Asset Management New Rules* would be extended to the end of 2021.

October 23
The PBOC issued the draft amendment to *the Law of the People's Bank of China*.

November 1
The *Decision of the State Council on Implementing Access Administration of Financial Holding Companies* and *the Interim Measures for the Supervision and Administration of Financial Holding Companies* took effect.

November 2
The China Banking and Insurance Regulatory Commission (CBIRC) and the PBOC sought public opinion on the consultation draft of *the Interim Measures for the Administration of Online Micro-lending Business*.

November 15
The Regional Comprehensive Economic Partnership (RCEP) was signed by 15 member countries, with China committing a further opening-up of financial industry.

November 23
The CBIRC agreed in principle for Baoshang Bank to enter into bankruptcy proceedings.

December 19
The National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) issued *the Measures for the Security Review of Foreign Investment,* including "important financial services" in the scope of security review of foreign investment.

2020 Regulatory Observations

1 "Market-oriented Reform" and "Tight Regulation" continuing as the main themes of financial regulation

As China accumulates regulatory experience and pursues ongoing reform of the financial system, the underlying trends of financial regulation in 2020 continued to be market-oriented reform and tight regulation.

The regulatory authorities simplified administrative procedures significantly and delegated much power in 2020, among them:

- the PBOC set out, for the first time, the simplified procedures in the newly amended measures for the implementation of administrative licensing;
- the counter-cyclical factor was removed from the RMB exchange rate mechanism;
- with the new *Securities Law* taking effect, the need to pre-approve any change of non-main shareholders of securities companies and other relevant changes was removed;
- the CSRC revised and abolished several securities and futures rules and regulations, carried out a categorized review of the re-financing of listed companies, and implemented a new registration system for shares listed on the STAR market and the Shenzhen growth enterprise market (GEM) and for corporate bond issuances;
- the CBIRC simplified the process for several administrative licenses, including: cancelling the requirement of approval of shareholders holding less than 5% of the shares of non-bank financial institutions; removing the requirement for foreign financial institutions to have total assets of at least US$1 billion for investment in trust companies; and removing the sector restrictions on the financial equity investment by insurance funds.

Among other measures, setting up a cross-border financial innovative regulatory sandbox in the Greater Bay Area, and initiating digital RMB pilots, are clear indications of the direction of market-oriented reform in the financial sector.

Although the pandemic brought lots of challenges, this did not lead to any reduction of strict regulatory supervision by the regulatory authorities in key areas. For example:

- in October, the PBOC fined three state-owned commercial banks for infringing the security of consumer financial data, one of them being fined as much as RMB14 million;
- the PBOC issued a consultation draft of *the Administration Measures of Combating Money Laundering and Financing of Terrorism by Financial Institutions;*
- the CSRC continued to combat market manipulation, insider trading, shadow margin financing, financial fraud of listed companies and other misconduct;
- the CSRC determined the facts and fined ZONECO by using new technology to identify misconduct - a case that attracted much attention - and investigated suspicious stock transactions of Tianshan Animal and other listed companies;
- by conducting a review of the market chaos, the CBIRC examined a number of high-risk activities, including real estate financing, shadow banking and cross-market financial services. It also punished a number of banks charging customers fees without authorization and infringing financial consumers' interests in the course of enterprise-related services;

- the CBIRC, through “window guidance”, instructed banks to scale down structured deposits and trust companies to reduce their trust financing business; and

- P2P online lending institutions were eliminated in 2020.

Above all, there has been an ongoing trend of tight regulation.

As we predicted in our PRC Financial Regulation Annual Report (2020), in the context of tight regulation, regulators stepped up the practice of punishing individuals found to be responsible in major cases of regulatory breaches. When the CSRC and the CBIRC fined several securities companies and banks for regulatory breaches, they also ordered the involved individuals to be held internally accountable. In the only three administrative cases involving punishment for money laundering disclosed by the PBOC in 2020, the PBOC revealed, for the first time, the names of the culpable individuals, as well as the fines imposed on them.

We also saw increased levels of cooperation between the different regulatory bodies. For example, following the default by Yongmei on bond repayments in November, the National Association of Financial Market Institutional Investors (NAFMII) led a program to require issuers and intermediaries to conduct investigations on themselves, and then handed over the evidence to, and coordinated with, the CSRC on formal investigations. This was under the general requirement of China's Financial Stability and Development Commission to exert more influence on the safer operation of the financial market.

The approach by the regulators to combine market-oriented reform with tighter regulation, as well as pragmatic law enforcement which allows for some flexibility as new regulations take effect, demonstrate the confidence and regulatory wisdom of the financial regulators in creating a stable financial market. We expect this approach to continue serving as the main theme of the financial regulation of China in the future.

2 Actively reducing financial risks and putting in place systems for financial risk prevention and control

In 2020, China moved towards the goal of creating a society which is "moderately prosperous", marking the final year of the 13th five-year plan. It was also the year that the Chinese authorities took significant steps to put in place controls to minimize risks in the financial system.

Against this background, a number of important high-risk financial groups and financial institutions initiated restructuring, takeover and disposal procedures in 2020.

- In February, the HNA Group, in effect a financial holding company, was officially taken over.
- In April, the Bank of Gansu received provincial government approval for its risk disposal plan.
- In July, the CBIRC and the CSRC announced the takeover of nine key financial institutions within the Ming Tian Group, including New Times Securities, Guosheng Securities and Guosheng Futures.
- In December, Sichuan Trust was officially taken over, one of many privately-owned trust companies that found themselves in financial distress and requiring the intervention of local CBIRC bureaus to conduct risk disposal.

Additionally, further actions were taken to continue the disposals of risks of a number of high-risk financial institutions. Anbang, Ming Tian and Huaxin were all required to liquidate assets and ring-fence risky activities.

In November, the CBIRC agreed in principle for Baoshang Bank to enter into bankruptcy proceedings, making this the first commercial bank in China's financial history to be liquidated in bankruptcy through judicial proceedings (rather than administrative shutdown procedures). In addition, it was proposed that the Anbang Group be liquidated and closed; Jinzhou Bank completed financial restructuring and capital increase; and Yongxing Securities, Huaxin Securities' successor company, officially opened for business.

The efficient and effective disposals of high-risk financial institutions made it crystal clear to the market that financial regulators would use an iron fist, where required. By allowing the market to provide solutions after using administrative powers to control failing companies, the regulators signaled their clear preference for a market-based approach to the operation of China's financial system.

Since 2020, financial risk prevention has been implemented by means of the dual-approach of developing the regulatory systems and enabling specific, identified institutions to dispose of risky businesses.

On one hand, in order to fill in the regulatory gap of macro-prudential policies: the PBOC has actively developed a macro-prudential policy framework, and the draft amendment to *the Law of the People's Bank of China* expressly includes macro-prudential management as one of the PBOC's responsibilities. The PBOC and the CBIRC will establish an assessment and identification mechanism for systemically important banks and a counter-cyclical capital buffer mechanism. The PBOC and five other departments have published a working plan for the coordinated regulation of financial infrastructure.

On the other hand, financial regulators have actively promulgated regulations so as to fill in gaps in the existing system: important financial services have been included in the scope of foreign investment security review; business areas which were not previously included in, or not formally included in, the regulatory supervision have now been regulated, such as the draft new online microcredit regulations; and there were new regulations on financial holding companies. Each of these measures had major impact in 2020.

The rectification work in areas including P2P, internet asset management, equity crowdfunding, virtual currency trading and internet foreign exchange trading is nearly complete. Regulations have been imposed on internet finance products, including commercial banks' internet loans and online insurance products.

All of these "system-building" initiatives will pave the way for risk prevention of financial institutions in the future.

3 Shifting from the fictitious economy to the real economy, and integrating industry and finance

Establishing a mechanism where the real economy is effectively supported by finance has been important to the design of China's financial regulatory system in recent years. The unique background of the 2020 Coronavirus pandemic further highlighted the urgency and importance of finance serving the real economy.

In terms of the shift from the operation of a fictitious economy: at the end of 2019, the CBIRC ruled that listed companies were no longer permitted to spin off financial subsidiaries for the purpose of listing; according to *the Report of Chinese Shadow Banking* issued by the CBIRC, the scale of shadow banking shrunk by RMB16 trillion, and inter-bank cash management was reduced by 90%, compared to the peak; and the size of management trusts declined in 11 quarters successively as of the third quarter of 2020, according to data from the China Trustee Association. In the past year, the pressure to reduce entrusted investment of banks, inter-bank investment, inter-bank deposits, and trust channel business was maintained.

In terms of encouraging the financial sector to support the real economy: the CBIRC required all banks and insurance companies to review and assess how their business is benefiting the real economy and to make sure the funds they hold are put to productive use, as well as preventing funds being circulated within the financial sector without entering the real economy.

In November, the CBIRC criticized four banking and insurance institutions for increasing the financing cost of their clients by bundle sales, and adding commission fees and investment advisory fees, while not assisting small and microbusinesses by reducing fees. The CSRC also announced six key missions to increase the percentage of direct financing to businesses through: fully implementing registration-based IPOs; accelerating the development of private equity funds; promoting long-term funds to be injected into the market; and encouraging highly reputable foreign securities and funds institutions to conduct business in the PRC, all in the cause of building up the real economy.

4 Developing high-level reciprocal opening-up, and promoting cross-border regulatory cooperation

As we predicted in the PRC Financial Regulation Annual Report (2020), the opening-up continued apace. The ups and downs in the Sino-US relationship and the pandemic did not delay the process of further opening up the financial sector. In 2020, the financial opening-up policies and implementation measures continued the trend over the past three years and fully demonstrating the determination of "promoting reform by opening-up" at the top level.

- After the negative list for foreign investment in the financial sector was removed, in February 2020, Mastercard became the second foreign-invested card settlement institution permitted to make preparations to set up.
- In April, the CSRC removed the restriction on foreign shareholding of securities companies pursuant to *the Sino-US Economic and Trade Agreement (First Phase)*.
- In May, the PBOC granted permission to Fitch Rating to become the second foreign credit rating agency.
- In June, the CSRC approved J.P. Morgan Futures to become the first wholly foreign-owned futures company.
- In August, BlackRock was approved to set up the first wholly foreign-owned fund management company.
- In September, the applications of Neuberger and Fidelity to set up fund management companies were accepted.
- In October, Standard Chartered's application for setting up the first wholly foreign-owned securities company was received by the CSRC.

Other financial sector businesses were given approval for the first time to be made accessible to foreign investors. The first wholly foreign-owned money brokerage company was approved in September. The Chinese subsidiary of S&P became the first foreign credit rating agency to complete securities credit rating filing with the CSRC (a new license after the amended *Securities Law*).

Upon these foreign-invested institutions entering the China financial services market, some will have the effect of spurring competition with domestic financial institutions (e.g., credit rating agencies); it remains to be seen how many of them will be successful in introducing advanced offshore experience and technology (e.g., asset management companies). However, we can expect more in the same vein in the future, with more qualified and competent foreign institutions further stimulating the Chinese financial market.

In terms of cross-border capital market investment and financing: the pilot "cross-border wealth management connect" was due to be launched in the Greater Bay Area. In September, the new rules on the Qualified Foreign Institutional Investor (QFII) were issued, which had the effect of lowering the access requirement and enlarging the investment scope of the QFII program. The State Administration of Foreign Exchange (SAFE) has updated the Qualified Domestic Institutional Investor (QDII) quotas regularly, increasing it by three times since September with a total new quota of US$12.7 billion to 71 institutions. This was the first time in nearly a year and a half that the SAFE had increased the quota allotment. Shanghai has announced that it intends to expand the offshore investment scope of QDIIs, and several cities have increased the scale of qualified domestic limited partner (QDLP)/qualified domestic investment enterprise (QDIE) schemes. More QDLP pilot areas were introduced. In October, SDIC Power became the fourth Chinese entity to issue GDRs under the "Shanghai-London Stock Connect" scheme following in the footsteps of Huatai Securities, China Pacific Insurance and China Yangtze Power.

There were significant breakthroughs in terms of cross-border financial cooperation, regulation and enforcement. There is scope for greater international financial regulation as provided for under the framework of the new *Securities Law*. One example of cross-border cooperation was the Luckin Coffee financial fraud case in which the CSRC, in accordance with the cross-border supervision operation with the International Organization of Securities Commissions (IOSCO), assisted the US

Securities and Exchange Commission (SEC) in the cross-border investigation. The CSRC worked with the European Union on QCCP regulatory equivalence assessment, and China's four futures exchanges have been included in the European Securities and Markets Authority (ESMA)'s third-country post-trade transparency positive list.

5 With separate supervision as the key theme, focus of regulation being switched from institutions based regulation to function based regulation, and there being further emphasis on macro-prudential and innovative regulation

There was much debate over the possibility of commercial banks being permitted to set up securities companies. However, the position remained that each type of business will continue to be separately regulated. The revised consultation draft of *the Commercial Bank Law* also retained the requirement for separate regulation of different types of institutions. As we previously forecast, the regulatory authorities have actively explored a greater focus on function-based regulation and greater coordination of regulation in specific areas.

The Financial Stability and Development Commission and the PBOC took the lead in coordinating regulation of financial institutions. The commission held approximately 40 meetings in 2020, four times as many as in 2019, and also issued 11 financial reform measures to promote risk disposal and the reform and development of the financial sector.

In terms of specific policy tools, in the amendment draft of *the Law of the People's Bank of China*, some of the multiple macro-prudential policies available to the PBOC already fell into the regulation scope of the CBIRC. The formal rules applying to financial holding companies, which impose unified regulation on a group of institutions on a look-through basis, add a new license on top of credit reporting, credit rating, payment and other financial licenses in charge by the PBOC.

At the specific financial products level, the trend was towards closer cooperation and interconnection between regulatory authorities. The Shanghai Stock Exchange and Shenzhen Stock Exchange clarified the specific conditions under which banks can participate in exchange-traded bond market transactions. The PBOC and the CSRC agreed to interconnect the infrastructure of the inter-bank bond market and the exchange-traded bond market to create a unified market with a unified price.

Meanwhile, function-based regulation continued playing an important role in 2020, and regulators emphasized that the financial sector is a licensed industry and relevant activities must be licensed: in order to truly address regulatory gaps and the scope for regulatory arbitrage, emerging financial activities will be fully and properly regulated and all financial products with the same functions and the same legal relationships will be regulated by the same regulatory authorities under the same regulations.

In 2020, the regulatory authorities filled in the regulatory gaps, and clarified the scope of regulatory overlapping areas. Following confirmation under the new *Securities Law* that the CSRC had all the regulatory power over asset management products, a consultation draft about mutual fund managers was issued, requiring wealth management subsidiaries of commercial banks to obtain their own licenses. The CBIRC has formulated specific regulations for micro-finance companies and financial leasing companies, following the change of regulator of pawnbrokers and financial leasing companies to CBIRC in recent years. In addition, the licensing requirement for financial holding companies strengthened the regulation and management over financial institutions held by or actually controlled by non-financial institutions. Overall, gaps in regulations and guidance that had come about largely for historical reasons were plugged.

It is worth noting that the regulatory authorities have shown a willingness to innovate in special areas. One example is the initiative to create fintech regulatory sandboxes involving the "Ten Cities" pilot launched at the end of 2019. Since then, nine "regulatory sandbox" pilot cities have publicly announced 60 pilot projects within one year. The new *Securities Law*, for the first time, established an administrative settlement system. The *Measures for the Implementation of Securities and Futures Administrative Settlement (Consultation Draft)* will promote administrative settlement in administrative enforcement of securities and futures regulations.

6 Top-level guidance, with coordination between central and local governments

As we stated in our PRC Financial Regulation Annual Report (2020), financial reform has continued on the basis of "top-level promotion and coordinated regulation". In 2020, the Financial Stability and Development Commission established offices in all provinces, within local PBOC branches and under the leadership and operational guidance of the central Financial Stability and Development Commission. The local financial regulation framework was established. In 2020, local governments led the process of risk disposal of financial institutions, including several small and medium-sized banks and trust companies, such as Sichuan Bank and Sichuan Trust. This echoed the repeated instructions from the central government that local governments exercise their responsibilities for the day-to-day and case-by-case regulation of financial institutions.

For financial leasing companies, the central government sets the regulations and local governments are responsible for implementing those regulations and managing risk disposals. *The Regulations on the Prevention and Disposal of Illegal Fundraising (Draft)* also provided that the provincial governments had the overall responsibility for the prevention of illegal fundraising. On this basis, a number of local financial service bureaus, such as those in Shandong and Hubei provinces, published lists of quasi-financial institutions, including the financial leasing companies and commercial factoring companies, and implemented a list-based management system.

