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FANGDA PARTNERS
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PRC
FINANCIAL
REGULATION

2024

Annual Report

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Preamble



2023 flung the world into a sea of uncertain challenges, spurred on by the relentless pace of shifting geopolitical sands and game-changing technology. In 2024, faced with contagion risk posed by the twin threats of rising global debt and de-globalization, China's financial markets will continue to steer choppy waters. However, thanks to top-level innovation and responsiveness, resilience in these uncertain times, China's financial regulation and institutional reform should continue to ensure that the financial services sector both plays its role as the invisible hand guiding the real economy and enhances risk prevention.

This year, Fangda Partners continues to make its contribution to the financial services sector by lending our professional perspective on the markets to provide forward-looking guidance to our clients. In our long-awaited series of "PRC Financial Regulation Annual Report (2024)", we provide in-depth analysis and unique perspectives to capture the defining moments of significance of both present and future times. In this new year full of possibilities, we look forward to join you in defining the new chapters of the financial services sector in China.

Finding certainty in the midst of uncertainty and helping our clients to achieve stable and long-term development are the unremitting pursuits of Fangda's Financial Industry Group. We advise both domestic and overseas clients on their most cutting-edge and complex legal issues involved in China's financial services sector. We are at the forefront of significant initiatives in such sector, leading the market's most groundbreaking transactions and developing new product structures. With our profound and unrivaled understanding of the market, we are able to provide creative solutions to our clients in a complex and changing financial regulatory environment. As can be seen from this Report, there are many complexities in China's financial regulatory environment. We understand those complexities and can help navigate our clients through them, to make sure they can achieve their commercial objectives.

We welcome and highly appreciate feedback from those working directly in the financial services sector. Please feel free to get back to us with any comments or suggestions on the content of this report.



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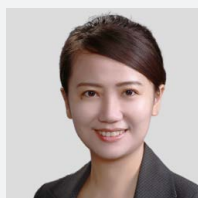
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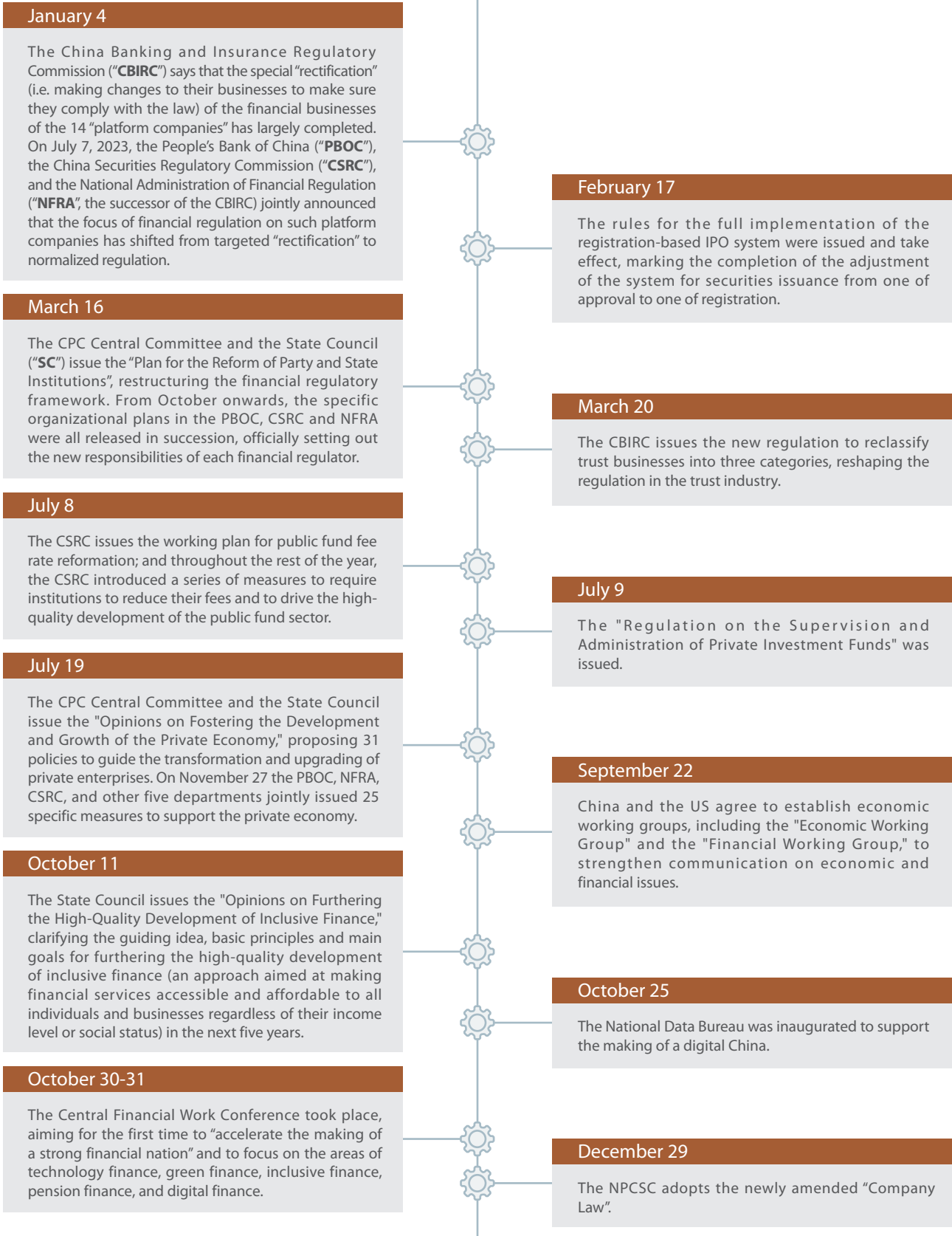
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PRC Financial Regulation:
Annual Report (2024)

General

2023 Regulatory Milestones



2023 Regulatory Mainline Review

01 The Financial Sector Receives Strategic Repositioning, with Top-level Direction

In 2023, China's financial services sector was accorded a new strategic importance. While previously the financial sector had been categorized as an "important national core competence", now 2023's Central Financial Work Conference positioned finance as "the lifeblood of the national economy" and, for the first time, proposed the goal of building a "strong financial nation", alongside other "strong nations" (for example, culture, manufacturing, and maritime activities).

At the same time, the systems and mechanisms regarding how the Party will manage the financial work were targeted for improvement. The "Plan for the Reform of Party and State Institutions" established the Central Financial Committee and set up the Office of the Central Financial Committee. The Plan also institutionalized the top-level role of the CPC to design, supervise and implement financial work, as well as having the power to review and make decisions about major policies and issues in the financial area.

The Central Financial Work Conference (held on October 30, 2023), unlike the previous five National Financial Work Conferences, was attended by all Members of the Standing Committee of the Political Bureau of the CPC Central Committee – the highest leadership in China – and was named the Central Financial Work Conference, indicating the unprecedented importance that the Central Party has attached to China's financial services sector. In the next stage, while maintaining the existing structure of specific financial regulators (which operate under the State Council), the Party is expected to bring new ideas and approaches to financial work through its centralized leadership.

02 Restructuring the Financial Regulatory Framework

Following the merger of the China Banking Regulatory Committee and China Insurance Regulatory Committee into CBIRC in 2018, China's financial regulatory framework underwent further restructuring in 2023. The intention is to optimize the system of financial regulation and to build a strong nation.

In addition to adhering to the core design of the Central Party's unified leadership over financial work, the establishment of the NFRA and the redivision of regulatory functions with the PBOC and

the CSRC mark the adjustment of China's regulatory framework to a kind of "twin peaks" model. This model aims to promote market behavior regulation, prevent speculative behavior, and protect consumer rights, as well as to prevent risks and maintain financial stability. Following the changes to the institutional structure, the responsibilities between the regulators have been divided up as follows: the PBOC is mainly responsible for formulating and implementing monetary policy and macroprudential regulation; the NFRA is mainly responsible for micro-prudential regulation and consumer rights protection; and the CSRC is mainly responsible for capital markets regulation. The NFRA is also expanded with a role as the default regulator of all financial activities, especially illegal financial activities. At the same time, the NFRA also has the function of conducting microprudential regulation of banking and insurance sector businesses. The role of the PBOC has become clearer as a pure monetary authority.

The relationship between the central and the local authorities has also been redefined. The starting point that financial regulation essentially derives from a central authority has been re-emphasized. That means having a central financial management department with local branches. At the same time, local Party committees will establish their own financial committees and financial work committees to make sure that the financial work instructed by the Central Party is carried out. The local financial offices and financial bureaus in the local provincial government is removed the responsibility/task for financial development that was originally entitled to them.

These changes have helped to resolve functional conflicts between the central organizations and local bureaus, as well as clarifying rights and responsibilities. It is expected that with the subsequent implementation of the "Regulations on Local Financial Supervision and Management," local financial regulatory institutions will play a more active and effective role in local financial risk prevention and resolution, as well as the supervision of the "7+4" institutions, which mainly refers to non-mainstream financial organizations that are mainly local and professional companies, such as micro-credit company, financing guarantees company, and various types of local trading places.

03 New Requirements for “Political and People-Oriented” Nature of Financial Work

The Central Financial Work Conference of October 2023 reiterated the need for China’s financial sector to understand the “political and people-oriented nature of financial work”, by which it was meant that financial institutions should work in people’s best interests. The Conference also called for the financial sector to operate to the highest standards.

In 2023, many policies were set out directly targeted at “common prosperity” and finance for the people: changes were made to how much investors are charged (“public fund fees”) to “enhance investors’ sense of gain”; the State Council issued the “Opinions on Promoting High-Quality Development of Inclusive Finance” in October 2023, clarifying the guiding principles and main goals for promoting high-quality development of “inclusive finance” in the next five years; the concepts of “new citizen economy” and “silver-haired economy” (which refers to the economics of serving older people) were introduced, and many policies were introduced in areas such as pensions, family trusts, and family wealth management, all with the aim of making sure that people benefited from financial products and services.

