PRESS RELEASE

ASIFMA Launches New Industry Report on China's Capital Markets: Investment Opportunities Still Abound for Both Domestic and Foreign Investors

30 June 2023 (Hong Kong) – ASIFMA, the region's leading capital markets industry association representing over 170 member firms, today launched a new industry report "China's Capital Markets: A Market in Transition" which examines the challenges and opportunities in China's capital markets.

"As China emerges from the pandemic, we believe China's large and dynamic capital markets will continue to transition, offering more investment opportunities for both domestic and foreign investors," said Alice Law, CEO of ASIFMA. "We appreciate and welcome the reforms undertaken by the Chinese government in recent years to further liberalise its financial markets for offshore investors and facilitate domestic access to its capital markets."

"This paper aims to identify areas of China's capital markets for further enhancement and offer insights on potential market development areas, which we believe are aligned with the relevant policies set out in the 20th CPC National Congress Report, particularly to deepen structural reform in the financial sector, strengthen and refine modern financial regulation, safeguard financial stability and improve the functions of the capital market," continued Ms Law.

The paper provides almost 150 specific recommendations to enhance China's capital markets.

<u>Summary of Recommendations by Relevant Objectives</u>

1) **Promoting "high-standard opening up".**

   To further incentivise foreign investments in China's domestic markets and reducing the cost of onshore hedging, we recommend: (1) treating all investment managers (including offshore ones) the same way as domestic public funds and exempting them from the short swing profit rule (2) removing the quota requirement on foreign exchange profit sell-off and the risk reserve ratio requirement on forward foreign exchange sales and (3) broadening access to a wider range of hedging products for currency and market exposures.

   To further enhance the attractiveness of onshore investments for global investors and incentivise foreign investors to tap into China's capital markets, we also recommend:

   - equipping global investors with more access to risk management tools such as securities lending and higher hedging quotas for listed derivatives;

   - expanding access to block trading for QFIs and for Stock Connect investors;

- removing the pre-funding requirement for QFIs to share the benefits of the DVP reform;

- providing tax incentives to foreign investors in respect of their investments under various market access schemes;

- allowing the use of Bond Connect assets as collateral for non-centrally cleared derivatives;

- shifting the client suitability framework from a product-based approach to a holistic, portfolio-based approach.

2) Amplifying the interplay between domestic and international markets.

There is strong market sentiment for further expansion and diversification of products available under various market access regimes (including Stock Connect, Bond Connect, Wealth Management Connect, Swap Connect, QDII, QFI and MRF schemes). For example:

- product eligibility criteria for Stock Connect should be further expanded to include the full universe of China A shares;

- the holiday trading mechanism for Stock Connect should be further expanded to facilitate trading on holidays;

- the scope of products available under Wealth Management Connect should be expanded to include higher risk products such as equity funds, products domiciled outside of Hong Kong and Hong Kong-domiciled funds that feed into overseas funds;

- private credit funds should be made available for insurers' investment under the QDII scheme;

- restrictions on the domicile of funds recognised under the MRF and delegation of investment management under the MRF should be relaxed;

- a Repo Connect scheme should be introduced to allow foreign investors to leverage their "Connect" infrastructure to access onshore liquidity and financing.

To promote greater integration and connectivity between China's capital markets and offshore markets, we recommend that the investment quota under Wealth Management Connect be increased and the range of eligible participants under Stock Connect (for SBL), Bond Connect and Wealth Management Connect (for distribution) be further broadened.

Furthermore, it is recommended that foreign entities should be allowed to participate in China's capital markets more actively. For example, foreign market makers should be welcomed to promote market liquidity and foreign bank branches should be eligible to serve as local custodians under the CIBM Direct multi-layer custodian bank model. International brokers and rating agencies should also be granted further access in the onshore markets.

3) **Enabling cross-border data sharing to cultivate a vibrant and globally connected financial market.**

We respectfully submit that the stringent or unclear requirements on cross-border data sharing, particularly among members of the same group, in the PRC pose operational uncertainties and challenges for capital markets participants, hindering their ability to share data, particularly in the financial sector, across borders for critical business flow and efficiency. Overall, we recommend revisiting and reassessing the rules applicable to cross-border data transfers using a risk-based approach and clarifying how they should be implemented. In terms of the financial sector, we recommend carving out certain types of data from the general prohibitions. For example, the sharing of research and investment outlook, portfolio or financial analysis, shareholding information and AML/CTF information between group companies should be allowed to meet legitimate business, compliance and risk management needs.