At the policy level, local governments were given more space for institutional innovation and regulatory flexibility. For example, Shanghai issued *the Opinions on Further Accelerating the Construction of Shanghai International Financial Center and Financial Support for the Integrated Development of the Yangtze River Delta,* Shenzhen issued *the Implementation Plan for the Comprehensive Reform Pilot Program for the Construction of a Pilot Socialism Demonstration Zone with Chinese Characteristics (2020-2025)*, and Hainan issued new policies concerning its free trade zone. It will be interesting to see how local financial regulatory authorities implement daily regulation and the impact this will have within the existing regulatory framework.

7 Rising requirements for equity and corporate governance in financial institutions and quasi-financial institutions

As a traditionally highly-regulated industry, one of the core directions of the reform of financial regulation is to improve financial institutions' internal governance and compliance. Having effective governance also helps to prevent financial risk.

Many regulations were issued in 2020, covering the activities of various financial institutions including securities companies, fund management companies, trust companies and commercial banks. These regulations relate to the equity management and the supervision of such companies, with the purpose of raising the standard of corporate governance of financial institutions. By way of examples, the proposed amendment to *the Commercial Bank Law* adds a specific chapter covering corporate governance of commercial banks; the draft rule for mutual fund managers, for the first time, requires independent directors to comprise no less than one half of the board where there is one controlling shareholder; non-financial companies intending to become the controlling shareholder of trust companies are subject to strict qualification requirements; and the draft Measures on *Equity Management of Securities Companies* newly introduced many provisions, including prohibiting the use of the valuation adjustment mechanism (VAM) in relation to the equity interests of securities companies.

Enforcement was stepped up. In its review of the market chaos, the CBIRC focused on the corporate governance of financial institutions, including assessing equity management, the effectiveness of the system of board of directors, board of supervisors and senior management, and the management of related transactions and the consolidation of financial statements. One of the reasons announced by the CSRC for taking over the financial institutions of the Ming Tian Group was that the group had concealed its actual controllers and shareholding percentages, resulting in skewed internal governance.

8 Protecting personal information security and safeguarding the legitimate rights and interests of financial consumers

The first statute to protect the rights and interests of financial consumers, *The Implementation Measures for the Protection of the Rights and Interests of Financial Consumers*, was issued; investors were given greater protection with the gradual implementation of the "special representative system" to settle disputes involving securities under the new *Securities Law*; and regulations were issued covering internet insurance sales and the sales of products by wealth management subsidiaries of commercial banks, both of which aimed at preventing illegal marketing and thus providing consumers with greater protection.

For the purpose of protecting financial customers, the protection of personal data in the digital era has been the absolute imperative in the financial sector. The Ministry of Industry and Information Technology (MIIT) cracked down on several financial apps for infringing the rights and interests of users, involving multiple types of financial institutions, including banks, funds and micro-finance companies. Legislation was passed to help regulate use of personal financial information from various angles, including the *Technical Specifications for the Protection of Personal Financial Information*, the *Data Security Law (Draft) and the Personal Information Protection Law (Draft)*.

At the enforcement level, regulators frequently imposed fines and publicly chastised those found to have breached data protection regulations. Failure in taking effective measures to protect customer information security, information leakage, and misuse of customer information were listed as the key rectification areas by the CBIRC in its review on market chaos.

2021 Regulatory Outlook

1 Maintaining financial stability, preventing and diffusing major financial risks

The bottom line of China's financial regulation is to avoid systemic financial risk, and this will continue to guide the formulation of specific financial regulatory policies in 2021. In the coming year, the global economy may continue to face the issues such as uncertainty or even recurrence of the pandemic. In terms of preventing and diffusing major financial risks, there still exists a large number of high-risk financial institutions that need to be sold off or otherwise disposed of, and the risks of large non-financial enterprises are very likely to spread to financial institutions by way of bond defaults or increase in distressed assets, among others. The risk disposal of high-risk financial institutions and other large enterprise groups will continue to be the regulatory focus in 2021.

From the legislative perspective, it is expected that the regulatory authorities will:

- accelerate the promulgation of the implementation rules for regulating financial holding companies;
- issue the implementation rules for regulating systemically important financial institutions (including releasing a list of, and imposing additional regulatory requirements for, systemically important banks), and likely set standards for systemically important securities and insurance companies;
- promote inter-bank bond market trading system; and
- formally amend *the Law of the People's Bank of China* and other fundamental financial laws, as part of the process of building a modern centralized banking system.

As the grace period of *the Asset Management New Rules* is now extended to the end of 2021, it remains to be seen whether regulatory authorities will implement differentiated regulatory measures on a case-by-case basis to deal with individual financial institutions that cannot meet requirements to improve their operations by the end of 2021.

We also expect to see rules on how the regulators will implement the security review of foreign investment in important financial services companies.

2 Deepening market-oriented financial reforms, multi-dimensional financial opening-up to be expected

The year 2021 will be the year when market-oriented financial reform reaches fruition. The registration-based IPO system, based on the existing experience, is likely to apply to the whole market. Detailed rules and procedures for NEEQ Select Tier companies (the equity market for small and medium-sized enterprises) to transfer their listings to the main board are expected to be published. The authorities will further look into the "easy entry, strict exit" approach to the listing and delisting of companies on stock markets, and the reform of the new delisting system is expected to be further implemented in 2021.

Further measures to reform the operation of the financial sector include restructuring small and medium-sized banks and continuing the process of issuing licenses to private banks. The above policies, which might involve either direct financial support to enterprises or facilitating companies to obtain financial licenses, will support the development of the real economy under the banner of market-oriented financial reforms.

We can also expect to see attention focused on how private enterprises are financed, a situation that has been exacerbated by the reduction in shadow banking and controls over private lending interest rates. It remains to be seen whether substantive measures will be adopted in 2021 to give preferential treatment for the financing of private enterprises, so as to solve the "dual-track" differentiation applied to the financing of SOEs and private enterprises. The role of the financial sector to support real economy will continue to be the long-term strategy given the uncertainty facing the global economy and the growing risks facing the financial sector generally.

Part and parcel of the market-oriented reforms is the opening-up of the financial sector, by granting foreign companies the same treatment and regulation as domestic companies (i.e. "national treatment").

Following the lifting of restrictions on foreign shareholding in the banking, securities, fund management, futures, and life insurance businesses, we expect to see more foreign-invested financial institutions being granted access in 2021. The government will make it easier for foreign companies to access the capital markets by: further simplifying the channels and methods for foreign investors to participate in China's capital markets following the new QFII rules, an increasing interconnection between domestic and overseas markets, increased access of international investors to exchange-traded bond markets, and the introduction of more commodity and stock index futures options.

There remain obstacles facing foreign financial services companies. There is still invisible discrimination, and for the purpose of macro-prudential management and maintaining the overall stability of the financial market, in practice it may be extremely difficult for foreign companies to obtain licenses to operate in certain areas, including securing licenses for payments, credit ratings and local financial asset management companies. There are also other reasons which may make it less attractive for foreign investors, such as foreign exchange restrictions.

Overall, we still expect the process of opening up the financial sector to foreign participation to continue and move towards foreign businesses being given national treatment, with some potential breakthroughs in 2021.

3 Tight regulation and zero tolerance being the main thrusts of financial regulation in 2021

In 2021, financial law enforcement will be more stringent. The revised draft of *the Law of People's Bank of China* shows a trend of increasing penalties for illegal financial activities. *The Amendment to the Criminal Law (XI),* which will come into effect on 1 March 2021, coheres with the amended *Securities Law* and significantly increases the penalties for financial crimes such as information disclosure fraud and market manipulation. The legislation progress of *the Futures Law* will be accelerated, and the regulations on the supervision of listed companies and private equity funds are expected to be issued. *The Regulations on the Prevention and Disposal of Illegal Fundraising* will become the first specific regulations on illegal fundraising after its formal issuance. The above laws and policies all demonstrate the determination of regulatory authorities to strengthen the regulation over illegal and criminal financial acts.

Following completion of the work to address P2P problems, regulators will look to address any left over issues following the closing of businesses. Unqualified persons and businesses suspected of illegal fundraising through live broadcasting will also be cracked down upon. Non-bank financial institutions will be required to be licensed and more regulations will apply to quasi-financial institutions as if they were financial institutions.

At the same time, regulatory authorities will continue to explore innovative ways to regulate and enforce. The approach of administrative settlement may be further expanded to the PBOC and the banking and insurance regulatory system, which brings together regulatory administration in a clearer structure from the experience of the CSRC. In terms of law enforcement, there will be more regulatory coordination. Under the unified command and coordination of the Financial Stability and Development Commission, the CSRC will set up a coordination working group to combat illegal activities in the capital markets. Regulatory Technology (RegTech) will become a powerful instrument to improve the effectiveness of regulation. Based on publicly available information, the PBOC is actively building up a regulatory technology application framework, the CSRC has established a new Technology Regulatory Bureau, and the CBRC is redoubling efforts to promote a regulatory big data platform.

For cross-border regulation, we may see supporting rules on the extraterritorial application under the new *Securities Law*. We look forward to more interaction and cooperation between Chinese regulatory authorities and overseas regulatory authorities in cross-border law enforcement in 2021.

4 Fintech to be further regulated and licensed, with greater protection for consumers

2020 was the watershed of fintech regulation, as the authorities took the view that fintech should not be seen as separate from finance, especially from a risk perspective. The focus of regulation in 2021 will be on the requirements for licensed operation, antitrust implications and the prevention of disorderly expansion, all of which were flagged up in 2020. Those fintech companies considered to have significant influence on the "platform economy" may find themselves the subjects of further stringent regulation.

The pandemic has certainly accelerated the "non-contact" digitalization of financial institutions. In this connection, fintech has undoubtedly helped to improve financial services but it also blurs the boundaries between financial institutions, posing new challenges to financial stability and financial regulation. 2021 is the last year of the Financial Technology (FinTech) Development Plan (2019-2021). Following the 2020 path set out, regulation in 2021 will continue to emphasize that financial activities must be licensed, and fintech services that fall into grey areas between technology and finance will be regulated as financial services companies, depending on their specific businesses. Thus, it can be predicted that in 2021, more regulatory rules in the field of fintech will be introduced, the regulatory framework under which fintech companies operate will be developed, and advanced financial technologies will be applied to regulate every aspect of fintech products including data protection, supply chain security and cross-business risk, so as to establish the whole life cycle management mechanism of fintech innovation products. This will also serve to promote closer collaboration between fintech companies and commercial banks and continue the redefinition of fintech as finance.

The protection of the rights and interests of small and medium-sized investors and financial consumers has always been the focus of regulation and law enforcement. In 2021, the framework of financial consumer protection, especially the regulatory system involving fintech enterprises will be further enhanced, including the ex-post protection mechanism for small and medium-sized investors and financial consumers. On the basis of the framework of personal information protection under *the Civil Code*, the information protection legislation, such as *the Personal Information Protection Law* and *the Cybersecurity Law*, is expected to be formally issued, and the PBOC will formulate *the Interim Measures for the Protection of Personal Financial Information*.

5 Judicial practice will further promote the implementation of financial regulatory policies

Judicial practice will play a larger role in implementing financial regulatory policies and preventing financial risks. After the issue of *the Asset Management New Rules*, the Hunan High Court issued a judgment declaring guaranteed returns on the asset management product as void. This ruling clarified the judicial interpretation of the guaranteed return clause commonly used in asset management contracts, and was therefore of great importance in invalidating the guaranteed return of asset management products.

In 2020, several asset management companies were punished for violation of regulations in connection with minimum return guarantees or no-investment loss promises, and the financial regulatory authorities also emphasized many times that the provisions on guaranteed return should be void. However, in judicial practice, following the *Minutes of the National Courts' Ninth Conference on Civil and Commercial Trial Work*, which clearly stipulated that the guaranteed return clause of asset management products were void, this judgment was the first case to implement such rule. With the grace period of the *Asset Management New Rules* being extended to the end of 2021, we expect that there will be more judicial precedents concerning the non-effectiveness of guaranteed return terms. By having investors take the risk of their investments, the regulatory and judicial rulings decreeing guaranteed returns to be void will aid the process of financial institutions laying off risks and prevent the transfer of risks to financial institutions. Although the courts will continue to have discretion when it comes to judicial rulings on guaranteed returns, the trend of eliminating such practices is irreversible.

The implementation of the new *Securities Law* served to pull together administrative law enforcement, civil recovery and criminal punishment. In addition to the development of administrative and criminal controls, investors can rely on greater protections to enforce their rights, including the securities civil compensation system and securities class actions. More progress can be expected in this regard in 2021, thereby establishing a connection and synergy between administrative law enforcement, civil recovery, and criminal punishment. After the Supreme Court issued the provisions on class actions involving securities claims, we can expect to see the first such class action soon. This should serve as a reference for courts to handle other mass financial civil disputes.

PRC Financial Regulation: Annual Report (2021) – Banking[1]

1. "Banking industry" as discussed in this Chapter includes commercial banks, rural cooperative banks, rural credit cooperatives, policy banks and the China Development Bank established in the People's Republic of China, together with financial asset management companies, trust companies, enterprise group finance companies, financial leasing companies, auto finance companies, money brokerage companies, consumer finance companies and other financial institutions established with license from CBIRC

2020 Key Dates

Late April

"Yuan You Bao" event (a crude oil futures trading product sold by the Bank of China resulting in substantial losses).

July 17

The CBIRC published the *Interim Measures on Internet Loans of Commercial Banks*.

August 20

In a judicial interpretation, the Supreme Court set the ceiling on the legal private lending rate at four times that of the loan prime rate (LPR).

September 18

The People's Bank of China (PBOC) published the *Measures on Financial Consumer Protection*.

November 16

Baoshang Bank announced that it wrote down the full RMB6.5 billion tier-two capital bonds, due to the fact of it being "insolvent and unable to survive". November 23: The CBIRC agreed in principle that Baoshang Bank could enter into bankruptcy proceedings.

December 11 and December 21

New license of direct banks with independent legal person status was issued again after three years: China Merchants Topology Bank and China Post Hui Wanjia Bank were approved for establishment.

July 4

The China Banking and Insurance Regulatory Commission (CBIRC) published the first list of "banking and insurance institutions shareholders in major violation of laws and regulations".

August 11

BlackRock, CCB Wealth Management, and Fullerton were approved to establish the second foreign-controlled wealth management company in China; September 24: Huihua Wealth Management, the first foreign-controlled wealth management company in China created by Amundi and Bank of China Wealth Management, was approved to open for business, and on December 10 it launched its first publicly offered product.

September 9

The CBIRC approved the preparation for the establishment of Sichuan Bank through the merger of two pre-existing local institutions.

Mid-October

The PBOC published the draft revisions on *People's Bank of China Law* and *Commercial Bank Law* for public comment.

December 3

The PBOC and the CBIRC jointly issued the *Assessment Measures for Systemically Important Banks*.

December 25

The CBIRC published the consultation paper of *Interim Measures on Sales of Wealth Management Products by Wealth Management Subsidiaries of Commercial Banks* for public comment.

2020 Regulatory Observations

1 Banking sector continuing to open up, reinforced by supporting policies

Foreign banks and institutions responded positively to the various measures introduced in 2019 that further opened up the banking sector. Through 2020, foreign investors invested in various banks or bank subsidiaries. For example, the direct sales bank CITIC Baixin Bank introduced Canada Pension Fund Investment Company to become a major shareholder; Temasek's Fullerton Financial Holdings established a joint venture with the Bank of China to create a network of village and township banks in the name of BOC Fullerton Community Bank; and approval was given to Blackrock, CCB and Fullerton to establish China's second foreign-controlled wealth management company.

In late 2020, the CBIRC issued the *Implementing Measures on Administrative Permission Matters of Trust Companies*, which removed the requirement that foreign financial institutions must have at least US$1 billion in total assets to invest in trust companies. The Shanghai Financial Court made the first ruling in China to recognize and enforce a Hong Kong court's ruling upholding the validity of a "keepwell agreement" in favor of offshore creditors. This was an important milestone in China's financial environment as it continues to operate more on the basis of market principles and in closer alignment with international rules.

2 Two major banking laws amended, strengthening PBOC's macro-prudential regulation

Draft revisions to both the *People's Bank of China Law* and the Commercial Bank Law were made in October 2020. The revisions aimed to turn into law well-established developments in the banking sector and new regulatory practices. These include: clarifying the different functions of the PBOC and the CBIRC in banking regulation; clarifying and strengthening the PBOC's role in regulation of systemically important banks, financial holding companies and macro-prudential policies; affirming the central bank's role in maintaining financial stability; and laying down requirements on organizations to dispose of financial risk. The two revision drafts also proposed significantly increased penalties for financial violations of the laws, as well as providing for new banking developments such as the issuance of digital currency.