All in all, there has been a real shift in the focus of the financial sector. As indicated by the Central Financial Work Conference, finance should provide high-quality services for economic and social development. Policies and systems related to currency, exchange rates, and capital markets should serve the real economy (rather than simply being products that only benefit financial institutions themselves).

There has also been much discussion about the professional culture of financial institutions. In February 2023, an article by the Central Commission for Discipline Inspection criticized the “financial elite theory,” and the Central Financial Work Conference emphasized the need to promote traditional Chinese culture in the financial system, being honest and trustworthy, and for all financial practitioners to be conscious of the need to be aware of their legal responsibilities.

04 Greater Emphasis on Financial Services Supporting the Real Economy

The Central Financial Work Conference defined unequivocally the financial sector as “the lifeblood of the national economy.” Subsequent financial policies in 2023 adhered to this requirement. For example, the new rating method for the trust sector included the ability of trust companies to serve the real economy when it comes to assessing systemic risk, and the “Regulations on Capital Management of Commercial Banks” emphasized the new regulation’s orientation towards better serving the real economy beyond pure capital regulation and risk management. In the money markets, in addition to various stimulative measures such as interest rate and fee reductions, the government paid more attention to the phenomenon of “capital idling” (which means funds circulating within the financial sector without entering the real economy) in 2023 and expected to invigorate such idle capital to supporting the real economy, as opposed to the “virtual economy”. One bank was fined RMB225 million during the year for carrying out activities that did not serve the real economy, and that was the largest fine imposed in the banking sector in 2023.

What is meant by “serving the real economy”? The Central Financial Work Conference specifically defined the “five major articles” as being “technology finance, green finance, inclusive finance, pension finance, and digital finance,” and explicitly required “allocating more financial resources to promote technological innovation, advanced manufacturing, green development, and small and micro enterprises, vigorously supporting the implementation of the innovation-driven development strategy, the regional coordinated development strategy, and ensuring national food and energy security.” The Central Economic Work Conference specifically proposed “guiding financial institutions to increase support for technological innovation, green transformation, inclusive small and micro, and the digital economy.”

Of the “five major articles,” the one that received most attention is technology finance. In the various enumerations of the real economy field, “technological innovation, ‘specialized, fine, peculiar, and new’ high-end manufacturing enterprises are given absolute priority. In the area of capital markets, technological enterprises should be given priority under what is called the “traffic light” industry orientation, giving technology entrepreneurial enterprises a high “political position”. The Beijing Stock Exchange also continued to introduce various supportive policies to make it easier for specialist enterprises to secure finance.

05 Progress in Risk Resolution and Normalization of Disposal for Financial Institutions

Significant breakthroughs were made in the resolution of major financial risks in 2023. The disposal of the last batch of "Tomorrow Group" institutions was concluded, with four insurance companies being restructured and Xinhua Trust ending in bankruptcy liquidation; Huarong Asset changed ownership, with the complete withdrawal of its financial subsidiaries; and risk disposals of Evergrande Life Insurance, Sichuan Trust, some village and town banks in Henan and Anhui, and related risks of Zhongzhi Group proceeded steadily. As mentioned in our reports in the previous two years, there has been a steady disposal of high-risk financial institutions, which should mean that in future there will be greater "normalization" in the financial sector. It is worth noting that with the accumulation of regulatory experience, effective coordination between central and local authorities, and changes in resourcing, high-risk financial institutions should present less of a problem in future.

"Stability before speed" has become the common feature of disposals: in-depth investigations and sorting out of underlying assets and liabilities in the early stage; long-term weighing of schemes to maximize the gathering of risk-disposing resources and balance the interests of all parties; and then rapid execution once the scheme is determined to quickly resolve the crisis. For example, the formulation of asset clearance and risk disposal schemes for the Tomorrow Group institutions taken over in 2023 took years, but once initiated, they were implemented swiftly and decisively.

A second notable trend has been the transition from administrative coordination to letting the market determine outcomes. In the early cases of bailing out institutions such as Baoshang bank, Anbang insurance, and Hengfeng bank, that involved large-scale use of industry protection funds or funding from the central government. More recently, there has been limited administrative intervention, meaning that financial regulatory authorities and judicial organs focus more on their statutory responsibilities (rather than support more funds) and local governments fulfill their local and stability maintenance responsibilities - each performing their roles according to the principle of "stabilizing the overall situation and coordinating." There are more market participants, for example the involvement of investment funds from the insurance industry being used when it came to the disposal of Huaxia Life and Huarong Asset. At the beginning of 2024, the NFRA summarized in its work conference the need to implement the "six-party responsibility" of institutions, shareholders, senior management, regulators, localities, and the industry, which is all in line with the draft of the Financial Stability Law.

Added to that, market-based disposal schemes offer greater flexibility when it comes to devising solutions in specific cases: Zhongzhi Company and Xinhua Trust were processed through judicial procedures such as bankruptcy, while the insurance industry generally favors the "new establishment and takeover" model. Alternatively, Yian Property Insurance adopted bankruptcy reorganization, and Tianan Property Insurance adopted asset package sales. The entities proposed to take over Tianan Life Insurance, Evergrande Life Insurance, and Junkang Life Insurance have different upper-level structures, participation levels of guarantee funds, and specific disposal logic. We expect that the final version of the Financial Stability Law will take into account the experience of different methods of dealing with disposals over the past two years.

06 Restructuring Regulatory Model for Greater Science and Rigor

The restructuring of the financial regulatory system has always been an important part of financial reforms. China's traditional financial regulatory system is institution-based regulation for different institutions. The National Financial Work Conference in 2017 emphasized the function-based regulation and the behavior-based regulation. The Central Financial Work Conference in 2023 further enriched the traditional financial regulatory system into "institution-based regulation, behavior-based regulation, function-based regulation, look-through regulation, and continuous regulation," making the regulatory system more scientific and prudent.

The merger of the CBRC and the CIRC and the unified enforcement of the bond market in the past few years are examples of function-based regulation and behavior-based regulation. Look-through regulation and continuous regulation are covered by on-site inspections and the disqualification of non-compliant shareholders of small and medium-sized banking and insurance institutions in the past few years.

The regulatory model have restructured as part of the process of making regulation more scientific and rigorous. So, for example, the NFRA has set up the Department of Large Banking, the Department of Joint-Stock and Urban Commercial Banking, and the Department of Rural Small and Medium-sized Banking to supervise different types of commercial banks - in other words, covering institutions-based regulation. The Department of Science and Technology Supervision, the Department of Asset Management Institutions Supervision and the Department of Institutional Recovery and Disposal, also created by the NFRA, focus on function-based regulation. The responsibilities of financial consumer protection, previously the remit of the PBOC and the

CSRC, have also been transferred to the NFRA – in other words, focusing on behavior-based regulation. The establishment of the Department of Corporate Governance Supervision and the Department of Institutional Recovery and Disposal is intended to strengthen the governance of financial institutions and promote the systematization of institutional exit and risk disposal, reflecting the idea of continuous regulation in the whole cycle and process of financial institution governance and its disposal. The principle of "substance over form" is embodied in look-through regulation and features strongly in specific regulatory rules (e.g., the qualifications of shareholders of financial institutions, verification of the underlying assets of asset management products, and the supervision of connected transactions) and regulatory measures (market access, off-site supervision, and on-site inspection).

07 More realistic system reform and more precise regulation

The process of reforming the financial sector continued unabated in 2023, which involved putting in place changes and bedding down the existing framework. This took many forms, whether it was the NFRA unifying the regulatory rules, the introduction of high-level new regulations in areas such as private funds and payment institutions, or the revision of basic regulations for commercial banks, securities companies, and trust companies, the focus was always on integrating and sorting out existing regulations, generally in line with market expectations.

While partly adjusting the registered capital subscription system, the new Company Law introduced innovative company governance systems, allowing for easier capital reductions, among other measures, as well as ascribing main responsibility for governance to boards of directors. The CSRC twice sought the market's opinions on proposed changes to the Measures on Derivatives Trading Supervision and Management and removed some provisions in the second draft that were ahead of market practice. This also indicated a desire of government departments to take a more realistic attitude to institutional reforms.

However, the regulatory authorities do continue to intervene in certain circumstances. For example, regulators issued instructions regarding product registration and business expansion in the public fund sector. Following the establishment of the registration process for IPOs, the CSRC controlled the number of IPOs approved in the second half of 2023. In the capital markets, the CSRC also issued guidance to stock exchanges to formulate new regulations on algorithmic trading, margin financing and refinancing. In other areas, such as financial risk disposal, and real estate and debt risk mitigation, regulatory authorities

emphasized that there should be no one-size fits all approach to utilize measures that work for that particular sector and indeed that particular situation.

08 Financial Law Enforcement: Stronger Structures and Strict Supervision

In 2023, China's financial regulatory authorities made improvements to the structures of regulatory institutions as well as stepping up enforcement. The NFRA established an enforcement task force as a directly affiliated law enforcement authority responsible for the investigation and evidence collection.

In terms of legislation, the draft regulations for the supervision and management of securities companies and private equity funds have significantly increased the levels of penalties and broadened the scope of law enforcement. There were more large fines imposed in 2023: the banking regulators imposed penalties of approximately RMB200 million for a total of 38 violations by a large state-owned bank in February and approximately RMB 225 million for a total of 56 violations by a joint-stock bank in November. The NFRA imposed penalties on 4,750 (person-times) banking and insurance institutions and on 8,552 "responsible" persons (person-times), with penalties and confiscation of illegal proceeds totaling RMB7.838 billion. all of which represented a significant increase compared to 2022.

The CSRC also focused on combating serious violations such as financial fraud, fund appropriation, illegal guarantees, market manipulation, and insider trading, cracking down on securities and futures illegal activities, as well as counterfeiting.

The penalties imposed on large fintech companies and more broadly on those companies falling foul of the regulations have become more stringent. This is a reflection of the attitude of strict regulation and zero tolerance, as well as the result of the strengthening of the regulatory capacity of each regulatory agency and the continuous improvement of the ability to identify violations of the law based on the abovementioned ideas of continuous and look-through regulation.