4) **Fostering a "world-class business environment" and advancing law-based governance.**

We believe additional regulatory guidance or dedicated legislation on the below topics would help clarify policy and regulatory expectations and facilitate compliance by market participants: (1) program trading rules for the securities and futures market, (2) trading protocols in the bond market, (3) workflow for the QDLP program, (4) form and scope of the personal information protection impact assessment report expected for cross-border transfers of personal information, and (5) the multi-layer custodian bank model under the CIBM Direct scheme.

We seek clarifications on certain aspects of the existing legal and regulatory framework, with a view to enhance investors' understanding and facilitate their informed assessment of investment opportunities and risks. For example, those relating to: (1) onshore retention of working papers and Sensitive Information transfer approval requirement in relation to overseas listing for PRC companies, (2) application of the uptick rules even to long sales for QFIs with outstanding borrowed securities, and (3) bond investments eligible for applicable tax exemptions.

We recommend that internationally recognised standards and industry documentation such as the ISDA Master Agreement for OTC derivatives transactions, GMSLA for bonds' lending and borrowing transactions, GMRA for repurchase transactions as well as ISO standards for clearing and settlement systems be more widely recognised and adopted in China's capital markets.

Furthermore, we believe standardising and streamlining processes and procedures in the share market, bond market as well as foreign exchange market will increase the accessibility and efficiency of China's capital markets. We recommend further enhancement of China's market infrastructures, such as its payment and clearing systems, including:

- development of a CNH PVP risk mitigation infrastructure to protect market participants against loss;

- update of SHCH's rules to allow a clearing member to initiate the close-out netting process in accordance with applicable clearing rules upon the clearing house's own default.

5) **Implementing talent development reform and increasing international talent exchanges.**

   We support the introduction of a dual-licensing regime for individuals and entities licensed in one jurisdiction within the GBA to engage in certain activities in another jurisdiction without having to obtain a separate licence in that jurisdiction.

   For brokers with segregated QFI and Stock Connect teams, we support allowing brokers' onshore trading desks to manage Stock Connect orders on behalf of offshore affiliates to break down barriers and provide onshore staff with greater opportunities.

   For asset management companies with portfolio or investment managers in the Mainland, we recommend that they be allowed to provide investment advice to their offshore affiliates and/or offshore funds of such affiliates.

6) **Accelerating the development of the digital economy and strengthening the safeguards for ensuring cyber and data security.**

   We would like to see regulatory clarity on: (1) whether PRC entities of FIs are permitted to use public cloud, (2) requirements and expectations on the use of cloud service providers in the PRC, and (3) PBOC's roadmap on adopting financial community cloud.

   To manage cyber risks, we recommend that (1) collection of sensitive data be limited to those directly relevant and necessary for accomplishing specific purposes, (2) any future material cyber events or data breaches are timely disclosed to impacted industry members , (3) alternative approaches for receiving and handling of sensitive data as well as FI's demonstration of cybersecurity capabilities be explored and (4) the Financial Sector Profile created by the global financial industry be recognised.

7) **Pursuing green and sustainable development.**

   We recommend expanding the PBOC's carbon emission reduction supporting tools, providing incentives to encourage financial institutions to participate in green finance product design and investment, attracting blend funds to energy conservation and low-carbon sectors, and further enhancing sustainability-related disclosures.

"As China continues its journey of financial development and reform, ASIFMA is pleased to continue its role as an important bridge between policy makers and market participants, providing feedback on issues arising from policy changes from the perspective of industry experts, as well as from an international perspective," concluded Ms Law.

The full paper can be found here.

ENDS

For media queries, please contact:

Corliss Ruggles, Managing Director - Head of Communications and Human Resources, ASIFMA
Tel: +852 9359 6996
Email: cruggles@asifma.org

About ASIFMA

ASIFMA is an independent, regional trade association with over 170 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, and competitive Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region. More information about ASIFMA can be found at: www.asifma.org.