3 The "Yuan You Bao" event exposing Bank of China's risk management failings, leading to tighter regulation of complex financial products

On April 22, 2020, a Bank of China wealth management product, "Yuan You Bao", caused investors to suffer massive losses as a result of price fluctuation and a negative settlement price of overseas crude oil futures to which the product was linked. This caused widespread concern. In addition to the sharp drop in demand for crude oil due to the spread of the pandemic overseas, the bank's risk management and investment expertise for the financial product was considered to be one of the main factors that caused the event. The "Yuan You Bao" event sounded an alarm for banks engaged in commodity trading. At the same time, it brought pressure on regulators to tighten their regulation of complex financial products, including clarifying their legal definition and increasing the accountability of those institutions issuing and selling them.

4 Regulators exploring market-based approaches to dispose of at-risk banks and calling a halt to "mandatory repayments"

The disposal of Hengfeng Bank in 2019 marked the start of regulators exploring how best to sell or otherwise dispose of "at-risk" banks, using a combination of administrative controls and market solutions, as well as engaging the participation of local governments. The Hengfeng disposal was followed by a series of cases through 2020, including: the CBIRC's instruction to Baoshang Bank to write down in full the bank's RMB6.5 billion tier 2 capital bonds; the CBIRC's consent in principle for Baoshang Bank to enter into bankruptcy proceedings and the selection of Huishang Bank to acquire four of Baoshang Bank's branches. The above cases reflect regulators' determination to put an end to "mandatory repayments". Allowing at-risk banks carrying out business in extremely poor operating conditions to exit the market through normal bankruptcy procedures (despite using some public funds to protect individual creditors) indicates the regulators' attitude towards adopting more market-oriented solutions.

5 Commercial banks' internet loans starting to be formally regulated, while internet deposit business coming to a sharp stop

The *Interim Measures on Internet Loans of Commercial Banks* issued in July 2020 clarified the standard regulatory rules relating to joint loans extended by commercial banks as part of their online loan business and collaborating institutions. These measures were the first formal regulations in effect recognizing how developed the online loan business had become and affirming the legal position of joint internet loans at the regulatory level.

Regulators also stopped the banks' business of collecting individuals' depositing funds via online platforms. Although the PBOC and the CBIRC have yet to issue formal notices or documents on such internet deposit products, many internet platforms (including Alipay, Tencent Wealth Management, and JD Finance) removed such products following a speech by a PBOC official at the financial forum in mid-December 2020, which gave strong signals about the regulators' intentions. Following that, on December 24, the CBIRC Zhejiang Office issued a *Notice on Further Regulating Certain Issues in the Deposit Market in the Jurisdiction*, calling a halt to the cooperation between banks and internet platforms to attract and solicit deposits. Internet deposit products give rise to a range of compliance issues, including high interest rates being charged, cross-regional solicitation of deposits by regional banks, and abuse of the deposit insurance mark. It remains to be seen how regulators will regulate banks' internet platform deposit business in the future.

6 Licensed consumer and auto finance institutions approved to expand their financing channels

Consumer finance and auto finance benefited from new regulations that were issued during the year. In November 2020, the *CBIRC General Office's Notice on Enhancing the Sustainable Development Capability and Improving the Quality and Effectiveness of Financial Services for Consumer Finance Companies and Auto Finance Companies* was issued. Companies offering consumer finance and auto finance were permitted to reduce the provision rate for non-performing loans (NPLs) from 150% to 130%. The policy also supports such two types of companies to transfer the income rights attached to these credit assets through the Credit Assets Registration and Exchange System, and allows them to issue tier-2 bonds on the interbank market. The regulators' support to the consumer finance and auto finance industries and the regulators' strict regulation on the small loan industry will lead to a change in the loan market, and consumer finance and auto finance companies have new development opportunities as a result of such changes.

7 Strict regulation of the banking sector becoming the norm, commercial bank shareholders fined, and anti-money laundering penalties significantly increased

Since 2017 when the China Banking Regulatory Commission (reformed and renamed as CBIRC in 2018) first started to address the erratic and disorderly events in the banking market, strict regulation has gradually become the norm. In 2020, the CBIRC updated various rules such as the *CBIRC Administrative Penalty Measures* and the *Code of Professional Conduct for Banking Practitioners* as part of its ongoing endeavors to strengthen the industry regulation. In June 2020, the CBIRC Altay Office (in Xinjiang Province) issued the first penalty notice against a shareholder of a bank for holding more than 5% of the equity of a commercial bank without approval. This was the first publicly disclosed case of penalty on shareholders of a commercial bank; previously, only banks themselves were punished for equity-related violations. In July 2020, the CBIRC published a list of shareholders who were found to have been in breach of regulations and indicated that publishing such lists would be a regular occurrence in the future.

Other developments include revisions to the *Anti-Money Laundering Law* and increased penalties imposed by the PBOC on those found to have been in breach of anti-money laundering regulations. The total amount of penalties levied in the first four months of 2020 alone exceeded those for the whole of 2019. This is all part of the PBOC's determination to take a firmer line on money laundering.

8 Regulators continuing to focus on financial consumer protection, introducing the first substantial financial consumer protection regulation

In June 2020, the CBIRC issued the *Notice on the "Look Back" Work on the Rectification of Market Disorder in the Banking and Insurance Industry*, which listed financial institutions' failure to take effective measures to protect customer information, and financial institutions' leakage and misuse of customer information as key priorities. In September 2020, the PBOC issued the Measures on Financial Consumer Protection, which were the first regulations issued at Ministry level on financial consumer protection. In addition, banking regulators have introduced stronger, multi-dimensional regulations for personal financial data security, and have issued several technical standards, guidelines and specifications for personal financial data protection technology, including the *Personal Financial Information Protection Technical Specification and Financial Data Security-Guidelines for Data Security Classification*. In practice, regulators have paid close attention to commercial banks' product issuance and distribution, internal processes, and personal financial data storage. Regulators have also increased the frequency and levels of fines imposed on those in breach of regulations. For example, in October 2020, the PBOC publicly reported six cases where the branches of three large state-owned banks were found to have infringed consumer financial data, the fines for which were over tens of millions renminbi.

2021 Regulatory Outlook

1 Banking sector will continue to open up, with increased foreign participation

In 2020, despite a challenging international political environment, both the central government and the regulators emphasized that China's finance sector would continue to open up. We expect that the pace of financial opening-up and marketization will remain unchanged in 2021, and foreign investors will continue to be active in increasing their presence in China by investing in domestic banks, investing/jointly establishing or controlling banks' wealth management subsidiaries, or even acquiring financial holding companies. We also expect that there will be more room for cooperation and mutual collaboration between domestic and foreign financial institutions, following recent policy measures to promote internationalization of the RMB, support the development of capital markets, and guide and encourage foreign banks to cooperate with their offshore parent banks to help Chinese enterprises "go global".

2 Personal financial information protection will continue to be strongly regulated, and supporting regulations and policies will be put in place

The *Measures on Financial Consumer Protection* issued in September 2020 were the first regulations issued at Ministry level on financial consumer protection. The significant fines in the amount of tens of millions also reflected the regulators' determination to crack down on infringements of consumer financial data. However, more detailed implementation rules on consumer financial data protection are yet to be introduced. For example, the standards and requirements on how to protect each category of data in the data security classification guidelines are not yet clearly defined. We expect that in 2021 regulators will continue to maintain the same strong and frequent enforcement of, and penalties related to, infringement of consumer financial information in the banking sector in a similar way that was implemented 2020. We also expect that regulators will continue to explore ways of protecting personal financial information, formulate further regulations covering data security protection, establish data security protection guidelines and a risk-based data security management system, clarify data classification and protection strategies, regulate the collection, sharing and use of personal information, and improve regulatory and technical protection measures.

3 The disposal of non-performing assets will intensify, and regulators may introduce related supporting rules

In 2020, the scale of non-performing banking assets continued to grow, in part due to the economic downturn as a result of the COVID-19 pandemic and in part as a result of accrued risks generated in the past due to poor risk management. Considering it takes time for non-performing loans (NPLs) to be exposed, we expect the number and scale of NPLs will continue to accelerate. Banks' disposing of non-performing assets in an orderly manner will continue to be a top priority for regulators in the coming year. As the CBIRC has been closely monitoring, analyzing, and assessing NPLs and conducting stress tests, we expect that the regulators will monitor and require small and medium-sized banks to dispose their non-performing assets more frequently, mitigating the risk in an orderly manner.

According to the *Notice on the Pilot Non-Performing Loans Transfer Program (Consultation Draft*) and the *Implementation Plan for the Pilot Non-Performing Loans Transfer Program* circulated by the CBIRC in 2020, pilot programs may be set up to allow banks to dispose of NPLs owed by enterprises, which are currently only allowed to be transferred in bulk and NPLs owed by individuals which are currently prohibited from being transferred. The pilot programs may be carried out through China Credit Assets Registry & Exchange Co., Ltd as one of the pilot NPL disposal channels. We expect that China Credit Assets Registry & Exchange Co., Ltd will issue supporting operational rules to accommodate the specific work entailed in the pilots, such as non-performing loan asset registration, listing, transfer services, information disclosure and market monitoring. On top of this, we expect new supporting rules and guidelines at the central government level will be issued, including permitting write-offs and bulk transfer of non-performing assets and the disposal of creditor-held assets for debt payments.

4 Regulators will take a firmer line in regulating non-traditional credit business, and may introduce new regulations for internet deposits and loans

In recent years, different banks have been cooperating with internet platforms and other third-party intermediaries to make the most of online opportunities, including introducing new customers, co-funding loan provisions and selling loans and deposit products. This type of activity has seen rapid growth, but lacking regulatory systematic oversight. In 2020, the CBIRC adopted the *Interim Measures on Internet Loans of Commercial Banks* and a series of other new regulations (e.g. the consultation paper of the new regulations for online small loan services) to expand the regulatory scope applicable to the internet loan business between commercial banks and their collaborating institutions. Such initiatives affirmed the legitimacy of lending collaboration between commercial banks and internet platforms, set boundaries on the dimension and breadth of such collaboration, and also reflected the regulators' position on the strong regulation of these credit businesses (including internet credit business) and joint loans businesses which did not fall within the scope of traditional commercial banks' offline financing.

Based on the impact of the new regulations on internet loans and online small loan services on the market, we expect the joint loan market which currently is of the scale of trillions of RMB, will be significantly reshaped. We expect that regulators in 2021 will promote the conduct of small loan businesses by banks, consumer finance companies and other banking institutions. In respect of the internet deposit business, there has been no formal regulation or guidance from the PBOC or the CBIRC, however, following the removal of internet deposit products at the end of 2020 and the issuance of some local supporting regulations, we expect there will be central-level regulations issued, which will likely establish a long-term regulatory mechanism by setting entry-level qualifications and standards, setting limits on scale and qualification for internet deposit business, and improving prudential regulation indicators. We expect that regulators will continue to focus on risk control of private lending and the internet deposit/lending business in 2021, ensuring that commercial banks with internet deposit and lending businesses restructure their operations to meet the regulatory requirements, aiming to improve and standardize the internet deposit and lending market for commercial banks.

5 Bank wealth management subsidiaries will further expand, and policies will be introduced to encourage more participation of commercial banks in capital markets

Since 2020, the CBIRC repeatedly emphasized its support for the development of China's capital markets by various measures, including guiding and encouraging new institutional investors to invest, approving the formation of more bank wealth management subsidiaries, and allowing foreign professional institutions to establish foreign-controlled wealth management companies, in order to enable commercial banks to be more involved in the process of conversion of savings into investments and capital. In practice, commercial banks' wealth management subsidiaries were expanding in the terms of the scale of business. The *Interim Measures on Sales of Wealth Management Products by Wealth Management Subsidiaries of Commercial Banks (Consultation Draft)*, a supporting regulation of the *Measures for the Administration of Wealth Management Subsidiary Companies of Commercial Banks*, was also published for public comments on December 25, 2020. The *Interim Measures* provided clear rules on the eligibility of institution engaging in the sales of wealth management products, administration of the sales of wealth management products, investor rights' protection, and supervision and liabilities. The *Interim Measures* emphasized, in particular, that without the permission from regulatory authorities no non-financial institutions or individuals were allowed to sell wealth management products directly or in disguised form.

It is expected that the CBIRC will formally issue the *Interim Measures on Sales of Wealth Management Products by Wealth Management Subsidiaries of Commercial Banks* in 2021, and will continue to formulate supporting rules on banks' wealth management subsidiaries. Furthermore, considering the recent regulatory policies promoting the issuance of equity-based asset management products, encouraging wealth management subsidiaries to increase securities investment, and promoting cooperation between banks and fund/insurance companies, we expect specific policies encouraging commercial banks to participate more in the capital markets to be introduced in 2021. As the market develops, both domestic and international institutions will face more opportunities and challenges especially in terms of product design, cooperation, and business development of wealth management subsidiaries.

PRC Financial Regulation: Annual Report (2021) – Securities

2020 Key Dates

March 1
The amended *Securities Law* came into effect.

March 27
First batch of six securities companies, including CICC, were included in the pilot "consolidated regulation" program.

April 1
Foreign ownership limitation in securities companies was officially lifted.

June 12
The China Securities Regulatory Commission (CSRC) issued a series of measures to reform ChiNext and pilot the IPO registration system.

June 18
The CSRC approved the change of equity structure for JP Morgan Futures, making it the first wholly foreign-owned futures company in China.

July 17
The CSRC took over New Times Securities, Guosheng Securities, and Guosheng Futures.

July 19
The PBOC and the CSRC agreed to connect the infrastructures of interbank and exchange bond markets.

July 31
The Supreme People's Court issued *Provisions on Several Issues Concerning Representative Litigation in Securities Disputes.*

October 10
The CSRC announced to have received the application for establishing the first wholly foreign-owned securities company, Standard Chartered Securities, in China.

November 1
The *Administrative Measures for Domestic Securities and Futures Investments by Qualified Foreign Institutional Investors (QFII) and RMB Qualified Foreign Institutional Investors (RQFII)* and supporting rules came into effect.

December 26
The NPC Standing Committee adopted *Amendment XI to the Criminal Law*, substantially sharpening criminal penalties for securities- and futures-related crimes.

December 31
Hangzhou Intermediate Court issued the first instance judgment for the Wuyang bond fraudulent issuance case, ruling that intermediary agencies must also bear joint and several liabilities.

2020 Regulatory Observations

1 The amended *Securities Law* officially came into effect and, together with the supporting regulations, strengthening the foundation of the rule of law in the securities market

On March 1, 2020, the amended *Securities Law* officially came into effect. The CSRC thereafter made significant amendments and improvements to the supporting regulations, with a total of 68 securities and futures-related regulations amended in 2020. At the same time, the CSRC continued to publish new rules or consultation papers to support the implementation of amended *Securities Law*. Such supporting regulations cover various securities-related areas, such as securities issuance, trading, information disclosure, refinancing, ongoing supervision and delisting. For example: the CSRC issued a series of measures to reform ChiNext, a subsidiary board under the Shenzhen Stock Exchange, to pilot the registration system for IPOs, and promulgated the *Measures on the Administration of Convertible Corporate Bonds*; the CSRC also sought public opinion on consultation papers such as the *Measures on Administrative Penalties for Securities and Futures-Related Violations of Law, Implementation Measures for Securities and Futures-Related Administrative Settlement Mechanism,* and the amended *Regulation on the Administration of Equities of Securities Companies*; and the CSRC amended the *Rules on Procedures for the Formulation of Securities and Futures Regulations* with the goal of improving the securities and futures legislation framework. Other bodies adjusted their rules to become synchronized with the overall revisions, including the CSRC local branches, the Shanghai and Shenzhen Stock Exchanges, and the Securities Association of China (SAC).

The implementation of the amended *Securities Law* has introduced or improved a number of key fundamental systems or procedures of China's capital markets, further strengthening the foundation of the rule of law, including:

- implementing in full the registration-based system for securities issuance, based on the example of reforms introduced by the Shanghai Stock Exchange STAR board (see also 4. below);
- requiring higher levels of information disclosure for listed companies, covering disclosure of "material matters", disclosure of changes in equity, and short-term trading, aligning requirements with those needed by the Shanghai and Shenzhen Stock Exchanges;
- adjusting the regulations and specific arrangements applying to different types of securities service providers from approval to filing, with detailed rules set out in the *Regulation on the Administration of Filing of Securities Service Providers Engaging in Securities Service Business*;
- substantially increasing costs for those carrying out securities-related violations, with the *Amendment XI to the Criminal Law* adopted in late 2020 also substantially increasing the criminal penalties for securities-related offences; and
- enhancing investor protection through a number of measures, including ensuring investor suitability management, advance compensation to investors before litigation is complete, allowing for "representative litigation" (China's class action-type litigation) in securities disputes, and introducing multi-forum dispute resolution.

The amended *Securities Law* is an integral part of China's capital markets structure, addressing all aspects of the operating and organization of the market and thereby offering far-reaching impact.