2024 Regulatory Outlook

01 Stability while Progress Creating before Phasing Out Old Dynamics

The Central Economic Work Conference, held in December 2023, spoke of the need for "Stability while Progress", "Promoting Stability through Progress" and "Creating before Phasing Out Old Dynamics" in 2024. We believe that these will be the core themes of financial regulation in 2024.

"Stability" is a long-term guiding value of financial policy. "Progress" is the main policy goal of the new stage. Taken together, "Promoting Stability through Progress" means using regulations to solve problems and resolve "contradictions", particularly in areas such as risk disposal. The principle of "Creating before Phasing Out Old Dynamics" is to do with creating new industries and dynamics while phasing out old industries and dynamics.

We expect that the regulatory policies in 2024 will be more moderate and steady, focusing on stabilizing expectations and growth. Financial innovation and non-standard investments may be permitted but only in a limited way, and efforts may be made to avoid short-termizing of long-term goals, such as adjusting the pace of certain long-term goals like "dual carbon goals" and the transformation of financial institutions.

The Central Political Bureau Meeting on December 8, 2023, mentioned the need to "enhance the consistency of the direction of macro policies," so we expect there to be more consistent application of multiple financial policies.

02 Expect More Legislation and Greater Enforcement

As we progress through 2024, the process of passing legislation and implementing regulations will continue. These will include a series of foundational regulations in the financial sector, including the Financial Stability Law, the PBOC Law, the Commercial Bank Law, the Insurance Law, the Banking Supervision and Management Law, and the Securities Company Supervision and Management Regulations. Further regulations for financial holding companies are also expected to be introduced. The updated regulations either fill in the gaps and expand regulatory scenarios or keep pace with the market, including, we expect, an increase in penalties for those who are in breach of regulations.

The so-called gray areas in regulation, which gave rise either to uncertainty or regulatory "arbitrage" (which enabled institutions to play off one regulator against another) have largely been eliminated after the completion of central institutional reforms and the full settlement of central and local financial decentralization. The NFRA stated in December 2023 that financial authorities will guard their respective regulatory areas, not only regulating "licensed violations" but also "unlicensed driving." We understand that cross-border financial activities will still be a focus of financial regulation.

In terms of the law enforcement, after the adjustment of powers and the establishment of the enforcement task force within the NFRA, the NFRA will become the center of financial law enforcement. It will lead the establishment of a mechanism for claiming regulatory responsibility and a safety net mechanism, promoting the clear assignment of regulatory responsibilities for cross-departmental, cross-regional, new industries and products. Where it is not possible to allocate responsibilities, the NFRA will be responsible for assuming supervisory responsibilities.

03 The Next Stage of Financial Institution Risk Disposal: Institutionalization and Marketization

In 2024, the financial sector will shoulder the heavy responsibility of supporting local government debt and real estate risk resolution. There will also a strong focus on helping the financial sector's risk management and disposal.

So far as legislation is concerned, there will be a Financial Stability Law and legislation introduced to cover insurance funds. That will provide a more professional and predictable working framework for financial risk disposal. The newly established Institution Recovery and Disposal Department of the NFRA (referred to above) will be specifically responsible for formulating the risk disposal system, standards, and procedures for high-risk institutions. In addition, financial regulatory authorities will monitor the financial sector for high-risk situations and be proactive in dealing with those risks.

Getting down to practical measures, some provinces have been formulating and implementing reform and risk resolution plans for small and medium-sized banks, to be followed by plans to address risk resolution in non-banking institutions. The Non-Banking Supervision Department of the NFRA has stated that the priority is to initiate disposals of high-risk non-banking institutions by the end of 2024. The very significance is that China is abandoning the idea of institutions being "too big to fail", while merely protecting the interests of small investors and depositors to the extent permitted

by market capacity. A good example of this was the approach to risk resolution of the Zhongzhi Group – since it has met the standard of bankruptcy, just let it be bankrupt.

04 Financial Markets: Supply-Side Reform

The Central Financial Work Conference has set the financial regulatory (supply-side) structural reform as the best means for ensuring financial services support the real economy and bringing about high-quality development. This in line with the top-level design of China's financial market development.

There will continue to be a strong focus on the large state-owned financial institutions. These measures may include encouraging state-owned asset groups to rationalize the structure of financial institutions internally, including considering granting financial holding licenses, and enabling capital to expand appropriately in the financial sector. Building first-class investment banks is sure to be discussed in 2024; some major securities firms have already included this goal in their five-year plans. The CSRC has previously stated its support for mergers and acquisitions between securities companies, and there have been many rumors and discussions in the market about which companies this is likely to include. The NFRA is studying whether to raise the threshold for institutional access and is likely to give priority to, market entities that comply with the policy of "serving the real economy".

At the beginning of 2024, the new financial leadership team has made it clear that they aim to "attract more foreign financial institutions and long-term capital to develop and thrive in China," so it is expected that there will be breakthroughs in the entry, efficiency and scope of foreign investment in the financial sector in 2024. This will continue the trend started in 2023. Regulators approved the application by a number of US financial institutions to have wholly-owned control of, or to set up, financial institutions in China. And the "Swap Connect" was officially launched in May. However, for various reasons, including geopolitical factors, some foreign financial institutions withdrew their applications to open in China, while other applications proceeded slowly. However, it should be noted that the CSRC has shortened the time it takes for foreign securities companies and fund management companies to open in Shanghai, Hainan, and other six free trade zones, from six months to 120 days.

In the coming year, industrial institutions and small and medium-sized financial institutions can expect to be subject to strict

enforcement – at least those who have fallen foul of the law. Even with the official relaxation of the platform economy at the beginning of the year and some support for the private economy, the first "private financial holding" license has yet to be issued, and internet finance is subject to regular regulation, reflecting the regulatory authorities' continued cautious attitude towards private capital's investment in the financial sector. In addition, with the increasing importance of financial institution governance, the governance of small and medium-sized life insurance, reform of rural credit cooperatives, and mergers and reorganizations of small and medium-sized banks are in full swing. Although most of these institutions have "rectified" their governance procedures (i.e. brought them in line with updated regulations), the regulatory authorities still require them to be passed and approved for risk prevention.

05 Aiming for Confidence and Consistency

In October 2023, the PBOC mentioned in the report on the financial work at the sixth meeting of the Standing Committee of the 14th NPC that more efforts should be made to expand domestic demand, boost confidence and prevent risks; further measures should be implemented to activate the capital markets and boost investor confidence. In addition, the financial institutions forum jointly held by the PBOC, the NFRA and the CSRC mentioned in November 2023 that it was necessary to address the problems currently faced by the financial sector to up confidence and look to the long term.

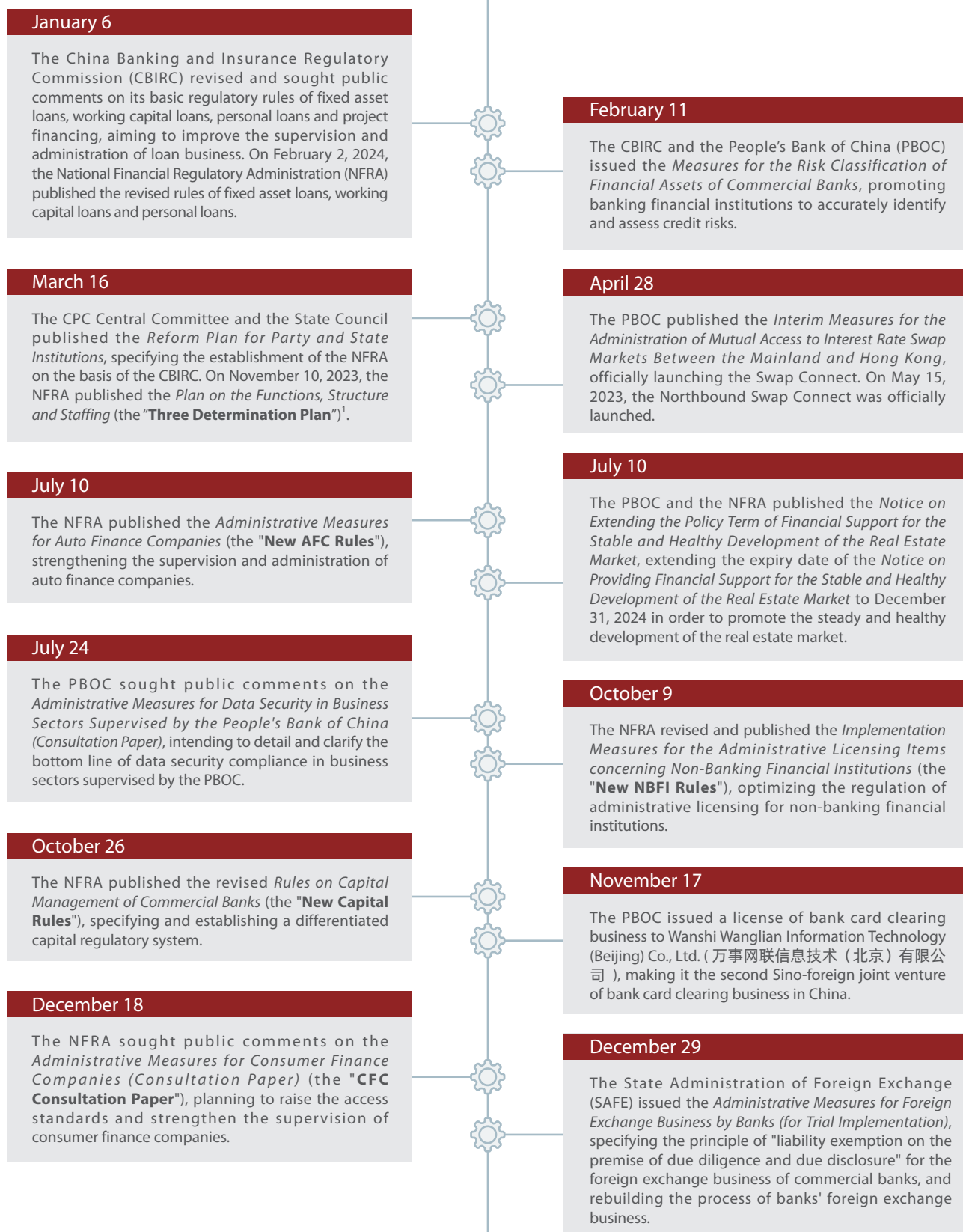
We expect that the financial policies in 2024 will be more people-oriented, paying more attention to short-term problems directly linked to investor interests and public confidence. We expect financial regulations will be more in tune with supporting the market. Finally, we expect there to be greater consistency between financial policies.



PRC Financial Regulation:
Annual Report (2024)

Banking

2023 Regulatory Milestones



1. Notice on the Issuance of Provisions on the Functions, Structure, and Staffing of the National Administration of Financial Regulation.

2023 Regulatory Mainline Review

01 Strengthening support for national economy and unifying behavioral and functional regulations

The Central Financial Work Conference held at the end of October noted that finance is "the bloodline of the national economy" and proposed for the first time the goal of "accelerating the construction of the country to a financial powerhouse". In order to realize this goal, regulators in the banking sector have continued strengthening the support for the national economy, especially from the perspective of real economy and financial inclusion². A number of policies were introduced to facilitate the financial inclusion for micro and small-sized enterprises, including the *Notice on Increasing Efforts to Improve the Quality of Financial Services for Micro and Small-sized Enterprises* issued by the General Office of the CBIRC in April, the *Opinions on Promoting the High-Quality Development of Inclusive Finance* issued by the State Council in October, and the *Notice on Increasing Financial Support for the Development of the Private Sector* jointly issued by the PBOC, the NFRA, and eight other departments of the State Council in December. There were also initiatives to encourage financial support for transportation, logistics, housing and expense reduction, among others.

It can be seen from the relevant policies that, on the basis of institutional regulation, the regulators are also enforcing both behavioral regulation and functional regulations. In this round of institutional reform by the State Council, the NFRA was formed on the basis of the CBIRC, and its internal departments were adjusted to adapt to the current landscape of banking industry. A number of new departments were set up in NFRA, including the Technology Supervision Department, the Asset and Wealth Management Institution Supervision Department, and the Financial Institution Authorization Department. The Joint Stock Bank Supervision Department and City Commercial Bank Supervision Department were merged into one. The aim was to bring about unified supervision of similar activities and functions.

02 The banking sector continues to open up with more and diverse opportunities for foreign institutions

The banking sector continued to open up in 2023. A number of regulations were introduced to lay the foundation for more types of foreign institutions to penetrate more deeply into the domestic market. For example, the New NBF Rules facilitate the investment of foreign investors in non-bank financial institutions, allowing foreign non-financial institutions to invest in financial asset management companies, permitting multinational groups to directly establish finance companies, and lowering the asset qualifications for foreign investors. The New AFC Rules broaden the scope of deposit-taking by auto finance companies ("AFCs") and changes the currency in which AFCs can conduct business from "RMB" to "local and foreign currencies", making it easier to access foreign funds and run cross-border business by AFCs.

At the same time, the development of mutual market accesses has been in full swing, with the turnover exceeding RMB1.8 billion in just half an hour after the launch of the Northbound Swap Connect (a new channel for mutual market access between Hong Kong and the Chinese Mainland, allowing international investors to trade without changing their existing trading and settlement practices). Another significant change was the "Cross-border Wealth Management Connect", launched in the Greater Bay Area, which released the *Detailed Rules for the Implementation of the Pilot Program of Cross-Border Wealth Management Connect in the Guangdong-Hong Kong-Macao Greater Bay Area (Consultation Paper)* after two years of its pilot. Among other rules covered in this arrangement was the upgrade of the qualification requirements for investors, the scope of participating institutions, the scope of qualified investment products, and the quota for individual investors and other aspects. This aims to further promote the mutual market access schemes in the Greater Bay Area.

Also noteworthy, at the end of 2023, the PBOC issued a series of policies to promote the facilitation of cross-border trade and investment. In the middle of the year, the pilot program to allow multinational companies to integrate the use of Chinese and foreign currencies within the group (called "cash-pooling") extended to cover more regions, ushering in greater use of RMB for cross-border trade and investment and creating a more favorable business environment for multinational companies.

2. Inclusive finance or financial inclusion refers to the provision of appropriate and effective financial services to all social strata and groups with financial service needs at affordable costs based on the requirement of equal opportunity and the principle of sustainable business.

Concurrently, a number of foreign investors were granted regulatory approval to participate more extensively in domestic financial business in various segments of the banking sector in mid-2023. In November 2023, China gave the green light to business opening of the second Sino-foreign joint venture (“JV”), Wanshi Wanglian Information Technology (Beijing) Co., Ltd. (万事网联信息技术有限公司 (北京) 有限公司), for bank card clearing operations. This JV is controlled by the second largest U.S. card clearing institution, MasterCard. Immediately thereafter, the PBOC approved the third capital increase of China’s first Sino-foreign JV, Express (Hangzhou) Technology Service Company Limited (连通 (杭州) 技术服务有限公司), for bank card clearing operations, making American Express the controlling shareholder. In December 2023, approval was given to DBS Bank (the largest shareholder already) to increase its stake in Shenzhen Rural Commercial Bank (深圳农村商业银行) again. In addition, four foreign-invested banks were included in the digital RMB pilot for the first time in 2023, namely HSBC, Hang Seng, Standard Chartered and Fubon China. A number of other foreign-invested banks are also actively pursuing their corporate digital RMB business. For example, in July 2023, DBS China with the cooperation of China UMS (银联商务) completed the first payment collection transaction of its corporate digital RMB collection business. With the Central Financial Work Conference sending an important signal that the financial industry is striving to promote high-level opening up, the banking industry will also steadily expand its opening-up and cooperation with foreign investors and market players.

03 Focus on the management of NBFIs to improve their operations

In recent years, a number of the regulator’s annual legislative work plans have frequently mentioned revisions and enactments of regulations of non-banking financial institutions (“NBFIs”) and a number of important provisions were finally implemented in 2023. The New NBF Administration Rules came into effect in November, and regulatory rules for AFCs and consumer finance companies (“CFCs”) were revised for the first time in more than a decade. In addition to the measures to promote opening-up mentioned above, there were also measures to improve regulation on shareholders and business, all leading to greater controls of NBFIs.

On the one hand, regulatory requirements such as equity management requirements of the NBFIs have been gradually unified. For example, the *Measures for the Administration of Finance Companies of Enterprise Groups*, the New AFC Rules and the New NBF Administration Rules imposed prohibitive or restrictive requirements on the pledge of equity interests by major

shareholders of most types of the NBFIs.

On the other hand, the criteria for the scope of financial leasing business of different institutions have been unified. Previously, though AFCs as well as nationwide financial leasing companies (in Chinese: 金融租赁公司) supervised by NAFR and local leasing companies for financing purpose (in Chinese: 融资租赁公司) supervised by local government all could engage in financial leasing business, unlike the other two types of institutions, AFCs specifically could not conduct sale and leaseback business. The New AFC Rules, while liberalizing the sale-leaseback mode, brings together the business under one regulatory roof.

Also at the end of 2023 the *CFC Consultation Paper* and at the beginning of 2024 the *Measures of the Administration for Financial Leasing Companies (Consultation Paper)* were both published for public comment. The *Measures for the Pilot Administration of Currency Brokerage Companies* were also included in the CBIRC’s (currently NAFR) 2023 annual legislative work plan. All of which is to note that there is more institutionalized regulation of NBFIs, and we can expect more of the same for other relevant types of NBFIs in the coming year.

04 Risk management rules upgraded, with greater focus on data and cybersecurity

There were a series of revisions to the risk management rules of the banking sector in 2023. In February, on the basis of the existing rules, the CBIRC and the PBOC issued the *Measures for the Risk Classification of Financial Assets of Commercial Banks*, which further clarified the scope of the risk classification of financial assets and refined some of the classification standards. In November, the NFRA issued the *New Capital Rules*, which improved the rules on the capital supervision of commercial banks, urging banks to strengthen the level of risk management.

At the same time, a series of risk management rules in the banking sector have also been revised. These changes are not only China’s positive response to the latest status of international regulatory reform represented by Basel III, but also the latest guideline on bank risk management by regulators synthesizing international experience and China’s practice. These changes have had a significant impact. On the one hand, the *New Capital Rules* added specific requirements in relation to monitoring scope and the data to make them better reflect the actual risk level of institutions more accurately, such as including all financial assets bearing credit risk in the scope of risk classification management, expanding

the scope of loan commitments that should be accounted to the risk capital of institutions, and including all off-balance sheet businesses in the monitoring scope. On the other hand, the New Capital Rules have imposed differentiated – and more reasonable – regulatory requirements: for example, the *New Capital Rules* have built a differentiated capital regulatory system, encouraging banks with different scales and types of business to adopt different risk management approaches, and set preferential weights for high-quality clients and micro, small and medium-sized clients, and set preferential weights of qualified traders for high-quality credit card customers, which reflected the policy support for financial inclusion. After such series of revisions, the risk management system of the banking sector has become increasingly complete and comprehensive, but it also adds new requirements on data reporting for relevant institutions.

Regulators have also focused on risk management as applied to information networks and data in 2023. Following the issuance of the *Measures for the Regulation of Risks in the Information Technology Outsourcing by Banking and Insurance Institutions* in 2021, in response to several security risk incidents involving outsourcing service providers of financial institutions, the NFRA issued the *Notice on Strengthening the Management of Cyber and Data Security in Third-Party Collaboration*, which requires financial institutions to carry out a self-check to identify the risks in all their arrangements with digital service providers and to strengthen the coordinated management of technology risks, especially for monitoring the off-site outsourcing risk and supervision reports. The PBOC has also issued the *Administrative Measures for Data Security in Business Supervised by the People's Bank of China (Consultation Paper)*, which intends to strengthen the data security management in various aspects of business, such as data categorization and grading, general requirements, management measures, technological measures, risk monitoring, assessment and auditing, and incident handling measures. All in all, there have been more specific rules introduced that have a bearing on data and cyber security in the banking sector, intended to deal with potential risk.