2 Regulators refining the classification of different types of securities companies, and encouraging greater specialization

Following on from the 2019 *Regulation on the Administration of Equities of Securities Companies*, regulators took further steps in the new *Securities Law* to complete the categorization of the different types of securities companies, with the aim of encouraging the specialized development of securities companies and therefore the market as a whole. This is the first time that the CSRC has classified securities companies according to business risk and capital requirements.

The 2019 *Regulation* classified securities companies into "professional" and "comprehensive" securities companies, depending on which business they are in. The shareholders of professional securities companies need to satisfy all basic statutory conditions, while the major and controlling shareholders of comprehensive securities companies are required to have a higher level of governance and risk compensation capability than those of professional securities companies. In line with such classification, the amended *Securities Law* listed "securities lending/borrowing" and "market-making" as "base securities business types", alongside other base securities business types such as "brokerage" and "underwriting".

In May 2020, the CSRC solicited public opinion on the draft amended *Regulation on Classified Regulation of Securities Companies*, where the classification system emphasized/recognized the business capacities in niche areas and the revenue of securities companies. The purpose was to encourage greater specialization by different securities companies, especially small and medium-sized companies, who could develop niche areas of business.

Leading and larger securities companies were also given regulatory support. In particular, under the *Provisions on the Calculation Basis for Risk Control Indicators of Securities Companies*, companies with Class A, Rank AA ratings or above for three consecutive years had their risk capital reserve adjustment ratio lowered (from 0.7 to 0.5). In April 2020, under the pilot "consolidated regulation" program, securities companies taking part in the program were permitted to operate on the basis of more flexible risk control indicators, which would take into account the consolidated data of any parent company and subsidiaries when filing regulatory statements of risk control indicators, as well as lower the relevant ratios.

3 Regulators simplifying ex-ante regulation of the securities institutions

As the CSRC has continued to refine and improve the regulations governing companies operating in the securities market, developments in 2020 focused on the streamlining of administration, creating more efficient government services, and generating greater delegation of responsibilities. The amended *Securities Law* eliminated many regulatory approvals that securities institutions previously had to obtain, requiring filing instead, and simplified other regulatory processes. The intention is to work towards an efficient operation of the capital markets, improved regulatory transparency and greater predictability for market players.

These reforms were manifested in many ways, including:

- Several matters previously requiring approvals need now only to be filed, including: the qualification of directors and supervisors of securities companies; the establishment, acquisition or revocation of branches of securities companies; securities companies' overseas establishment, acquisition of, or investment in, securities institutions; changes of registered capital and equity that do not involve changes in the major shareholders or the actual controller; and changes of important provisions of the articles of association;

- Filing procedures were made simpler, as their legal character of filing rather than licensing was clarified, and all qualification conditions were removed. For example, the *Regulation on the Administration of Filing of Securities Service Providers Engaging in Securities Service Business* (effective August 2020) simplified filing procedures; and

- Existing regulations were made clearer, by style, structure, and categorization to aid compliance by market players. For example, in July 2020, the CSRC consolidated all "Regulatory Q&As" addressing day-to-day regulation and M&A/restructuring review for listed companies.

4 Registration system being applied to existing securities markets, starting with ChiNext market IPOs and bond issuances

The STAR board, launched in 2019, became the testing ground for reform of China's capital markets by setting up a registration-based IPO system. The pilot was successful, leading to a similar system on the ChiNext market in June 2020. Apart from the ChiNext market, on the first day of the implementation of the amended *Securities Law*, the National Development and Reform Commission (NDRC) and CSRC both issued new regulations providing that enterprise bond and corporate bond issuance which previously were subject to NDRC or CSRC approval should move from needing prior approval of regulators to a registration-based system.

As well carrying out reforms on the issuance side, regulators took stronger action to enforce regulations. The regulation of ChiNext market was tightened substantially: in September, the CSRC investigated perceived abnormal trading behavior of Tianshan Biological and other stocks; in December, following an investigation on securities companies, the IPOs of two companies on ChiNext were cancelled; on the last day of 2020, the CSRC reported the alleged major financial fraud of ChiNext-listed company, Zhengzhou Sino-Crystal Diamond.

The Supreme People's Court, Guangdong High Court and Shenzhen Intermediate Court all stated to safeguard for the ChiNext market pilot registration system.

In addition, the CSRC moved to improve the delisting process. A total of 16 listed companies were delisted from A-shares in 2020, more than in any previous year. The CSRC stated that the delisting system shall be more rigid, and the Shanghai and Shenzhen Stock Exchanges also released draft amended delisting-related rules to solicit public comment in late 2020.

These efforts all lay the groundwork for the introduction of registration-based system in China's other securities markets.

5 Regulators strengthened the workings of the market by stricter regulation and ex-post enforcement, and implemented a policy of zero tolerance

For the registration-based system as well as streamlined administration and delegation of powers to be effective, there needs to be in place enhanced law enforcement and supervision, more severe penalty for violations and comprehensive civil, administrative and criminal accountability.

The amended *Securities Law* significantly increased the administrative penalties for many violations (e.g. fraudulent issuance and disclosure-related violations) and introduced other processes, such as ordering buybacks, advance compensation to investors before litigation is complete and class action-type "representative litigation". For example, the amount of fines levied on issuers in fraudulent issuance cases was increased from 1%-5% to 10%-100% of the amount of illegally raised funds; the maximum amount of fines on sponsors issuing sponsorship letters using false information, misleading statements or material omissions was increased from five times to 10 times business revenue. The *Amendment XI to the Criminal Law* significantly increased criminal penalties in respect of four types of securities and futures offences, including fraudulent issuance, fraudulent information disclosure, provision of false supporting documents by intermediaries, and market manipulation. On top of that, the CSRC, in its *Implementation Measures for the Regulatory Measures in the Securities and Futures Market (Consultation Draft)*, listed 16 common regulatory measures, other than administrative penalties, as effective supplements to financial regulatory tools.

All applicable departments were committed to vigorously cracking down on illegal activities in the securities and futures markets:

- in 2020, the CSRC carried out targeted attacks on illegal activities including on "black mouths" (disseminators of false market information), "illegal stock recommendations", "off-market financing", and chat groups APPs related to the illegal activities.

- the CSRC continued to target instances of financial fraud by listed companies.

- the CSRC, together with the Supreme People's Procuratorate, listed 12 typical securities offences, including market manipulation, insider trading and dissemination of false information on securities trading.

- the Supreme People's Court issued a notice requesting the courts nationwide to strictly punish securities and futures crimes, adopting a policy of zero tolerance.

- in the Wuyang bond issuance case in late 2020 involving fraud, 496 eligible investors jointly elected four investors to bring legal action on behalf of all of them, claiming a total amount of more than RMB810 million. The Hangzhou Intermediate Court, in its first instance judgment, ruled that the intermediaries such as lead underwriters, law firms, accounting firms, and rating agencies should be jointly and severally liable for compensation, causing much consternation in the market.

6 Compliance management and risk control of securities companies remaining the focus of regulation and enforcement

As the capital markets' reforms speed up, there has been a tightening of regulation of securities institutions. The number of penalties issued by financial regulators against securities companies (including branches and trading outlets) and relevant practitioners in 2020 far exceeded that of the previous year.

One of the main focuses of enforcement was on internal governance and equity management. For example, for the purpose of rectifying poor equity management and corporate governance structure, the CSRC took over New Times Securities, Guosheng Securities and Guosheng Futures in July 2020. For corporate governance failures and internal management issues, Zhongshan Securities was suspended from carrying out some of its businesses, including the filing of new asset management products, conducting some new capital-intense businesses (stock-pledged repo, stock lending/borrowing, etc.), and trading with related parties with its own funds or asset management funds (such as bond-pledged repo transactions).

Another enforcement focus was on compliance and risk control of securities companies' day-to-day operations. On July 10, the CSRC took action against GF Securities, including suspending its sponsor qualification for six months and suspending the acceptance of documents related to bond underwriting business for 12 months, for its failure to exercise due diligence in connection with investment banking business related to Kangmei Pharmaceutical. For failures such as major errors in their research reports, Zhongtai Securities, Founder Securities and China Securities were all punished.

7 The securities market continuing to open up

Opening up has long been central to reform of China's financial services sector. Both the securities and futures sectors saw increased liberalization over the past year.

The opening up of the securities sector accelerated during 2020, with the restrictions on foreign ownership of China's securities institutions being lifted on April 1. Since then, approval was given to Goldman Sachs, Morgan Stanley, Credit Suisse, Daiwa Securities and DBS Securities to become the controlling shareholders of their domestic joint venture securities companies; in October, the CSRC announced to have received the application by Standard Chartered Securities to establish the first wholly foreign-owned securities company; and in June, the CSRC approved JP Morgan Futures to become the first wholly foreign-owned futures company.

Cross-border transactions were more easily facilitated, with the removal of the restrictions on qualified foreign institutional investor (QFII) and renminbi qualified institutional investor (RQFII) investment quotas, the simplification of cross-border fund remittances, the combining of the QFII and RQFII qualifications and regulations, expanding investment scope, lowering entry qualifications, and lifting the limit on the number of intermediaries. The first QFII securities lending and borrowing transactions were completed at the end of 2020. In October 2020, the CSRC gave its approval to the Shanghai International Energy Exchange to conduct international copper futures trading, as well as allowing foreign traders to participate. In addition, the regulators issued the *Announcement on Foreign Institutional Investors' Investment in China's Bond Market (Consultation Draft)* in September 2020, which will connect the exchange and interbank bond markets, allowing foreign investors to access exchange-traded bonds.

Legislation on futures accelerating, legal framework for futures derivatives continuing to develop

Another legislative highlight in 2020 was the proposed dedicated legislation covering the futures market. Futures market is an integral part of the capital markets, whilst as yet, the legal basis only extends to administrative laws and regulations such as the *Regulations on Futures Trading*. According to the Chinese legislative hierarchy mechanism, there should be a "Futures Law" as the framework document of futures market.

The "Futures Law" was first proposed at the NPC meeting in 2014 and was included in the 2020 legislative work plan of the NPC Standing Committee. The draft is basically ready and will soon start the process of being reviewed. This will entail removing clauses dealing with securities derivatives contracts from the amended *Securities Law* and potentially moving them to the proposed *Futures Law*. The *Futures Law* will provide an overall legislative framework for futures and derivatives in China. The legislation will become the top level legislation of China's futures market and set out the legal status of the participating entities, establish basic legal relationships, civil rights and obligations and legal liabilities, clarify the regulation of the over-the-counter market, set out clear rules for market access, investor protection and opening-up to foreign participation, and provide a system of rules to safeguard the opening-up of the futures market, as well as cross-border regulation.

2021 Regulatory Outlook

1 Investment-side reforms will encourage greater long-term investments

In 2020, regulators repeatedly emphasized investment-side reform and the desire for entry of medium and long-term capital into the capital markets, as well as strengthening coordination and balance between the investment-side and the financing-side of the capital markets, in order to create a mature market for medium and long-term investors.

Throughout 2020, there have been many initial signs of these investment-side reforms, such as the lifting the quotas for QFII and RQFII, the moderate "loosening" of securities companies' investment in financial bonds issued by policy banks, index funds, and constituent stocks, the support given by the CBIRC to wealth management subsidiaries to increase their proportion of equity investments, and the ongoing relaxation of conditions imposed on insurance funds' investments.

As the financing-side reforms such as launching of registration-based system constantly deepen, the investment-side reforms will develop too in parallel with it. In this regard, we expect the following to be considered or introduced in 2021:

- so far as trading is concerned, regulators may pilot single T+0 trades and may lift limits on price fluctuation;
- the regulators will focus on expanding the pool of mutual fund managers, improving investment advisory business rules and developing the professional capabilities of asset management companies;
- in terms of market access, the Shanghai-Hong Kong Stock Connect, Shanghai-London Stock Connect, Bond Connect and foreign direct investment in the interbank bond market will continue to develop to further bring China's capital markets in line with international standards; and
- the financial derivatives market will continue to develop and broaden, allowing for the trading of more ETF products and more commodities and stock index futures/options, among others.

2 Fintech in the securities and futures sectors will be rolled out

Fintech is having wider applications in the securities and futures sectors. Blockchain infrastructure for regional equity markets' registration and custody, big data, cloud computing functions and program trading are increasingly being used. Fintech is also used in regulation: for example, the Shanghai Stock Exchange's new generation monitoring system is based on a big data platform, and the Shanghai Financial Court has used sophisticated IT calculation models and the "yield curve synchronized comparison" method to accurately assess investors' losses.

We expect that regulation of the application of Fintech to become standardized in 2021. The Technology Regulation Bureau, established by the CSRC in June 2020, will serve as an overall coordinator of regulatory functions related to the use of technology in the securities and futures sectors, such as coordinating the technology resources of regulators, guiding the technology development of the financial market infrastructure of the industry, carrying out data standardization governance, and taking charge of the filing of securities IT system service providers. The two batches of "filed securities IT system service providers", announced at the end of 2020, will mark the start of a routine filing procedure and regulation for such service providers.

Regulations may be introduced to regulate the practice of securities companies renting third-party online platforms to conduct securities business. Regulators will work towards establishing a mechanism aimed at preventing risks in Internet-based services. Third-party online platforms will fall within the category of IT system service providers for the purposes of unified regulation. The regulatory approach for program trading is also being explored, and we expect progress to be made in 2021. Fintech-related incentive measures are also being formulated, for example, in order to introduce more Fintech professionals into the CSRC, the CSRC intends to relax the level of work experience requirements of such Fintech professionals.

3 Securities laws enforcement will be carried out with zero tolerance, focusing on cases involving listed companies; regulators will further emphasize the intermediaries' duty to act as "market gatekeepers"

We expect that, in 2021, the focus of enforcement of securities laws will be on cases involving listed companies. This is one of implementation measures to support the registration-based system reform and other provisions of the amended *Securities Law*. The CSRC will continue to pay attention to problems caused by governance failure, management and control failures, and operational irregularities, such as illegal capital occupation, illegal guarantees, financial fraud, and manipulation of mergers and acquisitions. The CSRC may require listed companies to conduct self-inspection and it will step up on-site inspections and supervise the process of companies addressing and correcting internal failures. The regulators will also continue to pay close attention to insider trading, market manipulation, illegal information disclosure, and other securities violations.

Together with the amended *Securities Law*, the Wuyang bond issuance fraud case at the end of 2020 sounded a warning bell for many types of intermediaries who have a role in such activities by making them potentially jointly and severally liable. In 2021, intermediaries will face more comprehensive and stricter regulation, and their duties as "market gatekeepers" will have to be more rigorously performed.

4 Administrative settlement may play a more significant role in the securities and futures sectors

In February 2015, with the State Council's approval, the CSRC issued the *Implementation Measures for the Pilot Program of Administrative Settlement* and the *Interim Measures for the Administration of Administrative Settlement Payments*, thus officially beginning the pilot program of "administrative settlement" in the securities and futures sectors. In 2019, the CSRC reached and made public its first administrative reconciliation. The amended *Securities Law* provides more clarity on the administrative settlement at the legislative level, and the CSRC has also set up an internal structure, including the establishment of an Administrative Settlement Committee. Currently, the CSRC is pushing forward the development of supporting regulations, and the *Implementation Measures for Securities and Futures-Related Administrative Settlement consultation* paper were published to solicit public opinion in August 2020. We expect that, against the background of strengthened securities law enforcement, administrative settlement is likely to be more effective, striking a balance between efficiency and cost of law enforcement.

5 Judicial practice may be increasingly active in supporting the implementation of key regulations, with better and earlier involvement in major cases

The Wuyang bond issuance fraud case, where the various intermediaries were held to be jointly and severally liable, offered judicial support for the implementation of the amended *Securities Law* and current capital market policies. We expect that in 2021 the judicial system will continue to act in this vein, becoming more involved in major cases earlier and more decisively, and contribute typical case judgments in a number of specific areas.

We may witness the outcome of the first securities representative litigation in 2021. The *Amendment XI to the Criminal* Law also provides possibility of significant criminal liability cases in the securities sector.

PRC Financial Regulation: Annual Report (2021) – Asset Management

2020 Key Dates

Mid-January

The *China-US Phase-One Economic and Trade Agreement* was signed, which provided, among others, the undertakings given by China government in connection with fund custodian business.

March 18

New rules for insurance asset management, the *Provisional Measures for Administration of Insurance Asset Management Products*, were promulgated, and detailed implementation rules issued on September 7.

April 17

The CSRC published the consultation paper of the *Measures for Administration of Securities and Fund Investment Consultancy Business*.

April

The fallout from "Yuan You Bao (a financial product offered by Bank of China (BOC) linked to crude oil futures)", which took place in April, resulted ultimately in BOC being heavily fined.

May 8

The CBIRC issued the consultation paper, the *Provisional Measures for Administration of Cash Trust of Trust Companies*.

June 29

The *Joint Announcement on the Launch of the Cross-boundary Wealth Management Connect Pilot Scheme in the Guangdong-Hong Kong-Macao Greater Bay Area* was made.

July 31

The CSRC published the consultation paper, the *Measures for the Supervision and Administration of Publicly-raised Securities Investment Fund Managers*, and its detailed implementation rules.

August 5

The first province-level Hong Kong-controlled NPL asset management company, Hainan NWS Asset Management Corporation Limited, was approved.

August 21

The first wholly-foreign-owned public fund management company, BlackRock Fund Management Limited Company, was approved for establishment.

August 27

Citibank (China) Co., Ltd. became the second wholly-foreign-owned bank to hold a public fund custodian license.

August 28

The CSRC published the *Measures for Supervision and Administration of Publicly-raised Securities Investment Fund Distribution Agencies*.

December 25

The CBIRC published the consultation paper, the *Provisional Measures for Administration of Distribution of Wealth Management Products by Commercial Bank Wealth Management Subsidiaries.*

2020 Regulatory Observations

1 The regulatory framework for public asset management business centering the CSRC begins to take shape

A number of commercial banks set up wealth management subsidiaries ("WMSs") in 2019 and 2020, as required under the *Asset Management New Rules*, for the purpose of splitting asset management business from their banking businesses. These WMSs have become significant competitors to public fund management companies ("FMCs") and other asset managers with public fund licenses (such as securities companies and insurance asset management companies).

- In order to perfect the rules for approving public fund licenses and governing supervision of day-to-day operations, the CSRC published the *Measures for Supervision and Administration of Publicly-raised Securities Investment Fund Managers* and supporting detailed implementation rules ("FMC Consultation Papers") for public consultation in July 2020. This was the first time that a unified regulatory framework for public asset management business had been initiated. The *Securities Law* was amended in 2019 to make it clear that asset management products should be classified and regulated as securities. Adopting this regulatory stance, the FMC Consultation Papers added the requirement that WMSs are required to be approved by the CSRC before carrying out any public fund management business (though WMSs will be subject to dual supervision by the CSRC and the CBIRC at the institution-based regulation level).
- The FMC Consultation Papers relaxed the principle of "one participation/one control" (which means an entity may only directly or indirectly own equity interests in two FMCs, of which it may only have a controlling stake in one of them) to "one participation/one control/one license", allowing an entity to directly or indirectly control one FMC and one other asset manager with a public fund license. The new principle of "one participation/one control/one license" will likely leave room for any WMSs that have already started their public fund management business to apply for a retrospective license from the CSRC.

In addition to these measures, Yi Huiman, Chairman of the CSRC, stated in May 2020 that the CSRC would continue to welcome commercial banks' investments in FMCs in order to further promote the development of the public fund market. Given that there were no bank-funded FMCs in the past four years, the hope is that more new FMCs will now be set up.

2 The regulation of third party services to fund management is refined and improved

As the regulation of the asset management sector underwent further revisions, the regulatory system for third party services to the sector was also refined and improved into one integrated package.

- Following the debut of the fund investment consultancy business pilot scheme in 2019, the CSRC published the *Measures for Administration of Securities and Fund Investment Consultancy Business* ("Consultancy Business Consultation Paper") in April 2020, providing that securities investment consultancy, fund investment consultancy and research report businesses (together, "Consultancy Businesses") all came under the supervision of the CSRC. The Consultancy Business Consultation Paper further stipulated there should be overall supervision by the CSRC of fund investment consultancy services (especially those having discretionary mandates, where the service provider has discretion over the choice of underlying funds) in terms of shareholder qualifications, internal controls and business practices. Additionally, the Consultancy Business Consultation Paper explicitly mentions that Consultancy Businesses have to operate on the "one participation/one control" principle (see above).

- In July 2020, the CSRC officially published the *Measures for Administration of Securities Investment Funds Custodian Business*, unifying the standards applicable to both banking and non-banking financial institutions when applying for public fund custodian licenses and clarifying that a PRC branch of a foreign-incorporated bank is also permitted to apply for a custodian license (which therefore allows these institutions to hold the fund assets in trust for their clients). Following that, the wholly foreign-owned (WOFE) banks of Citibank and Deutsche Bank did apply, and were granted approvals, to secure a public fund custodian license. HSBC has also since submitted an application.

- In August 2020, the *Measures for Supervision and Administration of Publicly-raised Securities Investment Fund Distribution Agencies* ("FDL New Rules") was finally introduced after one-and-a-half-years' public consultation. The FDL New Rules impose more stringent requirements on agencies in terms of their establishment, subsequent changes to structure, and third-party fund distribution agencies, as well as explicitly prohibiting third-party fund distribution agencies from distributing private equity investment funds. Additionally, the FDL New Rules set out requirements on minimum volume of business agencies should conduct and limitations on client maintenance fees agencies can charge. Consequently, the FDL New Rules placed more burdensome regulatory requirements on third-party fund distribution agencies.

- In December 2020, the CBIRC published the consultation paper of the *Provisional Measures for Administration of Distribution of Wealth Management Products by Commercial Bank Wealth Management Subsidiaries* to regulate how wealth management products were distributed. The consultation paper only expressly allow banking institutions and WMSs to distribute wealth management products and wealth management products with the risk rating at Level Four or above (i.e., with relatively high levels of risk) could only be sold at outlets of banks or WMSs.

3 Asset management sector continues to open up, and there are more opportunities for cross-border asset management

The asset management sector has continued to open up and welcomed several new market players. In 2020, BlackRock, Neuberger Berman and Fidelity – all big names – applied for licenses from the CSRC to set up FMCs. In August 2020, BlackRock Fund Management Limited Company received the CSRC approval to become the first wholly foreign-owned FMC. The CBIRC then approved the application by BlackRock, China Construction Bank Corporation and Temasek (through its subsidiary Fullerton) to set up a wealth management company ("WMC"), which was the second foreign-controlled WMC being approved, following the approval of the joint venture WMC of Amundi Asset Management and Bank of China in 2019.

There were also a number of important developments in 2020 with reference to cross-border asset management.

- A new cross-border asset management channel - the Cross-Boundary Wealth Management Connect ("WM Connect") - as well as its pilot implementation in the Greater Bay Area, was announced to be launched. Pending the implementation rules, it remains unclear how the different regulatory regimes in mainland China and Hong Kong will be coordinated, for example when it comes to know your client (KYC), anti-money laundering (AML), suitability check, and exchange of tax related information for financial accounts.
- Although the ETF Connect, which allows international investors to trade exchange-traded funds ("ETFs") listed on the Shanghai and Shenzhen exchanges, and mainland Chinese investors to trade ETFs listed on the Hong Kong stock exchange, is still in its early stages of development, the first batch of Hong Kong-mainland cross-listed ETFs have been approved in October 2020. The two capital markets will be connected by way of ETF feeder funds' (listed on one market) investments in ETF master funds (listed on another market). Regulators will examine how this works in practice and how this affects the future operation of ETF Connect.
- Regulators increased the quota for Qualified Domestic Institutional Investor ("QDII") by allowing WMSs to apply for QDII qualification. The State Administration of Foreign Exchange ("SAFE") also indicated it would expand the foreign exchange quota and the range of cities undertaking Qualified Domestic Investment Partnership ("QDLP")/Qualified Domestic Investment Entity ("QDIE") pilot schemes. These will all provide onshore investors with more opportunities to participate in the global asset management market.

4 *Asset Management New Rules* continue to be implemented and transitional period extended

Following the issuance of implementation rules of the *Asset Management New Rules* (issued by multiple financial regulators in 2018) governing banks, securities firms, futures and fund houses in 2019, in 2020, implementation rules governing asset management businesses conducted by the insurance and financial asset investment companies ("AIC") were also issued (an AIC is a non-banking institutional approved by the CBIRC, mainly engaging in the business of converting the debts owed to banks into equities and provision of other corresponding supportive businesses), in addition to the consultation paper of the rules governing asset management in the trust sector. As such, implementation rules of the *Asset Management New Rules* have been issued to regulate all the relevant types of institutions across the sector.

The result is that, while all of these types of institutions retain their core characteristics, the whole sector is innovating. The intention is to have one set of regulations applying to asset management generally.

- The new regulatory framework for asset management carried out by insurance companies involves a "one + three" supervision model, i.e. in addition to the requirements under *Asset Management New Rules*, the CBIRC also introduced specific rules governing individual category of investment by the asset management schemes (including debt investment, equity investment, and portfolio products).

- The consultation paper of the *Provisional Measures for Administration of Cash Trust of Trust Companies* allows flexibility when it comes to how much a trust company can invest in "non-standard" products acknowledging the difference between the trust sector and other asset management sectors.

- The new rules that specifically apply to AICs set higher requirements for who can be qualified investors for asset management schemes launched by AICs.

Because of the impact of COVID-19 and the effects on the macro economy, which has in turn heightened levels of risk generally, the PBOC has extended the transition period for the *Asset Management New Rules* to come into full effect. It is worth noting that the PBOC has said that any financial institution that has failed to fully comply with the new regulations when the extended transition period has ended will need to discuss special treatment with regulators on a case-by-case basis. The approach is one in which regulators strike a balance between encouraging a healthy development of the market while ensuring stability of the financial system, in order to avoid having to extend the transition period again.

5 More cases of default and more investor disputes, and the principle of *caveat venditor* ("seller beware") and *caveat emptor* ("buyer beware") is being enforced

Due to increase of default cases, 2020 has seen more investor disputes in the asset management sector. This has led to greater engagement of regulators and courts, whose opinions have been listened to with great interest by the market as a whole.

So far as regulators are concerned, the Trust Institution Supervision Department of the CBIRC declared in July that asset management companies were breaking the law if they guaranteed investment return to investors, and that any statements to this effect or clauses in contracts would be deemed void and not protected by law. Both the CBIRC and the CSRC introduced new rules/consultation papers to impose higher standards on sellers when promoting or selling their products. The PBOC stressed that the premise of breaking the return guarantee to investors is that there should not be any fraudulent or misleading behavior by sellers, otherwise, there is no basis for the seller to claim "buyer beware" and the seller should take the loss by themselves and even get punished.

So far as courts are concerned, the courts have made some significant pronouncements, In cases where there was liquidity difficulty, some trust companies declared they would only make a partial repayment to investors, which, in turn, prompted investors to file a claim for full indemnity on the basis that the sellers/trust companies of those trust schemes had not fulfilled their duties. However, the courts did not uphold such a claim for indemnity. In December, the Higher People's Court of Hunan Province held that any clause agreed by trust companies guaranteeing investment return to investors should be null and void.

The "Yuan You Bao" event in April (in which investors invested in a product linked to the price of oil which had been sold to them by the Bank of China (BOC)) raised a wide discussion in the market, especially for cross-border business of financial institutions. Whether BOC fulfilled its obligation to check whether investors were eligible to invest was one of the issues under discussion. As reported, the proposal of an out-of-court settlement, as proposed by BOC, was not accepted by all investors. The higher courts in many provinces have appointed the single jurisdiction to rule on multiple disputes that arose in those provinces. In late November, several commercial banks suspended their precious metal trading businesses following the window guidance of the regulators, which was indirectly caused by this event. Eventually, in early December, BOC was fined by the CBIRC for this event and the regulator found that BOC had not carried out investor eligibility tests as it should have done, including but not limited to that few investors did not meet the age criteria.

The event demonstrated that both regulators and courts moved strongly to protect the interests of financial consumers. It also underlined the fact that the rules governing financial consumer right protection are developing along with the enforced investor education, improved internal controls and a constantly changing market environment.

6 Nationwide and regional asset management companies grow in number, and new ways of disposals of non-performing assets are explored

There has been a marked increase in activity in connection with the sale and purchase of non-performing assets owned by Chinese enterprises following the spread of COVID-19 and the global economic slowdown. At the same time, Chinese regulators are actively introducing new players to this market. In January 2020, The *China-US Phase-one Economic and Trade Agreement* allowed US financial service providers to acquire non-performing loans directly from Chinese banks, beginning with provincial licenses. In March, the CBIRC approved the transformation of Jiantou CITICS Asset Management Co., Ltd. into a nationwide asset management company, which thereafter became known as China Galaxy Asset Management Co. This company became the fifth nationwide asset management company to be licensed to acquire non-performing assets, thereby injecting fresh impetus into the market. In August, the first provincial non-performing asset investment company was established in Hainan province (controlled by Hong Kong shareholders). A pilot scheme involving cross-border transfer of non-performing assets was extended. Following the examples of existing pilot schemes in Shenzhen and Guangdong, regulators in Hainan, Beijing, Shanghai and Sichuan have all issued rules to start pilot schemes for cross-border transfers of non-performing assets in their provinces.

In June 2020, the regulator issued a consultation paper, the *Notice for Launching Pilot Scheme for Transferring Non-performing Loans*, and the *Implementation Plan for Pilot Scheme of Transferring Non-performing Loans in Commercial Banks*. These were intended to explore the possibility of transferring non-performing assets with a single institutional debtor, and transferring bulk non-performing assets with natural person debtors. The Chairman of the CBIRC, Guo Shuqing, said in an interview that it was intended to allow insurance asset management companies and AICs as new market players to explore new ways of acquiring non-performing assets by cooperating with banks. Such moves would help banks to dispose of non-performing assets and improve their asset quality.

7 Financial innovation and use of technology are encouraged and valued

As well as tightening financial regulation, the PRC regulators are at the same time encouraging more innovation, both in products and infrastructure. Whether the new products/infrastructure will work well (e.g. balancing interests and risk, and realizing the expectation of regulators) are to be tested by the market and investors.

In April 2020, the issuance of the *Notice of the Work Related to Promoting the Pilot Program of Real Estate Investment Trusts (REITs) in the Infrastructure Field* initiated a pilot scheme covering REITs. This was followed by the promulgation of a succession of rules governing REITs' regulation. The first batch of REIT products are expected to be officially released soon.

In May, the CBIRC issued the *Notice of Launching Asset Management Business by Financial Asset Investment Company* to provide specific rules on the set-up and management of debt-to-equity swap schemes by AICs via asset management business. This adds a new investment channel for funds in the market.

In June, the National Association of Financial Market Institutional Investors declared that the sector planned to introduce asset-backed commercial paper (ABCP) that would fall within the existing regulatory framework of asset-backed notes (ABNs). For an ABCP product, it would allow rollover issuance and different maturity dates between the note and the underlying asset (i.e. the maturity date of the note could be before that of its underlying asset, and investors of the note may exit by transferring trust units to new investors).

In July, the CSRC issued the *Guidelines for the Side Pocket Mechanism of Publicly Offered Securities Investment Funds (for Trial Implementation)* which sought to bring in the practice used in developed markets. (A side pocket is a mechanism often used by a fund to keep illiquid, hard-to-value, and often highly risky assets separate from the fund's other investments.) This was a further step by regulators to protect investor rights.

Regulators have also sought to encourage greater use of technology and to help bring about standardized electronic processes that can benefit the asset management sector, in part generated by COVID-19-related lockdowns.

In March 2020, the CSRC issued the consultation paper, the *Management Rules on Leasing Third Party Internet Platforms to Conduct Securities Business Activities by Securities Companies,* which explicitly stipulated there must be a barrier between securities business and technology services and required third party service providers to file with the CSRC. Such rules would apply by reference to fund management companies, securities investment consultancy institutions, mutual fund distribution institutions, and investment consultants.

In July, the consultation paper of the *Management Rules on Investment Consultancy Services for Securities Investment Funds* was issued. The paper laid down that investment consultancy institutions that provided robo-advisory services, relying on AI and other data management functions, should report to the CSRC with details of their technology plans, matrix of models and their investment rationale.

In October, the Asset Management Association of China issued the consultation paper for the *Management Rules of Electronic Contract Business for Private Investment Funds (for Trial Implementation)*, which looked at how private investment funds should manage electronically agreed contracts and lay down the contract execution procedure.

In December, the consultation paper of the *Interim Measures on Distribution and Management of Wealth Management Products of Commercial Bank Wealth Management Subsidiaries* was issued, which stipulated that any institutions which sell wealth management products to non-institutional investors via electronic channels should record all steps taken in that process, including marketing promotion, product risk disclosure, the information provided to buyers, buyers' confirmation and feedback, and ensure that back-track checking and evidencing are possible.

Regulators maintain tough enforcement against violators, identifying common breaches, isolated violations and industry-specific issues

Through 2020, regulators and self-regulatory institutions continued to crack down on those in the asset management and wealth management business acting in breach of laws and regulations. The statistics are not complete, but, so far as is known, at least 31 commercial banks, 12 trust companies, 18 securities companies and subsidiaries, 1 fund management company subsidiary, 1 insurance asset management company, 18 independent fund distribution institutions, and 107 private fund managers had sanctions imposed on them or required to change their behavior by regulatory bodies within their sector. Analysis shows there were some common types of breaches across the sector, as well as industry-specific violations.