Overall, risk management in the banking sector has been comprehensively updated, adopting a prudent attitude towards emerging areas as well as a more refined and contextualized approach, with a view to accurately controlling risks.

05 Preventing financial risks remains a long-term task, with a special focus on diversified reform of small and medium-sized banking financial institutions upgrading their risk management systems

In recent years, there has been many merger and reorganization of small and medium-sized banks, including the reorganization of urban commercial banks such as Xinjiang Bank(新疆银行), Shanxi Bank(山西银行), Liaoshen Bank(辽沈银行) and Zhongyuan Bank(中原银行). The process of small and medium-sized banks resolving risks through reforms has accelerated significantly in 2023. During the year, a number of village banks were merged and converted into subordinate branches of other commercial banks, 10 village banks were dissolved, rural credit cooperatives ushered in a wave of reformation and merger, a number of rural commercial banks were absorbed and merged, and more than a hundred small and medium-sized banks had changes made to their equity structure. Risks were mitigated by acquirers taking the initiative to integrate advantageous resources, expand the assets size and the business operations scope, strengthen the ability to continue to operate in a compliant manner, enhance the regional brand influence, reduce the regional homogenization of competition, etc.

The risk resolution of small and medium-sized banking financial institutions has continued to adhere to the category-specific approach, and have developed and implemented various programs based on the specific conditions of each province and bank/company. For village banks and rural commercial banks, which are the key focus of regulators, there were those dissolved by absorption and merger by large banks, including: Huaxia Bank(华夏银行)'s acquisition of Beijing Daxing Huaxia Village Bank(北京大兴华夏村镇银行), Harbin Bank(哈尔滨银行)'s merger of Yanshou Rongxing Village Bank(延寿融兴村镇银行) and Bayan Rongxing Village Bank(巴彦融兴村镇银行); and there have also been absorptions and mergers among village banks and rural commercial banks, such as absorption and merger of (i) Gaocheng Hengsheng Village Bank(藁城恒升村镇银行) and Jinzhou Hengsheng Village Bank(晋州恒升村镇银行) by Shijiazhuang Xinhua Hengsheng Village Bank(石家庄新华恒升村镇银行) and (ii) Sichuan Guanghan Rural Commercial Bank(四川广汉农商银行), Sichuan Shifang Rural Commercial Bank(四川什邡农商银行), Sichuan Mianzhu Rural Commercial Bank(四川绵竹农商银行) and Sichuan Zhongjiang Rural Commercial Bank(四川中江农商银行) by Deyang Rural Commercial Bank(德阳农商银行). In addition, there are consolidations and mergers. Aksu Tarim Rural Commercial Bank(阿克苏塔里木农商银行) was established by the merger and acquisitions of five rural commercial banks and three rural credit

cooperatives in the Aksu region.

Besides that, significantly broadening the capital replenishment channels for small and medium-sized banks is also an important tool for reform and risk mitigation. As an exogenous capital replenishment tool, the pace of the issuance of special bonds by local government for small and medium-sized banks in 2023 has significantly accelerated.

06 Regulation undergoes digital transformation to improve management quality and efficiency

Alongside the digitalization of the financial sector, regulators have increasingly used digitalization as a way to be more efficient in how they regulate the sector. This is what is called "regulatory digitalization". Following the PBOC's proposal in 2022 to "accelerate the all-round application of regulatory technology and strengthen the construction of digital regulatory capacity", the CBIRC proposed to enhance the level of regulatory digitization and intelligence in its 2023 working conference, making regulatory digitization an inevitable trend. . In 2023, the NFRA issued the *Notice on the EAST Data Quality "Enhancement Project"*, and also issued special notices for local small and medium-sized banks and finance companies of enterprise groups. This was the first time that the NFRA has carried out such an enhancement project, following a series of efforts over the past few years. In addition, the *Measure for the Administration of Banking and Insurance Regulatory Statistics* implemented in February 2023 also requires the establishment of an information system to make sure that businesses have the necessary statistics for regulatory purposes and improve the level of digitalization. It is evident that regulators are focusing on improving the quality of regulatory statistics and technical support to drive the quality and effectiveness of banking regulation and governance to a higher level.

In addition, regulatory digitalization also improves administration and better serves the market. In March, the Ministry of Natural Resources, together with the CBIRC, issued the *Notice on Collaboration in the Service of "Transfer of Ownership of a Mortgaged Property" for Bringing Convenience to the People and Benefiting Enterprises* to implement the "transfer of ownership of a mortgaged property" which was explicitly stipulated in the PRC Civil Code. This involved online and efficient handling of the "transfer of ownership of a mortgaged property" through the "headquarter-to-headquarter" connection of business and system among administrative institutions, direct connection of the system or "real estate registration via internet", comprehensive application

of electronic real estate registration certificates and other means, all with the goal of making real estate mortgages easier to secure. In addition, the *Notice on Improving the Level of Digital Services of Banks in Handling Capital Account Business* promoted the digital services of capital account business nationwide on the basis of the previous pilot project, which explicitly supported banks to handle the capital account business by means of reviewing the electronic documents and included the foreign exchange and cross-border RMB business of capital account that banks have the authorization to handle directly offline in the scope of the digital services, which also greatly improved the efficiency of handling foreign exchange business of banks. It is evident that regulatory digitization also plays an important role in improving the efficiency of specific business.

07 Financial support for technology companies becoming increasingly critical, leading to some innovative approaches

In terms of strengthening financial support for technology, the banking industry has made a number of useful attempts in 2023. Despite the gap between credit assessment and business logic of traditional financing and the "three highs and one light" (i.e. high-tech, high-risk, high-growth and light-asset) characteristics of tech companies, the market was still full of innovative approaches to bridge the gap. For example, in March, China Everbright Bank provided a RMB10 million loan to Shenzhen Weiyang Technology Co., Ltd (深圳微言科技有限责任公司), which is the first unpledged loan with credit enhancement of data asset in China. In December, the Shenzhen branch of the PBOC led a number of banks to participate in its pioneering "Takeoff Loan" (腾飞贷) to support tech companies through a unique product design that is different from the traditional way.

Practical innovations in systems and mechanics are also worthy of attention. First of all, in response to the difficulty in valuing intellectual property financing, the China National Intellectual Property Administration (CNIPA), the PBOC and the NFRA have jointly formulated the *Patent Evaluation Guidelines*, which provide guidance on the evaluation of patent pledges (such as the matters that should be paid attention to in constructing the value analysis and evaluation index system). In August, they also provided guidance to the China Construction Bank to carry out an internal pilot project and assessed the Guidelines' practical effects. Previously, there were only few rules or guidelines issued by the CNIPA or industry associations, basic rules were formulated at an early stage and there was little participation by financial regulators. With the rapid growth of IP-related financing, if the Guidelines can

serve as a bridge between the financing sector and the patent valuation sector, it will not only facilitate the support of the financial sector for tech companies, but also generate more business opportunities for banking institutions.

Secondly, when it comes to making it easier for tech companies to secure finance, in addition to the convenience mechanics introduced by the new revision of the loan supervision rules, the National Development and Reform Commission initiated a pilot cooperation mechanic of "linking" investment and loan provision with a number of banks, i.e., financing support to companies through the combination of equity investment and loan provision. This mechanic aims to achieve interconnection and sharing via the investment online platform and the credit system of the banks and enhance the financing support of banks to companies through the way of combining equity investment and loan provision.. Shenzhen also issued the *Guidelines on Promoting the Construction of Science and Technology Sub-branches of Banking Financial Institutions in Shenzhen*, encouraging banking institutions to set up science and technology sub-branches specializing in technology finance, and appropriately decentralizing the business authorization of credit approval, interest rate pricing, etc., and giving internal policy support in credit resources and performance evaluation, in order to encourage banks to provide credit to tech companies. These steps reflect the determination of authorities to make significant efforts in the area of "technology finance". Whether or not these steps can effectively solve the problem of financing difficulties of tech companies remains to be seen.

in 2023, with the fines amounting to RMB28.75 million in total. The penalties are mainly related to non-compliance with the proportion requirement for assets invested by wealth management products and failure to disclose the requisite information. Fines have also been imposed on those failing to conduct proper risk management of the underlying asset.

Regulators continue to promote the "dual penalty system" to punish both institutions and personnel. The number of fines with penalties involving individuals is on the rise compared with 2022. For every fine imposed on institutions issued by the regulator, there is a probability of more than 70% involving individuals. Penalties for individuals were still mostly warnings and fines, but more than a hundred people have been prohibited from practicing or managing in the banking sector, including those at the level of president, vice-president or other senior management roles. Some people have been banned for life from engaging in the banking sector for life. At the end of 2023, a number of payment institutions were penalized. For example, one payment institution received a fine with an amount of nearly RMB90 million, with those deemed responsible for illegal decisions being subjected to punishments, including the general manager, vice president, etc.. With the *Regulation on the Supervision and Administration of Non-Banking Payment Institutions* officially due to be implemented in May 2024, we can expect even greater supervision of payment institutions.