Regulators had concentrated on a few issues, in particular, including: whether institutions had set up compliant internal controls; whether they had identified key risks for their business; whether they were adhering to investor eligibility criteria when selling investment products; and whether they were disclosing the required information to regulators. Analysis of sanctions imposed by regulators reveals a number of other areas where institutions were falling foul of regulations, including: the levels of borrowing by commercial banks to support wealth management businesses; the levels of proprietary business being conducted by commercial bank wealth management arms; trust businesses offering guaranteed returns; and failures of compliance in asset management institutions regulated by the CSRC.

2021 Regulatory Outlook

1 Asset management will benefit from more coordinated overall supervision, and function-based regulation will continue to be implemented

As the *Assets Management New Rules* are gradually being implemented and financial reforms continue to embed in the system, the likely consequence for the asset management sector is that regulations will transition from institution-based regulation to function-based regulation. The publication of the *FMC Consultation Papers* indicate the overall trend to unify regulations applicable to asset management business offering public products, in particular relating to internal controls, investment operations of funds, compliance management, staffing, and corporate governance. It is worth noting that the CBIRC published the consultation draft of the *Provisional Measures for Administration of Distribution of Wealth Management Products by Commercial Bank Wealth Management Subsidiaries*, which indicates that CBIRC will continue to improve its regulatory system of WMS (in respect of the corporate policies to be established within WMS). However, we still expect that, as regards regulations covering publicly offered asset management products, the financial regulatory regime is being shaped towards function-based regulation supported by ancillary institution-based regulation, such that the CSRC will be in charge of license approvals and product registrations, including inspections and enforcement, while the CBIRC will be entrusted by the CSRC to carry out day-to-day regulation of WMS. As regards regulations of privately offered asset management products, we expect the overall regulatory regimes established by the *Assets Management New Rules* will be adopted in different sub-sectors in the long run and, during such process, the PBOC will play a leading role to stabilize the financial market.

2 Regulations will cover fund third-party service providers, and the market infrastructure in the asset management sector will be built and improved

Once the asset management sector regulations become well bedded-in, we expect that regulators' focus will turn to service providers used by asset managers, such as custodians, distributors, fund administrators ("FAs"), transfer agents ("TAs") and IT service providers. These service providers will be directly regulated by financial regulators or indirectly managed via asset managers (i.e. by regulators imposing mandatory obligations on asset managers to monitor and manage their service providers), so as to ensure that asset managers focus on their main business and risk control and to promote the specialization of fund service providers.

As the fund sector continues to open up, we expect there to be more wholly foreign-owned fund management companies. To better align local fund management companies with international practices, fund management companies may be allowed to outsource certain middle and back offices (with conditions/restrictions), there will be more systematic regulations concerning FAs and TAs accessing the market, and independent custodians (which are not banks or securities firms) may be allowed. In the private funds area, we expect the registration of FAs/TAs will be expedited and foreign players will enter these fields.

In addition, we expect the regulators to strengthen the requirements of registration of asset management products, with the aim both of assigning clear responsibilities to each party in each transaction and making sure there are whole-process risk controls, and of establishing a market infrastructure for the future unit transfers of asset management products (e.g. trust unit transfers and private fund unit transfers).

3 Law enforcement of the trust sector will be stepped up, and there will be further action to stamp out "mandatory repayments"

Trust businesses have come under particular scrutiny, involving intensive screening and monitoring, with regulators clamping down on risky practices. A few trust companies have been taken over by regulators. In its *China Financial Stability Report (2020)*, the PBOC spelt out that, in its view, a number of trust companies had become "high risk" institutions, the risk exposure in the trust sector was speeding up, and there was a likelihood of risk spillover.

We expect the risks of trust sector will continue to be exposed in 2021, and there may be more takeovers of trust companies by regulators and even the potential for trust companies going bankrupt. We also expect a certain amount of trust schemes, will be forced to cease mandatory repayments in 2021. To ensure a steady transition and avoid systematic financial risk, regulators will balance the interest of "clearing channel business and prohibiting cash pool" with the potential impact of cracking down on high-risk institutions. We also expect there to be more court judgments and judicial views on "mandatory repayment" and custodian's responsibility following on the lines of that handed down by the Higher People's Court of Hunan Province, which decreed that mandatory repayments were void. Trust companies will be compelled to change their business practices, to move away from the practice of channel business and the use of trust schemes for financing purposes. Regulators may provide certain levels of assistance and support as the process unfolds.

4 Further cross-border transactions of asset management products will be allowed and opening-up will continue

Under the PRC laws, in addition to exchanged-traded asset management products (such as ABSs and ETFs), QFIIs are currently allowed to invest in CSRC-regulated asset management schemes and private securities investment funds. In 2021, we expect that the asset management market will continue to open up, with greater scope for cross-border transactions, adding to the existing cross-border trading of bonds and stocks. The ETF Connect and WM Connect regimes in the Greater Bay Area will progress and may potentially be fully implemented in 2021. We hope that implementing rules addressing the fundamental differences of custodian and settlement requirements between onshore and offshore markets will be rolled out in 2021, which is a prerequisite for the securing of cross-border transactions of asset management products. Finally, we expect more foreign players to take advantage of the opening up of the asset management market, including foreign-invested asset managers, custodians, distributor, and TAs/FAs.

5 Regulatory framework for the wealth management sector will be gradually established

Following the promulgation of rules regulating asset management, fund investment advisory businesses and fund distribution, we can say that the basic regulatory framework of the wealth management sector has been put in place.

We expect that unlicensed independent wealth management companies (which used to be non-financial institution type one-stop shops for people's wealth management needs) will gradually exit the market, and there will be closer cooperation among regulated entities (such as commercial banks, securities companies, trust companies, fund management companies and independent fund distributors) to better serve the needs of high net worth individuals. In order to provide a one-stop shop experience for customers, regulated entities will have increasing needs to share client information.

Companies in the wealth management sector will find they face the challenge of developing their businesses, which depends on gaining extensive knowledge about clients, while meeting increasingly tighter regulations covering consumer protection and data protection. Separately, it cannot be ruled out that regulations on family and charitable trusts may be substantially developed in 2021.

PRC Financial Regulation: Annual Report (2021) – FinTech

2020 Key Dates

February 13
The People's Bank of China (PBOC) issued the *Personal Financial Information Protection Technical Specification*.

April 21
The PBOC started pilot projects to implement the Central Bank digital currency in four cities, including Shenzhen.

July 2
The *Data Security Law (Draft)* was issued for public consultation.

July 12
The CBIRC issued the *Interim Measures for the Administration of Internet Loans of Commercial Banks*.

August 14
The CSRC issued the *Administrative Provisions on the Securities Companies' Renting of Third-party Internet Platforms for Securities Business Activities (Interim Measures) (Consultation draft)*.

September 7
The State Council approved the establishment of the National FinTech Risk Monitoring Center in Beijing.

September 15
The PBOC issued the *Implementation Measures for the Protection of Financial Consumers' Rights and Interests*.

October 13
The *Personal Information Protection Law (Draft)* was submitted to the 13th NPCSC for initial review.

November 2
The *Interim Administrative Measures for Internet Small Loan Business (Consultation draft)* was issued for public consultation.

November 6
The CBIRC stated fintech activities should be regarded as, and supervised as, financial activities.

December 7
The CBIRC issued the *Regulations on the Supervision of Internet Insurance Business*.

December 8
the CBIRC stated that all P2P internet loan institutions with actual operations had been closed down by mid-November.

2020 Regulatory Observations

1 Regulations expanded to cover all internet-based financial activities, and framed to prevent regulatory arbitrage

Regulations governing businesses in the fintech sector underwent a significant shift in 2020. In broad terms, there was a switch from “institution-based regulation” and “behavior-based regulation” to “function-based regulation”. The regulations were broadened to cover not just finance and technology but business operations and activities associated with fintech, such as market entry stipulations, licensing requirements, rules or operation, and risk management requirements.

In September 2020, the CBIRC singled out two internet platforms, Xianghubao (相互宝) and Shuidihuzhu (水滴互助), which it said had engaged in commercial insurance and therefore should abide by strict market entry and licensing requirements required by insurance companies. On December 7, 2020, the CBIRC issued the *Regulations on the Supervision of Internet Insurance Business (effective from February 1, 2021)*, which stipulated that "Internet insurance business shall be carried out by insurance institutions established according to the law, and other institutions and individuals shall not carry out Internet insurance business".

Then, in November 2020, the CBIRC identified that a number of loan products offered via a collaboration between banks and fintech companies were in effect bank loans but were not being governed by rules setting rules for standard rates for such loan products. The CBIRC separately issued the *Interim Administrative Measures for Internet Micro-Loan Business (Consultation draft)*, which imposes regulations on online micro-loan businesses and brings them into line with regulations governing bank loans. These include such matters as the analysis of borrowers’ credit risk and the use of technology and data management, such as cloud computing and the mobile internet, when transacting loans. These new rules also set out regulatory requirements for the internet micro-loan business in terms of the business territory restrictions, loan quotas, joint loan business restrictions, reserve funds, capital requirements, and leverage and liquidity ratios to fill in the coverage gaps of the existing rules and to eliminate any scope for regulatory arbitrage (i.e., allowing institutions to opt for more favorable regulations).

2 Regulations implemented to prevent risks associated with financial institutions' cooperation with third parties

Another major area of attention for regulations was to address the growth of collaboration between financial institutions and fintech companies. Holding the financial institutions as being primarily responsible for instigating such cooperation, regulators introduced regulations that prohibited financial institutions from outsourcing information technology (IT) management and imposed on them much stricter risk control obligations. The *Banking and Insurance Institutions Information Technology Outsourcing Risk Regulation Measures (Draft)* emphasized that banks should integrate the management of IT outsourcing into their internal risk management procedures for the better control of outsourcing-related risks. Securities companies, too, came under the regulators' spotlight. The *Administrative Provisions on the Securities Companies' Renting of Third-party Internet Platforms for Securities Business Activities (Trial) (Consultation draft)* laid out the responsibilities of securities companies when conducting securities business via third-party internet platforms.

Particular attention was paid to banks' cooperation with third parties in granting online loans. The *Interim Measures for the Administration of Internet Loans of Commercial Banks* required banks to establish their own risk control and decision-making models. The *Notice on Regulating the Cooperative Business between Banks and FinTech Companies and Internet Insurance Business* issued by the Beijing office of CBIRC provided that banks should not operate beyond their own business scope or circumvent regulatory restrictions when cooperating with other parties. This notice also explicitly stated that certain key steps during the online loan business such as the assessment before approving any loan, the review of loan applications, and post-loan inspections, as well as risk control management, should not be outsourced to business partners, and that credit funds should be strictly prevented from flowing into prohibited areas such as internet lending platforms and real estate markets.

3 Legal framework for data protection established, and regulators following up with strict enforcement

In 2020, China introduced a number of important legislative and regulatory changes to cover data protection, providing consumers with greater protection and imposing greater obligations on institutions storing and managing personal data. In May 2020, the Civil Code was promulgated, setting out the fundamental principles of data protection and covering personal information, and the obligations and responsibilities of entities/persons handling personal information. The Code highlighted the legal challenges arising from the impact of new technologies on personal data protection. Afterwards, drafts of the *Data Security Law* and the *Personal Information Protection Law* were published, which, when passed into law, will further clarify and strengthen the requirements of data governance and personal information protection. In the meantime, the new standard *GB/T 35273-2020 Information Security Technology - Personal Information Security Specification* was officially released and came into effect on October 1, 2020, replacing the previous standard.

The requirements of financial institutions to protect personal information they hold about their customers were tightened and made more stringent. In February and September 2020, respectively, the PBOC issued the *Personal Financial Information Protection Technical Specification* and the revised *Implementation Measures for the Protection of Financial Consumers' Rights and Interests*. The latter was a revision of a previous version issued in 2016, and the changes include the addition of a "Legal Liability" chapter, which provides for potential liabilities on both the institution and responsible individuals. The *Interim Measures for the Administration of Internet Loans of Commercial Banks* and the *Regulations on the Supervision of Internet Insurance Business* promulgated in 2020 also emphasized the protection of personal information. In addition, the regulators pointed out that some fintech companies collected and used customers' information beyond the scope of what they needed the information for, and failed to properly manage and protect such information. They urged fintech companies to pay more attention to consumers' information security.

To make sure the new regulations were effective, enforcement was stepped up, with a particular focus on apps. In July, the Ministry of Industry and Information Technology ("MIIT") launched a "special rectification action of apps' infringement on users' rights and interests" in order to address and eliminate illegal collection and use of users' personal information, user harassment and deception, and inadequate controls of application and distribution platforms, among other issues. Ninety-four apps were removed from app stores, following their failure to correct non-compliant activities. There were more investigations and an increase in punishments meted out to those committing crimes. The Ministry of Public Security gave examples of 10 typical cases involving infringement of personal information. In the nationwide "Clean Internet 2020" program, perpetrators of crimes such as reselling personal information and illegally collecting private information, were punished. The *Financial Mobile Application Software Security Management Specification*, issued by the PBOC in September 2019, was implemented in 2020. This requires all financial apps to address and correct any inconsistencies with regulations and to file the apps with the National Internet Finance Association of China ("NIFA"). On May 19, 2020, the NIFA announced the first batch of 73 financial mobile apps that had to be filed with NIFA, and said that publication of filings of financial mobile apps would be made on a regular basis in the future.

4 P2P internet loan platforms converted into small loan institutions, and regulations of Internet small loan businesses tightened

The process of cleaning up P2P internet loan platforms, which had begun in 2016, was largely completed by 2020. From then on, online loans have been, and will be, routinely regulated. By mid-November, there were no P2P internet loan companies still active. The CBIRC stated that it would focus on resolving risks associated with accrued P2P loans, with the aim of bringing about a higher repayment rate. At the same time, local governments were given the task of converting P2P platforms into small loan companies, and regulated accordingly. To this end, a pilot program was set up, in accordance with the *Guiding Opinions on the Pilot Projects of Transforming Internet Loan Information Intermediaries into Small Loan Companies* issued in November 2019. In May 2020, two P2P internet loan institutions in Xiamen received approval to be converted into small loan companies. The result is that loan facilitating businesses and small loan companies (including internet small loans companies) will need to operate to higher regulatory standards, as will online lending businesses operated by banks cooperating with third-party institutions.

On November 2, 2020, the CBIRC and the PBOC issued the *Interim Administrative Measures for Internet Small Loan Business (Consultation Draft)*, imposing more stringent requirements on the operation and regulation of internet small loan companies. These included changing the approval and regulating authority from local financial bureaus to the CBIRC, increasing registered capital requirements, setting minimum capital ratio requirements, and prohibiting cross-province operations.

On promulgation of these new regulations, small loan businesses became integrated into the CBIRC's unified regulation system and subject to the same strict regulations applying to banks.

5 Regulation of payments tightened and enforcement leading to sector consolidation; launch of Central Bank digital currency marking start of new era for payments

In 2020, the regulation of the payments business was further enhanced. In June and October 2020, respectively, the PBOC issued the *Notice of the PBOC on Strengthening the Management of Payment Receiving Terminals and Related Business (Draft)* and the *Notice of the PBOC on Regulating the Agent Collection Business*. The former regulates payment receiving terminal devices, the payment receiving business and other related business from four aspects: the management of payment receiving terminals, the management of contracting merchants, the monitoring of payment receiving businesses, and inspection and supervision. The latter set out the management obligations of collection agents in various collection situations in order to mitigate risks that might result from related payments business.

A number of payment institutions were fined for breaching regulations. These included Helibao (合利宝), Rongbao Payment (融宝支付), Yisheng Payment (易生支付), Yinyingtong Payment (银盈通支付), Kailiantong Payment (开联通支付), Chuanhua Payment (传化支付), Bianlitong (便利通) and Shangyinxin Payment (商银信支付). On October 10, 2020, the Business Management Department of the PBOC issued a notice indicating that six payment institutions had received warnings and had been fined RMB178 million (in total), and that eight individuals with responsibility for these businesses had been fined RMB2.4 million (in total). A number of payment institutions were shut down. There has been an overall consolidation of the payments sector, resulting in a reduced number of officially licensed payments operators.

The promotion and implementation of the Central Bank digital currency (see 8, below) is posing a challenge to point-of-sale (POS) payment receiving businesses and for third-party payment institutions. However, there remains scope for these payment institutions to incorporate digital currency transactions into their businesses. To date, Lakara and Union Pay have both signed strategic cooperation agreements with the PBOC Digital Currency Research Institute.