08

Strong supervision remains a key feature, and importance of "double penalties"

Overall, in 2023 the approach of "strict supervision and strong punishment" has continued. The overall number of fines and the total amount of fines increased compared to 2022, with over-ten-million-yuan fines occurring more frequently and a number of over-billion-yuan fines appearing. Among them, a Chinese bank was fined more than RMB200 million, and there were cases of a foreign-invested bank being fined nearly RMB50 million. Administrative penalties have focused on credit businesses (e.g., flow of credit funds), corporate governance (e.g., related party transactions, equity management) and internal control compliance (e.g., employee behavior management). In addition, since regulators issued the first batch of fines for wealth management companies in 2022, with the end of the transition period of the *Measures for the Administration of the Internal Control of Wealth Management Companies* in February 2023, five more wealth management subsidiaries were penalized

2024 Regulatory Outlook

01 Access threshold for institutions to be raised and financial regulation with "teeth and thorns" to continue

In 2023, the NFRA finalized the Three Determination Plan, adding the Financial Institution Authorization Department, the Investigation Bureau, and the Administrative Penalty Bureau to its internal structure. Setting up the Financial Institution Authorization Department separately means that the standards and requirements covering access of institutions and personnel will be more uniform and stricter in the future, including access management of institutions and their licensed business scope, as well as the qualifications of director and senior management personnel. The Investigation Bureau will be responsible for the investigation of illegal financial activities, and the new Administrative Penalty Bureau will realize the "separation of investigation and punishment" in terms of supervisory structure, which will implement the "teeth and thorns" of financial supervision. The year 2024 is expected to see an increase in both the number of cases that are investigated and punishment of violations and the number of severe punishment cases. The collaboration with the Ministry of Public Security and the Supreme People's Procuratorate in handling cases will also be strengthened. Meanwhile, the *Implementation Measures of Discretionary Administrative Penalties* is expected to be formally introduced in 2024, the standards for penalizing violations of laws and regulations in the banking sector will be unified, and administrative penalties will be further strengthened.

02 The "Unified Consumer Protection" system to be accelerated and sales and marketing rules to be optimized

In the 2023 institutional reform, the NFRA was established on the basis of the CBIRC, and the NFRA is responsible for consumer protection in the financial sector. Li Yunze, the president of NFRA, said that the next step of consumer protection work includes: accelerating the set-up of "unified consumer protection", focusing on management of consumer appropriateness by clearing distribution channels and implementing graded processing, as well as resolving outstanding issues by addressing both the symptoms and root causes. At the same time, the "three appropriateness" requirements for financial products, sales channels, and the target clients have also been put forward. It is expected that regulators will formulate separate rules relating to consumer appropriateness for banking institutions, marketing regulation (including online business), and information disclosure to customers. In addition, given that the recent revised rules for specific types of institutions (e.g., the New

AFC Rules, the CFC Consultation Paper, etc.) have added a special chapter on consumer protection, the regulation of consumer protection for related institutions will also be strengthened in practice. Added to this, we can also expect more regulatory focus on credit card complaints, early repayment of personal housing loans and other issues that have given rise to frequent complaints by consumers.

03 Policy guidance for banks in different sectors according to their size

Given that the Central Financial Work Conference has clearly put forward to improve the positioning of institutions, support the development of large state-owned financial institutions to serve as the main force for serving the real economy and the ballast stone for maintaining financial stability, and impose strict access standards and regulatory requirements on small and medium-sized financial institutions to carry out a more focused operation on the basis of local areas. In the future, banking institutions may develop in different types and directions according to the principle of "sticking to the position and returning to the origin". It is expected that in 2024 regulators will introduce more policies to encourage large banks to actively invest in real estate bailouts and other areas, and relevant rules and window guidance may be launched simultaneously. Large banks will also be actively engaged in making significant efforts in areas of "technology finance, green finance, inclusive finance, pension finance and digital finance", in particular, to increase their credit investment in related areas, for which the PBOC may launch preferential policies. As for small and medium-sized banks, on the one hand, they will continue to implement the requirements for risk resolution. On the other hand, institutions with good operations will adopt a development strategy different from the previous nation-wide expansion, mainly focusing on local services, micro and small-sized enterprises, inclusive finance, and increasing the credit granting for rural revitalization.

04 Campaign of anti-money laundering ("AML") drawing to a close, and AML law amendments expected to be introduced

The year 2024 is the final year of the three-year action plan (2022-2024) to combat money laundering and illegal crimes. China is also expected to undergo the fifth round of mutual evaluation by the Financial Action Task Force (FATF), and the regulation of AML and counter-terrorism financing may be accelerated in terms of

legislation, judiciary and financial supervision. It is expected that "strict regulation and strong punishment" will still be the main thrust of promoting AML work in 2024. More progress is expected in such aspects as revision of the *Anti-Money Laundering Law* and the applicable judicial interpretations, improvement of AML data statistical capture and data information sharing. The *Anti-Money Laundering Law (Consultation Paper)* and the *Interim Measures for the Management of Information on Beneficial Owner of Market Entity (Consultation Paper)*, which were issued in 2021, are expected to be formally introduced in 2024. These measures are likely to cover non-financial institutions in AML regulation, address the beneficial owner rules, and prevent the laundering of virtual assets. In addition, a number of other regulatory measures on AML are also expected to be introduced.

05 Financial supervision should achieve full national coverage and local financial institutions will be subject to greater supervision

With the implementation of the NFRA's Three Determination Plan, the scope of regulation of local financial organizations should eliminate regulatory gaps. The plan makes it clear that local financial organizations (which are mainly under the supervision of local government) such as microcredit companies, financing guarantee companies, pawn shops, unregulated financial leasing companies, commercial factoring companies, and local asset management companies shall be brought under the supervision and administration of the Bureau for Combating Illegal Financial Activities. The regulators deal with both "violation with a license" and "violation without a license". In addition to formulating a regulatory system for applicable local financial organizations, the Bureau for Combating Illegal Financial Activities will also collaborate with local financial regulators, and it is expected that the crackdown on illegal financial activities of local financial organizations will be strengthened.

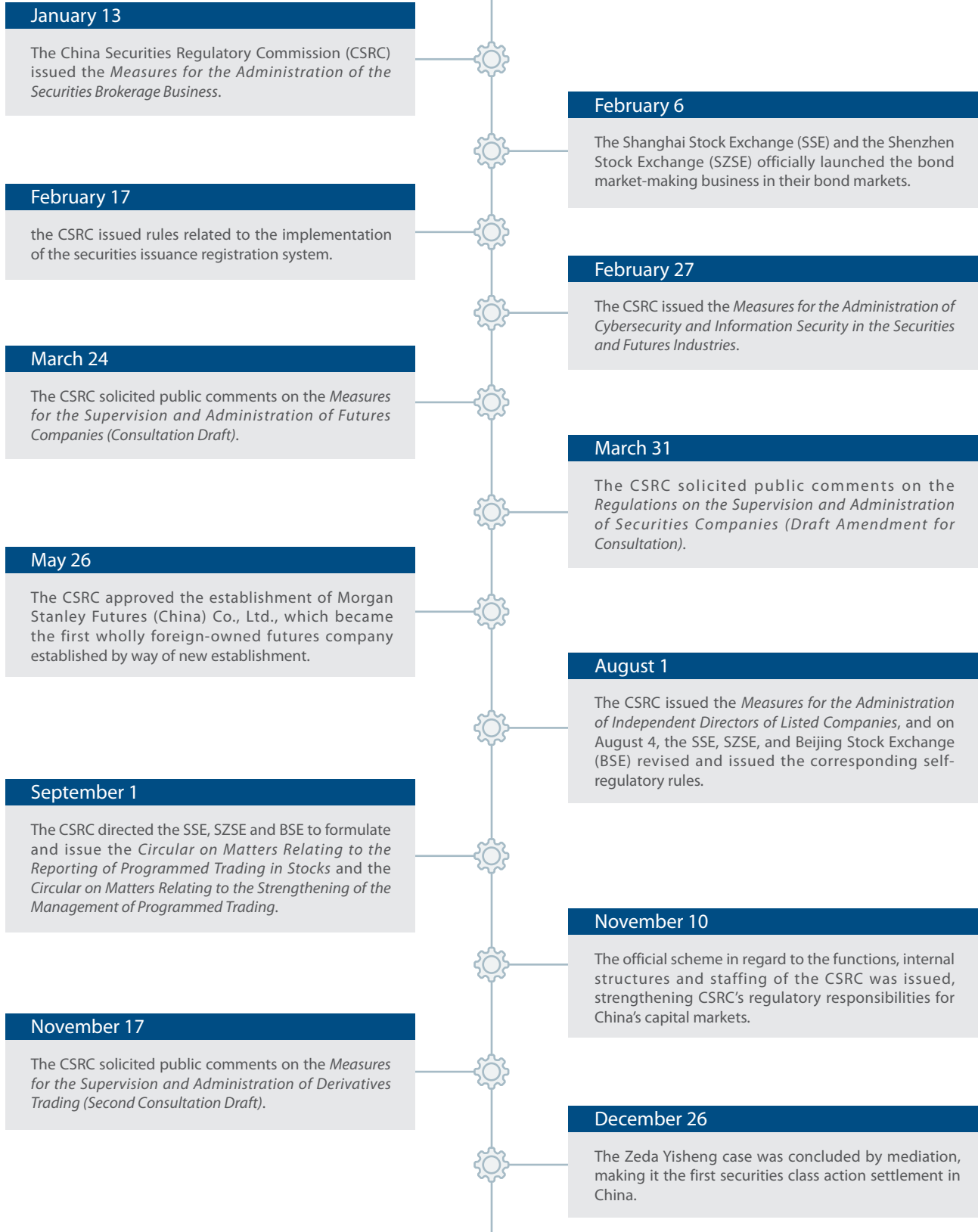
Now that the Three Determination Plan had been finalized, this may accelerate the official release of the *Regulation on Local Financial Supervision and Administration*. The *Regulation on Local Financial Supervision and Administration (Consultation Paper)*, which was included in the State Council's 2023 legislative work plan. Once formally released and put into effect, there should be national-level legislative supervision of local financial organizations (including emphasis of licensed operation and no cross-provincial business, clarification of the positioning of local financial organizations and the acceleration of the cleanup of non-compliance) with the intended consequence of sustainable development of local financial organizations.



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Securities and Futures

2023 Regulatory Milestones



2023 Regulatory Mainline Review

01 Reform of the financial regulatory system, with a clear signal to focus on the development of capital markets

In March 2023, the *Plan for the Reform of Party and State Institutions* was issued, proposing the establishment of the National Financial Regulatory Administration (NFRA) based on the former China Banking and Insurance Regulatory Commission (CBIRC), which was responsible for the supervision of the financial services sector, with the exception of the securities sector. The former CBIRC was no longer retained, and the People's Bank of China's daily regulatory responsibilities for financial holding companies and other financial groups, financial consumer protection responsibilities, and the investor protection responsibilities of the CSRC were transferred to the NFRA. In addition, the CSRC was restructured from being a public institution directly affiliated with the State Council to becoming a government agency directly under the State Council. Moreover, the responsibility for approval of corporate bond issuance originally undertaken by the National Development and Reform Commission (NDRC) was transferred to the CSRC. Despite the replacement of the former CBIRC, the CSRC retained its position and gained an upgraded status, reflecting the importance attached to the regulation of securities and development of the capital markets through top-level regulation.

02 Full implementation of the securities issuance registration system, with corresponding improvements in the supporting regulations

Following the success of the pilot system of registration in the Sci-Tech Innovation Board, Growth Enterprise Market, and Beijing Stock Exchange, on February 17, 2023, the CSRC issued rules for the "comprehensive" implementation of the registration system. Simultaneously, various securities exchanges, including the National Equities Exchange and Quotations Co., Ltd., China Securities Depository and Clearing Corporation Limited, China Securities Industry Association, and other institutions, released supporting implementation rules. This marks the expansion of the system of registration to the entire market and all types of public securities offerings (including stocks, convertible corporate bonds and depository receipts), representing a milestone in the development of China's capital markets.

Under the registration system, the issuance conditions under the previous system (which was based on approvals) will be transformed into disclosure requirements, as much as possible. Additionally, the regulator and exchanges will monitor the quality

of information disclosure and enforce the chief responsibility of issuers for information disclosure and the gatekeeper responsibility of intermediary institutions through on-site supervision and inspections. The division of responsibilities and operations for exchanges review and CSRC registration have been unified and better coordinated. The exchanges will conduct comprehensive reviews of whether or not corporates meet the required issuance conditions, listing conditions, and disclosure requirements, while the CSRC will be tasked with ensuring compliance with national industrial policies and sector positioning simultaneously and will carry out registration procedures based on exchanges review opinions. The full implementation of the new registration system will enable corporates with development potential and excellent fundamentals to be able to list more effectively and efficiently.

Following the implementation of the registration system, the CSRC also improved the relevant rules. For example, on November 10, the CSRC solicited public comments on the revision of the *Provisions on On-Site Inspection of Issuers for Initial Public Offering* and the *Regulations on Supervision and Guidance of Initial Public Offering and Listing of Stocks*, aiming to establish on-site inspection and listing guidance supervision mechanism suitable for the registration system. Additionally, on December 22, the CSRC revised and issued two financial information disclosure rules to enhance the effectiveness of financial information disclosure rules in the capital market. The Optimization of relevant supporting regulations will further ensure the smooth progress of registration system reform.

On April 10, 2023, the first batch of 10 companies was listed on the Shanghai and Shenzhen Stock Exchanges' main boards under the new registration system, marking the comprehensive implementation of stock issuance registration system. Around 290 companies were listed under the registration system in 2023, accounting for over 90% of the total number of IPOs for the year.

03 Revision and promulgation of multiple rules to implement the *Futures and Derivatives Law*, and the futures sector continues to open up

In 2022, the promulgation of the *Futures and Derivatives Law* laid the overall regulatory framework for the futures and derivatives markets. To implement this foundational law, in 2023, multiple futures and derivatives related rules were introduced or revised.

In March, the CSRC solicited public comments on the *Supervision and Administration of Derivative Trading* and the *Supervision and Administration of Futures Companies*. Additionally, the revised *Measures for the Administration of Futures Exchanges* were formally

promulgated to reflect and elaborate on the contents of the *Futures and Derivatives Law*. It is worth mentioning that the *Measures for the Supervision and Management of Futures Companies (Consultation Draft)* underwent significant revisions, particularly expanding the scope of futures companies' business. Subject to certain qualification requirements, futures companies are allowed to engage in futures market making and derivatives trading, which were originally within the business scope of risk management subsidiary of the futures company. This should bring new opportunities for leading futures companies to further expand and strengthen their businesses.

In November, the CSRC solicited public comments on the revision of the *Measures for the Supervision and Management of Derivative Trading (Second Consultation Draft)*. Compared to the first draft published in March 2023, this second Consultation draft adjusted the scope of derivatives trading institutions, reports on derivatives contract development, and supervision of overseas/cross-border derivatives transactions. However, for certain issues that sparked market discussion, such as the consolidation of positions of exchanges and OTC market and prohibited trading activities, the CSRC maintained a strict attitude consistent with the first draft, reflecting its cautious approach to strengthening regulation in the derivatives market, addressing regulatory gaps, and its determination to combat illegal activities and prevent risks in the derivatives field.

In addition, the CSRC and the China Futures Association (CFA) have also established and improved applicable rules regarding the management of futures practitioners, the opening of accounts for futures companies, and the management of futures market positions. For example, the *Interim Provisions on Futures Market Position Management* issued on July 31, 2023 stipulate regulations on position limits and exemptions, hedging, reporting of large positions, and position aggregation, filling the gap in position management requirements at the departmental regulation level.

Further to rule revisions and updates, in 2023, various securities and futures exchanges also introduced many new futures and options products. For instance, in June, two exchange-listed options contracts based on the Sci-Tech 50 Index – Huaxia Sci-Tech 50 ETF Options and E Fund Sci-Tech 50 ETF Options – were listed on the Shanghai Stock Exchange, with the combined scale of the two ETF products exceeding RMB 87 billion. In July, lithium carbonate futures and options were listed on the Guangzhou Futures Exchange, becoming the second largest listed product after industrial silicon futures and options.

Meanwhile, the opening-up of the futures sector continued. In January and August 2023, a total of nine futures and options contracts from the Zhengzhou Commodity Exchange and the

Shanghai International Energy Exchange were designated as specific domestic products, allowing the participation of overseas traders in trading. Additionally, on November 24, 2023, the Hong Kong Securities and Futures Commission (SFC) and the Hong Kong Stock Exchange (HKEx) simultaneously announced plans to launch treasury futures contracts in Hong Kong, offering additional risk management tools for overseas investors and generally enhancing the ecosystem of offshore renminbi products.

04 Improvement of securities firms-related regulatory rules, involving multiple business and internal control compliance aspects

In 2023, the CSRC and the Securities Association of China (SAC) issued and revised multiple regulatory rules related to securities firms, covering supervision and administration of securities firms, business rules, internal control compliance, and other aspects.

Specifically, on March 31, the CSRC solicited public comments on the *Regulations on the Supervision and Management of Securities Firms (Revised Draft for Consultation)* to further implement the requirements of the new Securities Law enacted in 2019. Adjustments or supplements were made in the corporate governance, compliance risk control, and business rules of securities firms.

At the level of business rules, the CSRC issued the *Measures for the Administration of Securities Brokerage Business* in January 2023, which clarified the scope of brokerage business, optimized business processes, and strengthened client behavior management and rights protection. The SAC subsequently released related detailed business rules. In February, the CSRC put into place corrective measures for illegal cross-border business by domestic securities firms' overseas subsidiaries, prohibiting overseas institutions without domestic licenses from opening accounts for new domestic investors and requiring them to resolve existing domestic clients in an orderly manner. Regarding the bond business, in July and October 2023, the SAC issued several rules, involving underwriting, entrusted management, handling of bond default risks, and quality evaluation of bond businesses. In October 2023, the CSRC made adjustments to margin trading and the Shanghai Stock Exchange and Shenzhen Stock Exchange issued notices regarding margin trading and securities lending trading arrangements. Securities firms were required to establish sound mechanisms for margin trading securities sourcing, penetration verification, and access control, and strengthen management of margin trading transactions. Most securities firms had implemented these requirements by the end of 2023.

In terms of internal control and compliance rules, the SAC issued multiple related rules in 2023, such as the *Guidelines for Internal Auditing of Securities Firms*, *Guidelines for Stress Testing of Securities Firms*, *Guidelines for Operational Risk Management of Securities Firms*, and norms related to employees' integrity and professional conduct. On November 3, 2023, the CSRC solicited public opinions on the *Regulations on Calculation Standards for Risk Control Indicators of Securities Firms*, whose aim was to improve the risk control indicator calculation standards adopted by securities firms for market making, asset management, participation in public real estate investment trusts (REITs), while strengthening classified supervision, supporting compliant and stable high-quality securities firms to improve capital utilization and providing more leverage space for leading securities firms.

05 Improvement of information technology-related rules in the securities and futures sector, and introduction of regulatory measures for algorithmic trading

In recent years, securities and futures companies have resorted to using an increasing number of technological tools and. That has led to a number of regulations and rules being introduced to cover how these tools are used in securities and futures businesses in 2023.

In March 2023, the CSRC issued the *Measures for the Administration of Cybersecurity and Information Security in the Securities and Futures Industries*, which covers various entities such as infrastructure operators, operating institutions, and information technology system service providers in the securities and futures field, proposing more comprehensive regulatory requirements for cybersecurity, personal information protection, and other issues. In June, applicable industry associations issued a three-year improvement plan for the cyber and information security of securities firms, futures companies, and fund management companies, further refining the work objectives and requirements of relevant institutions. Meanwhile, in April, the CSRC solicited public comments on the *Administrative Provisions on Trading Server Colocation for the Securities and Futures Markets (Consultation Draft)*, aiming to regulate the provision of trading server colocation services by securities and futures exchanges and the leasing of related colocation services by securities and futures operating institutions. Furthermore, the CSRC released a series of financial industry standards related to information technology in the securities and futures industry in 2023, continuously improving the informatization construction of the securities and futures field.

Another major regulatory measure that attracted market attention in 2023 was the introduction of rules related to algorithmic trading

by the Shanghai, Shenzhen, and Beijing stock exchanges. On September 1, 2023, the three exchanges simultaneously issued notices regarding matters related to the reporting of algorithmic trading in stocks and strengthened management of algorithmic trading. Building upon the existing system for reporting algorithmic trading in convertible bonds, the exchanges officially established a reporting system for algorithmic trading in the stock market and stipulated that the requirements for algorithmic trading would also apply to funds and depositary receipt trading conducted on the exchanges. In addition to specifying reporting requirements for investors, the notices also emphasized strengthening monitoring of abnormal and high-frequency trading and required securities firms to fulfill their responsibilities in managing algorithmic trading. The introduction of these exchange-related rules is conducive to guiding the standardized development of algorithmic trading, assisting regulatory authorities in clarifying the situations of quantitative trading in the domestic market and lay the groundwork for subsequent regulation or reform.