6 Fintech technology developing, and industry standards and technical specifications upgraded

In the past year, blockchain technology has increasingly been used in supporting the main banking business, in what is a significant step-up in the delivery of banking services. In July 2020, the China Construction Bank and the Bank of Communications, two of the five major Chinese banks, both launched their respective blockchain platforms. The "blockchain international syndicated asset transfer platform", which the China Construction Bank developed internally, led to the simultaneous launch of the public blockchain cloud and a new generation private blockchain cloud and was used to support its first asset transfer business valued at US$70 million. The Bank of Communications successfully launched the international trade "one-stop" financial blockchain platform in Xiamen, which was used for domestic foreign exchange transfers and payments for sea freight. This was the first time in China that blockchain technology has been used for payment in a non-trade business (i.e. sea freight business) in a one-stop platform. Elsewhere, Tencent Financial Technology, JDDigits and Mashang Consumer Finance (all part of the Ant Group) each made progress in the development and application of blockchain technology.

There has also been modification of industry standards and technical specifications as they apply to fintech activities. The *GB/T38671-2020 Information Security Technology - Technical Requirements for Remote Face Recognition System* was officially issued by the State Administration for Market Regulation and the National Standardization Management Committee on April 28, 2020, and took effect on November 1. Drafting of the national standards was officially started with a meeting to discuss the *Information Security Technology - Blockchain Information Service Security Specification*. This specification will help to guide blockchain information service providers for security purposes.

7 Regulatory sandboxes continuing to expand

There has been a concerted effort to promote the use of technology in the fintech sector. The regulators have announced at least 49 innovative pilot projects in Beijing, Shanghai, Shenzhen, Chongqing, and Hangzhou, among others. Of these applications, at least 20 of them were classified as financial service applications, 35 of them involved utilization of big data, more than 30% of them involved blockchain and distributed accounting technology, and a large number of them involved artificial intelligence (AI), 5G, and cloud computing technologies. The regulators have shown a certain degree of tolerance to the risks associated with technology innovation, which also reflected the determination of the regulators to actively explore flexible regulation.

Key among the projects has been the promotion of "regulatory sandboxes", frameworks set up by regulators to allow fintech start-ups and other innovators to conduct live experiments in a controlled environment under regulatory supervision. So far, only licensed financial institutions are eligible to operate within a regulatory sandbox; fintech companies can only benefit from the pilot as a partner of a financial institution. It is expected that this restriction will be relaxed in the next stage of the pilot project, allowing non-licensed institutions which meet qualification requirements and have outstanding technical products to apply to enter the regulatory sandbox independently, and thereafter be matched with licensed financial institutions.

8 The Central Bank digital currency poised to launch, and related proprietary rights to be protected

All eyes are on the timetable for the official launch of the Central Bank digital currency, which is currently being piloted internally. According to the reported timetable of the regulators, the Central Bank digital currency will replace cash nationwide in the next two to three years. The digital currency will not only hugely change the infrastructure supporting payments, but will also help China to promote the internationalization of the RMB as an alternative to the current US dollar-dominated international payments structure and the global SWIFT currency settlement system.

There have been a number of policies and regulations paving the way for the formal issuance of the digital currency, including clarifying the legal status of the digital currency and other new rights and interests. The Civil Code provides guidance on the protection of data and virtual property, but has not, as yet, provided substantial implementing rules. On July 22, 2020, the Supreme People's Court and NDRC jointly issued the *Opinions on Providing Judicial Services and Guarantees for Accelerating the Improvement of the Socialist Market Economic System in the New Era*, which stated that new rights and interests such as those relating to digital currency, virtual internet property and data rights should be protected. On October 23, 2020, the PBOC published the *Law of the PRC on the People's Bank of China (revised draft for comments)*, which stipulated that the RMB currency can be in both physical and digital form. It also provided that in order to prevent virtual currency-related risk, no entity or individual shall make or issue tokens and digital tokens to replace the circulation of RMB in the market.

2021 Regulatory Outlook

1 "Function-based regulation" will be strengthened. License requirements for operating financial business will continue

With the increasing integration of the financial and technology sectors in recent years, we expect regulators will look to strengthen the regulation of functions, rather than institutions, via "function-based regulation", which focuses on the substance of financial functions and associated risks, and implement "see-through" supervision over each operation step and module within the entire fintech ecosystem. There are two aims here: to avoid regulatory arbitrage and the circumvention of regulation.

In 2020, regulators proposed to fully incorporate all financial activities into the regulation framework, and issued supporting rules and consultation drafts to this end. In 2021, we expect that the regulators will continue to apply this principle, imposing well-defined regulations and clarifying the boundaries of responsibility among the different participants in the sector by identifying the substance of business activities. The regulators will continue to crack down on unlicensed business activities conducted in the name of providing tech services. The supporting rules for the *Interim Measures for the Supervision and Administration of Financial Holding Companies* and the *Interim Administrative Measures for Internet Small Loan Business* are expected to be issued.

2 Financial institutions will ramp up digital transformation, and more regulations will be issued to regulate joint business between financial institutions and third parties

In 2020, a number of policies and guidelines were released at both the national and local levels to encourage and support the development of fintech and promote the digital transformation of traditional financial institutions. The *Fintech Development Plan (2019-2021)* specifically proposed that financial institutions should accelerate their digital transformation. The CBIRC and the SAC both issued articles to encourage the asset insurance companies and securities companies, respectively, to use big data, cloud computing, blockchain, AI and other scientific and technological means to promote the digitization of their businesses.

The process of digital transformation has been accelerated with the emergence of the COVID-19 and the need for lockdowns to prevent human contact. The arrival of the digital currency will also become a key driver of the digitalization of the financial services sector. More and more financial institutions are investing in fintech and using technology to upgrade their processes and systems, either on their own or through cooperation with third parties. While regulators support the digital revolution, they also recognize the need to regulate business activities associated with fintech, in particular to accurately identify risks arising from the digital transformation of financial institutions and to regulate them. We expect this approach to continue to be uppermost in regulators' minds. The risks arising from the cooperation between financial institutions and third-party technology companies will be the focus of supervision. For example, the formal drafts of the *Administrative Provisions on the Securities Companies' Renting Third-party Internet Platforms for Securities Business Activities (Trial) (Consultation draft)* and the *Banking and Insurance Institutions Information Technology Outsourcing Risk Regulation Measures (Consultation draft)* are expected to be published in 2021.

3 Regulators will strengthen regtech, continue to expand the pilot and application of innovative fintech products, and collaborate to improve fintech regulation

Through 2020, we saw increasing adoption of regtech, the application of technology in the exercising of regulation. For example, the pilot project of big data anti-insurance fraud carried out by the CBIRC and the Ministry of Public Security had promising initial results. Also happening were the release of industry standards to ensure effective and safe use of new technology. These included the *Information Security Technology - Technical Requirements for Remote Face Recognition System* and the *Guidelines for Construction of the National New Generation AI Standard System*. The scope of the pilot "regulatory sandbox" was extended (see 7, above), and related innovative fintech products were registered and put into practice. In addition, the National FinTech Risk Monitoring Center was given approval to set up in Beijing, and the local financial risk monitoring platform are also under exploration.

In 2021, the fintech regulatory framework will continue to develop. We expect that the regulators will continue to strengthen the application of regtech, actively exploring further use of big data, AI, cloud computing, blockchain and other technologies. The objectives will be to build digital regulatory capacity, continue to enhance financial risk prevention capabilities, and make sure that regulation is professional, uniform and extends to all areas that need to be covered by regulation.

Local regulators will be given greater powers, under the overall coordination of the PBOC, and we expect there to be the adoption of local financial regulations tailored to meet local conditions. We anticipate that non-licensed institutions will be allowed to apply independently to join regulatory sandboxes.

4 Regulation of data property rights will be a particular focus

Substantial progress was made in 2020 in the field of data and data trading. Many localities developed local policies relating to data. On September 29, the Beijing Local Financial Supervision and Administration together with Beijing Municipal Bureau of Economy and Information Technology issued the *Implementation Plan for the Establishment of Beijing International Big Data Exchange*. The services of the Exchange include a data information registration service, a data products trading service, data operation and management services, data assets financial services, and data assets fintech service, and so on. Hainan announced that it would gradually expand the opening-up of its data sector, and carry out online data processing and transaction processing business for the whole Hainan Free Trade Port and internationally. Shenzhen will study the viability of data trading markets as proposed in the *Implementation Plan (2020-2025) for Comprehensive Pilot Reform in Shenzhen to Build the City into a Pilot Demonstration Zone for Socialism with Chinese Characteristics*.

However, the legal framework for data property rights and interests lags behind these positive developments. The *Data Regulations of Shenzhen Special Economic Zone (Consultation draft)* released in July 2020 proposed the concept of a "data right" for the first time, and proposed clarifications of such issues as ownership of private data, public data and the data collected and generated by relevant market players. In 2021, it is expected that regulators will release applicable both at the overall level and at the local level that will make clear fundamental rights such as data ownership, rights of usage and management obligations. Applicable laws and regulations are expected to be promulgated to regulate and protect the collection, use and trading of data, and intellectual property ownership. We will also see regulations issued covering international coordination of cross-border data flows.

5 Information security remains a top priority, and anti-trust may become another regulatory focus

Personal information security and privacy protection will continue to be the focus of regulation as the financial services sector continues its digital transformation and the data sector grows in importance. We therefore expect to see more regulations bearing upon these sectors, as well as the release of industry standards. It is well understood that fintech companies have access to, and process, large volumes of personal and financial information, yet there are no clear standards about these companies' information protection obligations. The *Implementation Measures for the Protection of Financial Consumers' Rights and Interests,* newly revised in 2020, still only apply to traditional licensed financial institutions. Whilst the *Personal Financial Information Protection Technical Specification* is applicable to all relevant institutions involved in the processing of personal financial information, it is only a recommended industry standard.

In 2021, in addition to the *Personal Information Protection Law (Draft)*, regulations on the security and protection of financial data for all institutions in the financial services sector that are involved in the processing of personal financial information are expected to be issued.

Antitrust is also likely to become another focus of fintech regulation. The *Antitrust Guidelines on Platform Economy (Consultation draft)* released in November 2020 signaled that regulators will look at potential anticompetitive nature in the operations of internet platforms. In December, regulators imposed penalties on three unreported merger cases, which indicated how seriously they are taking the situation. Existing antitrust legislation focuses on traditional issues such as monopoly agreements, market abuse and concentration of undertakings, which may not cover potential antitrust issues that arise in the fintech sector, such as the data monopoly advantage of large technology companies, and the use of platform and data advantages to obstruct fair competition and the entry of new institutions. The CBIRC has emphasized the importance of regulating the antitrust behavior of fintech companies. In the future, more antitrust regulations focusing on specific business practices such as financial marketing, platform referral traffic and use of financial information are expected to be issued.

PRC Financial Regulation: Annual Report (2021) – Insurance

2020 Key Dates

March 18
The China Banking and Insurance Regulatory Commission (CBIRC) issued the *Interim Measures for the Administration of Insurance Asset Management Products*, establishing the regulatory framework for insurance asset management together with the subsequently issued implementation measures.

June 17
The CBIRC approved AIA's conversion of its Shanghai branch to a wholly-owned subsidiary. AIA Life Insurance was the first wholly foreign-owned life insurance company in China.

July 17
The CBIRC took over Tianan Property Insurance, Huaxia Life Insurance, Tianan Life Insurance, and Yi'an P&C Insurance.

July 30
Provisions on the Regulation of the Solvency of Insurance Companies was published for public consultation.

September 14
Anbang Insurance Group Co., Ltd announced its dissolution and liquidation.

September 19
The *Guiding Opinions on Implementing the Comprehensive Reform of Auto Insurance* were officially implemented, starting a new round of auto insurance reform.

November 5
Definitions for critical illnesses were updated, and steps were taken to move critical illness insurance products into the new framework.

November 13
The CBIRC removed industry restrictions on financial equity investment by insurance funds.

November 23
The *Provisions on the Regulation of Insurance Agents* was issued, reshaping the regulatory framework under which insurance agents work.

December 14
The CBIRC issued the *Measures for the Regulation of Internet Insurance Business.*

December 30
China Agricultural Reinsurance Co. Ltd. was approved to open for business.

December 31
Consultation paper, the *Implementation Rules of the Regulations on the Administration of Foreign-Funded Insurance Companies*, was published for public consultation.

2020 Regulatory Observations[2]

1 The trillion RMB insurance fund market undergoing reform and opening up a new era for insurance asset management

Following repeated signals from regulators in 2019 to encourage insurance funds to enter the market, a number of new regulations were issued and implemented in 2020, offering more space for insurance funds in terms of investment scope and investment management capabilities.

One of the most notable changes has been the removal of industry restrictions on financial equity investments by insurance funds. Direct equity investment by insurance funds, both domestically and internationally, has long been limited to a few specific types of companies. In November 2020, the CBIRC issued the *Notice on Matters Related to Financial Equity Investment with Insurance Funds*, which gives insurance companies more liberty in financial investments through a "negative list + positive guidance" regulatory mechanism.

Also relaxed was the upper limit on the portion of equity assets permitted to be held by insurance companies in their total assets. In July 2020, the CBIRC issued the *Notice on Optimizing the Regulation of the Allocation of Equity Assets of Insurance Companies*, which adjusted the previous "one-size-fits-all" limit of 30% of the insurance company's total assets to a differentiated regulatory model based on the level of solvency, with the highest level of limit set at 45% of the insurance company's total assets (as measured at the end of the previous quarter). Such series of policy adjustments have made it possible for insurance funds to enter the equity investment market on a larger scale. Allowing investment into traditional industries, support for small and medium-sized enterprises, participation in technological innovation and dovetailing with the wider financing needs of the real economy may become some of the main focuses of insurance funds in the next phase.

Other investment sectors were also opening up. In addition to the relaxation of the conditions for issuers of tier 2 capital bonds and non-fixed term capital bonds, the regulations relating to investment in financial derivatives, treasury bond futures and stock index futures have also been issued. Insurance funds may be permitted to invest in convertible debt investment plans, which are included in the "white list" of financial products that can be invested in by insurance funds. It is also worth mentioning the removal of the filing requirement for investment management capacity of insurance institutions, which strengthens the interim and ex-post regulation from the perspective of rules and regulations. This move also reflects the determination of regulators to "delegate power, streamline administration and optimize government services".

The regulatory system of insurance asset management developed during 2020, with the *Interim Measures for the Administration of Insurance Asset Management Products* and its supporting rules (including the *Detailed Implementation Rules for Portfolio Insurance Asset Management Products*, the *Detailed Implementation Rules for Debt Investment Plans*, and the *Detailed Implementation Rules for Equity Investment Plans*) coming into effect. As anticipated by the market, the new rules defined the privately-offered nature of insurance asset management products, aligning the requirements of the guiding opinions of regulators on asset management.

As insurance asset management institutions developed from catering purely to the insurance market to becoming part of the wider world of institutional investors and even serving high net worth individual clients, while enjoying regulatory policy benefits, insurance asset management institutions also faced new challenges of leveraging their investment capabilities and improving their risk control capabilities.

2. Data and some information referred to in this chapter are mainly obtained from the disclosed information or statistics on the CBIRC official website, and relevant media reports from Securities Daily, Financial Times, Shanghai Securities News, China Banking, Insurance News and Caixin, etc.

2 Advanced opening-up of the insurance sector being steadily promoted

In 2020, regulators continued to push forward the opening-up of the insurance sector. In mid-2020, the CBIRC approved the opening of Korean Re's branch in China and Hannover Re and Swiss Re to increase their capital in their China branches, thus enabling foreign reinsurers to increase their China investments. There are now more foreign reinsurance companies than Chinese ones.

A number of international insurance companies increased their equity investments. The US company Chubb increased its stake in Huatai Insurance Group, becoming the largest shareholder, while AIA upgraded its Shanghai branch into a wholly foreign-owned life insurance company, becoming the first wholly foreign-owned life insurance company in China. At the same time, the market has also seen a number of international insurance companies exiting the China market, either in whole or in part, as a result of their own commercial objectives (e.g. business integration or transformation).

The *Regulations on the Administration of Foreign-Funded Insurance Companies* and its implementation rules have been the main regulation for foreign insurance companies. The *Regulations*, as amended in 2019, for the first time allowed international insurance groups to establish foreign insurance companies in China, as well as permitting international financial institutions to acquire shares in foreign insurance companies based in China. At the end of 2020, the CBIRC issued a consultation draft of the implementation rules of the *Regulations* with the aim of clarifying the scope and qualification of these two types of institutions and further improving the alignment of the *Regulations* with the *Measures for the Administration of Equities of Insurance Companies* and other existing insurance regulations.

Although, in practice, "group companies" and "financial institutions" are still defined differently, as applied in the domestic and foreign regulatory contexts, the issue of the final regulations may provide an opportunity for foreign licensed institutions to either increase their investments or establish a stronger presence in China, or both, as well as being able to take advantage of creating regional operations within China. All of this is in line with the objective of ensuring the same treatment for domestic and foreign investment in the insurance sector and having compatible rules for access.

Although there have been some restraints on opening-up over the past year, in part because of the pandemic and in part because of delays in updating the relevant regulations, many foreign insurance companies have signaled their investment plans in China, and many have already locked in partners or submitted preliminary applications. We believe that we will see a new round of accelerated opening-up of the sector to foreign involvement in the near future.

3 Regulators tackling misconduct, corporate governance, and management of shareholder risk

Increasingly, the CBIRC has attached great importance to regulating corporate governance. According to the *Three-Year Action Plan for Enhancing Corporate Governance in Banking and Insurance Industry (2020-2022)*, shareholder misconduct and unclear equity structures (e.g., lacking in transparency of who the shareholders are) have been the main reasons for the “disorder” in the banking and insurance sectors. One of the main tasks of regulators in 2020 has been to put in place regulations that address these failings, in particular ensuring that there are curbs placed on majority shareholders. In July and December 2020, the CBIRC published two lists of shareholders of banking and insurance institutions which had been found to be in major violation of laws and regulations. Among the 47 institutions named, 12 were shareholders of insurance companies involving a total of three insurance companies (including two Anbang-linked insurance companies). The main violations included: preparing or providing false materials, concealing the actual controller and affiliation, and non-compliant sourcing of investment funds. It is expected that the regulators will continue to publish such lists regularly to create a nationwide record.

4 Risk resolution being further escalated as Ming Tian group was taken over; Dajia Insurance’s engagement with potential strategic investors meeting difficulties

Since 2017, the regulators have formulated a series of plans with the goal of preventing and resolving financial risk. This task was all but completed in 2020. Following the takeover and disposal of the Anbang group in 2018, in July 2020 the CBIRC announced the takeover of six institutions that formed part of the Ming Tian Group, including Tianan Property Insurance, Huaxia Life Insurance, Tianan Life Insurance, and Yi’an P&C Insurance, which were taken over by special groups established by China Pacific Property Insurance, China Life Health Industry Investment, New China Life and PICC P&C, respectively. Based on the experience of the process taken to resolve risks of Anbang group previously, private capital and foreign investment may have the opportunity to be introduced on completion of the liquidation, debt restructuring and confirmation of the equity structure.

The reorganization of Dajia Insurance adopted, for the first time in the insurance sector the model of "new establishment and takeover". For various reasons, the introduction of strategic investors was not completed in 2020. However, we believe the introduction of new investors for Dajia Insurance will continue, not only because of special nature of the China Insurance Security Fund, but also the regulators’ determination to demonstrate their desire to prevent and eliminate risk in the insurance sector.

5 Strict regulation of the insurance sector continuing

In 2020, the CBIRC continued its strict regulation of the insurance sector, with an increase in penalties for institutions and an increase in the number of fines for individuals. This was under the “dual punishment system”, aimed at both institutions and individuals. According to statistics from reports, the CBIRC and its local branch offices imposed a total of some 1,800 penalties on more than 1,100 institutions and more than 1,500 individuals, with total fines levied of more than RMB230 million. On all these counts, the numbers did not drop due to the pandemic but were far higher than in 2019.

A new focus of compliance centered on the use of funds. In particular, regulators looked at certain areas of activity that needed addressing and correcting. These included: the use of unlisted equity and real estate investments to set up platform companies; the retention, misappropriation and transfer of insurance funds through such platform companies; the illegitimate transfer of benefits to connected parties; and the illegal use of funds for capital increases.

In September, the regulators carried out a special risk inspection on the use of funds, and identified a number of problematical issues, including uncontrolled investments and other illegal uses of funds, for which the offenders were fined.

Added to this, the regulators focused their attention on insurance intermediaries, signified by the promulgation of *Measures for the Administration of the Handling of Banking and Insurance Consumer Complaints*, *Work Plan for Rectifying Disorder in the Insurance Intermediary Market in 2020* and *Notice on Effectively Strengthening the Administration of Practitioners of Professional Insurance Intermediaries*. The scope of regulation of the insurance intermediary market has been expanded and the seriousness of penalties increased.

6 Regulators addressing the need to regulate Internet-generated insurance

The outbreak of COVID-19 catalyzed the growth of Internet/online sales of insurance products. This contributed to the finalization towards the end of 2020 of the *Measures for the Regulation of Internet Insurance Business*, which had been in the process for two years and had involved three rounds of public consultation. The new regulations replaced the previous outdated interim measures and also reflect requirements on internet insurance contemplated in several recently issued regulations. The key words for Internet insurance are "licensed institutions and licensed personnel", as insurance institutions may only sell internet insurance products or provide services from their own online platforms or those of other insurance institutions, and the web pages used for enrolment must also be part of the insurance institutions' own online platform. The intention, and the desired end result, is that any cooperation between insurance companies and third-party online platforms on client data sharing will end. The main responsibility for conducting online business will now lie completely with licensed institutions. The final regulations removed the potential for insurance companies and third-party online platforms to engage in joint marketing and promotion.

However, this does not mean that internet companies will no longer be able to participate in the insurance market. For this to happen, they will need to obtain an insurance agency license in order to sell products and provide services using their own online platform, as set out in a specific chapter in the final regulations covering internet companies. We can expect to see internet companies returning to the insurance market, who, in addition to complying with the above regulations, will also be required to adhere to the *Provisions of the Regulation of Insurance Agents* and future regulations dealing with concurrent businesses agent qualifications.

As well as the establishment of the general regulatory framework, attention has also been paid to the regulatory system for online products, which is close to completion. The *Notice on Internet Life Insurance Business* was recently circulated for public consultation. When finalized, these rules will expand the scope of online life insurance products while also raising the qualification bar for those to conduct such business. The *Notice* also indicates that, in future, there will be a specific mechanism designed for approval or filing in respect of online products.

7 Development of regulations on insurance products being intensified, auto insurance adjusted in favor of consumers, and more extensive definitions of critical illness introduced

In 2020, regulators were focused on the formulation of the regulatory regime for insurance products. Among the insurance products, guarantee insurance had become increasingly used and sold by property insurers, in respect of which there had been provisional measures dating from 2017 but which were due to expire. In timely fashion, CBIRC issued the *Measures for the Regulation of Credit Insurance and Guarantee Insurance* in May 2020, followed by the publication of two operating guidelines dealing with for pre-insurance and post-insurance management. The new regulations aimed to improve insurers' risk prevention capabilities, avoid the risk transmission that accompanies the blind growth of the credit insurance business, and resolve other risks to head off any more insurance companies collapsing. At the end of 2020, the *Regulation on Liability Insurance Business* was issued, clarifying the relationship between liability insurance and other types of insurance to prevent regulatory arbitrage through the mechanism of insuring financing credit risks through liability insurance.

Regulations in the field of auto insurance, the *Guiding Opinions on Implementing the Comprehensive Reform of Auto Insurance*, issued by the CBIRC during 2020 were widely viewed as the boldest of reforms in this sector. At the core, the reforms aimed to reduce premiums for consumers, increase coverage and improve services. Specific measures included: increasing the liability limits of compulsory auto liability insurance and commercial auto insurance, increasing the coverage of commercial auto insurance, and modifying the no claims discount coefficient in commercial auto insurance. The Insurance Association of China subsequently amended the *Terms and Conditions of Compulsory Auto Liability Insurance for Motor Vehicles* and the *New Plan of Premium Rate Floating Coefficients for Compulsory Traffic Accident Liability Insurance for Motor Vehicles* for reference and use by all auto insurance companies. In the highly competitive auto insurance market, this reform would mean lower per-customer premium income and more insurance coverage. There will be challenges for every insurance company offering auto insurance, as they adjust their cost-to-income ratios while still ensuring compliance.

So far as life insurance was concerned, the city-customized commercial medical insurance named “Benefiting People Insurance” launched in more than 70 cities across the country in the middle of the year, attracting a large number of policyholders. In November, the CBIRC issued the *Notice on Standardizing the City-customized Commercial Medical Insurance Business of Insurance Companies (Consultation Draft)*, listing a range of violations that had transpired and setting out the main responsibilities of companies to offer city-customized commercial medical insurance. In the same month, the amended *Specification on the Use of Disease Definitions for Critical Illness Insurance* was officially issued, replacing the first version that had been issued in 2007. The new *Specification* established a classification of critical illnesses, introduced a definition of “mild” illnesses and expanded the number of diseases and scope of coverage in order that the regulations became closely aligned with modern medical technology and practice. A transitional period was provided-for in the new *Specification*, until January 31, 2021, after which insurers will no longer be allowed to sell critical illness insurance products that do not comply with the new *Specification*. Since then, the CBIRC also issued a *Notice on Regulation of Short-Term Health Insurance Business*, which prohibited guaranteed extension of insurance policies, and clearly conveyed the regulators’ attitude that short-term insurance should not be operated on a long-term basis.

8 The much-anticipated new regulatory system for insurance agents and intermediaries being established

The *Provisions on the Regulation of Insurance Agents* came into effect on January 1, 2021, replacing multiple regulations such as the *Provisions on the Regulation of Full-Time Insurance Agencies, the Measures for the Regulation of Insurance Sales Personnel*, and the *Interim Measures for the Regulation of Concurrent-Business Insurance Agency*. For the first time, the new *Regulation* created a unified regulatory system for insurance agents, bringing full-time agencies, concurrent-business agencies and individual insurance agents under a single regulation. In accordance with the requirements of "delegating power, streamlining administration and optimizing government services", the new *Regulation* removed the three-year term for insurance agency licenses, but also raised the minimum requirement on registered capital of regional agencies and strengthened the entry and exit requirements of all types of agents.

The new *Regulation* incorporated the previous pilot program on "independent individual insurance agent" into the formal regulatory framework. Subsequently, the CBIRC issued the *Notice on the Development of Independent Individual Insurance Agents*, which provided more detailed rules on the implementation of the *Regulation*. In addition, in August, the regulators issued consultation drafts of the *Implementation Measures for Administrative Licensing and Filing of Insurance Intermediaries*, and at the beginning of 2021, issued the *Provisions on the Regulation of Informationization of Insurance Intermediaries* following public consultations, incrementally complementing the subordinate rules governing the regulation of insurance intermediaries.

2021 Regulatory Outlook

1 The regulatory system will continue to be built and improved

The year 2020 has been an exceptional year but during this period, regulators were able to do their work towards building a well-functioning regulatory system – this was indeed a great achievement. During the last year, some regulations were published for consultation but not yet finalized and issued, in particular the *Provisions on the Regulation of Solvency of Insurance Companies (Consultation Draft)* published in mid-2020, one of the most important areas and critical for the development of the insurance sector. The *Consultation Draft* elevated the principle and framework requirements in the regulatory rules of China Risk Oriented Solvency System Phase II (C-ROSS Phase II) to the level of departmental regulations; set out three regulatory indicators: the core solvency adequacy ratio; comprehensive solvency adequacy ratio and comprehensive risk rating; and provided effective regulatory tools available to regulators when needing to respond to cases of insufficient solvency of insurance companies.

As things stand, some of the major industry regulations were formulated in the context of the C-ROSS Phase 1 but which are now are out of step with the latest regulations. The introduction of new solvency regulations may involve a wave of amendments that will help to unify the regulatory framework.

As well as these, consultation papers have been published for other regulations such as the *Administrative Measures for Policy Mortgage Loans of Life Insurance Companies*, the *Implementation Measures for Administrative Licensing and Filing of Insurance Intermediaries*, the *Administrative Measures for the Real-Name System of Individual Insurance*, and the *Implementation Rules of the Regulations on the Administration of Foreign-Funded Insurance Companies*; and regulations on the pilot long-term care insurance projects, internet life insurance business, and city-customized medical insurance have all been circulated within the industry for comments. In 2021, we expect more fundamental and core regulations to be issued and implemented, helping to establish a well-operating regulatory system.

2 Local-level regulation may be extended; and reforms will continue to progress in order to "delegate power, streamline administration and optimize government services"

Delegating responsibility for regulation at the local level has been in mind for a long time. As early as 2014, regulators tried to set up local-level regulation to regulate use of insurance funds. In early 2019, the CBIRC delegated some administrative licensing matters to its local branch offices. In February 2020, the CBIRC issued the *Notice on Further Strengthening and Improving the Regulation of Products of Property Insurance Companies*, which formally introduced local-level regulation for property insurance products, which, except for some specific products, would be filed with, and regulated by, the relevant CBIRC branch offices. Subsequently, the application of local-level regulation expanded from product to institutional regulation.

In July 2020, the CBIRC issued the *Reform Plan for the Responsibilities of Regulators of Property Insurance Companies and Reinsurance Companies*, dividing 87 property insurance companies and 13 reinsurance companies into two categories: companies directly regulated by the CBIRC, and companies regulated by the local CBIRC branch offices, with a clear division of regulatory responsibilities. At the beginning of 2021, the CBIRC issued the *Reform Plan for the Responsibilities of Regulators of Life Insurance Companies*, taking basically the same approach as had been adopted for property insurance and reinsurance and applying it to life insurance, i.e., dividing 91 life insurance companies into two categories: 39 companies directly regulated by the CBIRC, and 52 companies regulated by the local CBIRC branch offices.

In the future, we anticipate that local-level regulation may be extended to other types of regulated insurance entities.

Also, as part of the ongoing reform program, in the beginning of 2021, regulators discontinued the practice of directors, supervisors and senior management in the banking and insurance sectors having to sit for a qualification examination. As regulators have been more innovative in their approach to regulation and streamlined resources needed for regulation, more licensing matters may be removed or delegated to local branch offices in the future, and it is expected that "post-entry regulation" will play a larger role.

3 Strict regulation will continue to be the key theme

In recent years, the insurance industry has been the subject of more detailed regulation, which has also been more strictly enforced. In 2020, the CBIRC issued the *Administrative Penalty Measures of the CBIRC* and the *Provisions on the CBIRC Administrative Licensing Procedures* to standardize and unify the administrative licensing and penalty procedures in the banking and insurance sectors. With such regulations and more regulatory resources released at the local level, we can expect to see no softening of China's efforts to stamp out irregular practices. Regulators will continue to focus on regulation of shareholdings in insurers. The next regulatory focuses will likely be on internet insurance business and consumer protection taking into account the issue of various new rules and the current government stand to impose comprehensive regulation on internet finance. Already in 2021, there have been two cases of insurance companies infringing consumer rights, and we expect there to be more examples of penalties being imposed, as the insurance sector follows in the footsteps of the banking sector.

4 Positive prospects continue for insurance funds to enter the capital markets; asset management institutions will be formally classified and rated

In December 2020, the executive meeting of the State Council pointed out that it is required to improve the long-term investment capacity of insurance funds, to encourage insurance funds to participate in the construction of major projects such as infrastructure and new urbanization construction, and to have insurance funds play a greater role in supporting the real economy. In the same month, the State Council regular policy briefing endorsed policies to improve the long-term investment capacity of insurance funds and to support insurance asset management companies launching long-term products. As industry restrictions are lifted on insurance companies conducting financial equity investment, we expect the government will guide insurance institutions to make value investments, long-term investments and prudent investments in 2021, as well as granting more favorable policies for investments.

In terms of regulation of institutions, in January 2021, the CBIRC issued *the Interim Measures for the Regulatory Rating of Insurance Asset Management Companies*, which 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. Ratings would be divided into four bands. For institutions of different bands, regulators will apply differentiated regulatory measures in terms of market access, business scope, product innovation, and on-site inspection. This coming year will be a trial period of classified regulation, during which time each insurance asset management institution is expected to conduct internal investigations and make any changes necessary to meet rating indicators, in order to be ready to meet and comply with future regulations, when they are fully implemented.

5 Greater Bay Area cross-border insurance be considered and developed

Based on the top-level design of the development of the Greater Bay Area, the PBOC, the CBIRC, the CSRC and the SAFE jointly issued the *Opinions on Financial Support for the Development of the Guangdong-Hong Kong-Macao Greater Bay Area* in April 2020. The goal was to encourage cooperation between insurance institutions in Guangdong, Hong Kong and Macao to develop innovative products especially, cross-border medical and auto insurance. In November 2020, the CBIRC issued the *Notice on Promoting the Work Relating to Life Insurance Products in the Guangdong-Hong Kong-Macao Greater Bay Area,* following which the first cross-border medical insurance and critical illness insurance products for permanent residents in the Greater Bay Area were launched. Cross-border auto insurance, based on the principle of "recognizing equivalent products first", is likely to take the form of single policies covering the whole area, which should be available for Hong Kong and Macao car owners in 2021. Before that can happen, however, a number of issues need to resolved, including cross-border payments, tax management and differences in industry regulation. If the pilot programs in the Greater Bay Area work out well, future cross-border cooperation in the insurance industry may not be far behind.

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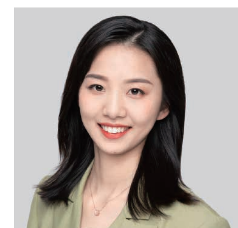

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