06 Rules for overseas listing of domestic enterprises fall into place, unified implementation of filing requirements

On February 17, 2023, the CSRC issued rules covering the management of overseas listings, including the *Trial Measures for Administration of the Issuance and Overseas Listing of Securities by Domestic Enterprises*, and five supporting guidelines. The rules and regulations refine the "negative list" - situations where overseas issuance and listing are not allowed according to the principle of "minimum and necessary", do not set additional thresholds and conditions for overseas listings, as well as specifying the requirements of the overseas listing filing process. Such measures bring together in one place the filing management process for both direct and indirect overseas listings by enterprises and also require overseas securities firms acting as sponsors or lead underwriters for domestic enterprises' overseas issuance and listing businesses to fulfill filing obligations to the CSRC. These changes to the overseas listing regulatory system emphasize the combination of delegation and regulation and are intended to make it more efficient for domestic enterprises to secure overseas financing.

On the same day, the CSRC signed a memorandum of regulatory cooperation with the SFC on matters related to overseas listings, clarifying the regulatory cooperation arrangements and procedures in areas such as issuance and listing, cross-border law enforcement cooperation, intermediary supervision, and information exchange. This was intended to strengthen regulatory cooperation on matters related to mainland Chinese enterprises listing in Hong Kong.

In addition, to provide clearer guidance for the confidentiality and archive management of enterprise overseas listing activities and improve related cross-border regulatory cooperation arrangements, the CSRC, together with applicable departments, revised and issued the *Provisions on Strengthening the Confidentiality and Archive Management of Domestic Enterprises' Overseas Issuance of Securities and Listing* on February 24.

As of December 31, 2023, 81 companies received notice that they needed to file for overseas listing filings (including filings for overseas issuance and listing and filings for "full circulation" of unlisted shares domestically), while 87 enterprises were in the process of filing. Additionally, as of December 31, 2023, 185 overseas securities firms engaged in domestic enterprises' overseas issuance and listing businesses had completed their filings with the CSRC.

07 Major changes in regulations of bonds and multiple institutional reforms including bond registration

In 2023, significant changes were made to China's bond regulatory system, and the regulators introduced many policies to promote the development, unification and standardization of the bond market. Based on the reform of the financial regulatory system by the State Council, bond market regulation tended to be unified. In addition to the supervision of the interbank bond market retained by the People's Bank of China, corporate bonds fell under the supervision of the CSRC. The transition period for corporate bonds was completed on October 20, 2023. On the same day, the CSRC clarified the arrangements for accepting and reviewing corporate bond registration, custody, risk prevention and control, and issued revised rules related to the issuance and trading of corporate bonds, incorporating corporate bonds into the regulatory scope, and establishing a unified regulatory system for corporate bond regulation rules.

Another significant change in the bond market in 2023 was the refinement of the system of bond registration. On June 21, the CSRC issued the *Guiding Opinions on Deepening the Reform of the Bond Registration System* and the *Guiding Opinions on Improving the Practice Quality of Bond Business of Intermediary Institutions under the Registration System*. These were intended to optimize the bond review and registration process, strengthen the management of bonds during the issuance period, make clear the responsibilities of issuers and intermediary institutions, and improve the quality of intermediary institutions. At the same time, efforts were made to increase the crackdown on serious violators of laws and regulations in the bond market.

Furthermore, to promote the high-quality development of the bond market and enhance market vitality, the Shanghai Stock Exchange and Shenzhen Stock Exchange officially launched bond market-making services on February 3, 2023. By the end of 2023, a total of 15 institutions had become market makers on the Shanghai Stock Exchange's bond market, with 14 of them also providing market-making services for the Shenzhen Stock Exchange's bond market.

In addition to these changes, many new regulations targeting specific enterprises or specific areas of bonds were introduced in 2023. In April, the CSRC issued the *Action Plan for Promoting the High-Quality Development of Bonds for Technology Innovation Companies*, making it easier for high-tech companies to access the bond market; in December, the CSRC and the State-owned Assets Supervision and Administration Commission (SASAC) jointly issued the *Notice on Supporting Central Enterprises to Issue Green Bonds*, with the aim of facilitating finance support for the issuance of green bonds and to encourage central enterprises to invest in green projects.

08 Strict crackdown on illegal activities in the securities field and maintaining a high-pressure enforcement posture

In 2023, the crackdown on illegal activities in the securities field continued to maintain a high-pressure posture, and significant progress was made in several cases of false statements, fraudulent issuance, and related investor lawsuits and claims.

In 2023, the CSRC remained focused on the compliance of securities firms' investment banking business. On September 6, the CSRC issued 13 fines in one go, taking regulatory steps against 6 securities firms and 13 executives for violations of laws and regulations related to investment banking. On December 8, 2023, the Ministry of Public Security, in conjunction with the CSRC, cracked down on multiple major cases of insider trading and market manipulation, arresting more than 50 people in cases involving more than RMB9 billion.

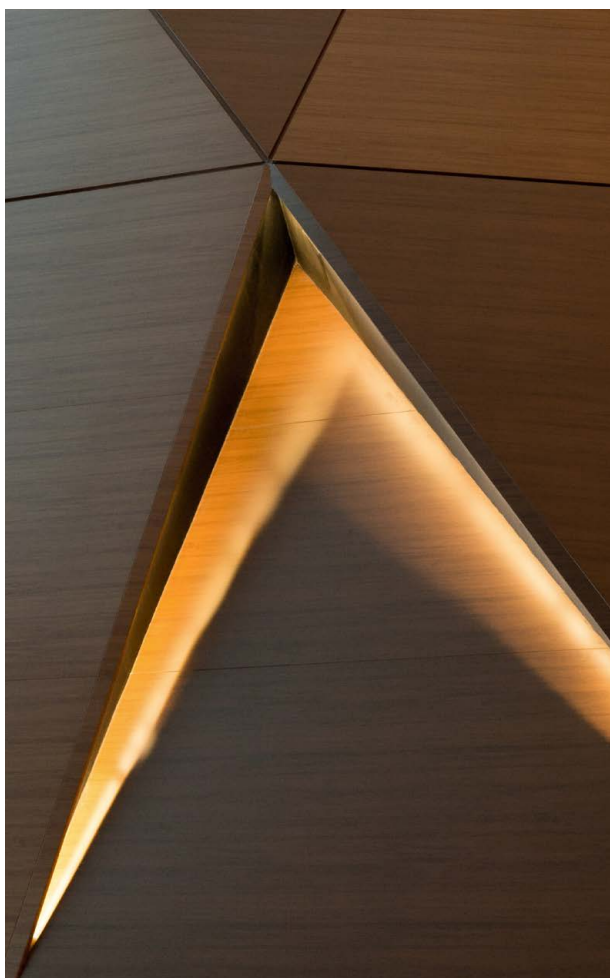
Regarding major cases of false statements and fraudulent issuance related to securities, on July 28, after the Zeda Yisheng Securities false statement liability dispute officially became the second special representative litigation case in China after the Kangmei Pharmaceutical case, the case was settled through mediation on December 26, with the China Securities Investor Service Center representing 7,195 eligible investors receiving full compensation of over 280 million yuan, making it the first case of collective securities litigation and settlement in China, with demonstration significance. On December 29, based on the administrative law enforcement

2024 Regulatory Outlook

01 Continuing to expand the opening up of the securities and futures market to international participants

commitment system stipulated in the Securities Law, the CSRC signed commitment recognition agreements with intermediary institutions involved in illegal and irregular activities under the Zijin Storage case, with four intermediary institutions fulfilling commitments such as paying commitment fees and self-inspection and rectification. Under such a system, if the parties involved make corresponding commitments during the investigation, the CSRC can suspend the investigation, and if the parties fulfill their commitments, the CSRC can terminate the investigation. This system ensured efficient and maximum protection of investor interests in the Zijin Storage case, while ensuring that the parties involved were duly punished, which is of great significance for quickly restoring market order.

So far as cross-border law enforcement is concerned, the CSRC held two law enforcement cooperation work meetings with the SFC in 2023, exchanging work priorities and progress in major case handling, which helps further improve the cross-border law enforcement cooperation mechanism between the two places.



China made some progress in opening up the securities and futures markets in 2023. We expect that in 2024 China will continue to open up its securities and futures markets.

In 2023, the CSRC approved the establishment of some foreign-funded securities companies and foreign-funded futures companies such as Standard Chartered Securities (China) Co., Ltd. and Morgan Stanley Futures (China) Co., Ltd. There are a number of foreign-funded securities or futures institutions in the process of applying to set up in China, and it is expected that more foreign-funded securities or futures institutions will get approval to carry out business in China in 2024. In addition, China is also continuing to put in place supporting measures to facilitate foreign institutions to expand their business in China. Among these measures are recognition of overseas financial professional qualifications in the securities, futures and funds sectors, and facilitating the employment of qualified professionals from abroad in China.

So far as cross-border trading is concerned, it is expected that the interconnection mechanism between Mainland and Hong Kong Stock Markets (the "**Interconnection Mechanism**") will expand in 2024. In August 2023, the CSRC and the SFC reached a consensus to accelerate the inclusion of block trading (non-automated counter trading) in the Interconnection Mechanism, and the supporting rules are expected to formally come into effect in 2024. The intention is that the inclusion of block trades in the Interconnection Mechanism will make for greater trading convenience and help to promote the capital markets in both markets. As at the end of 2023, China's futures market had 24 specific products open to foreign traders for trading, and 46 commodities, stock index futures and options products were open to QFIIs and RQFIIs for trading, of which the proportion of primary products had reached 96% and 70% respectively. It is expected that in 2024, the varieties of futures open to foreign traders as well as the varieties of futures and options products open to QFIIs and RQFIIs, will continue to expand, thus attracting more foreign institutions to participate in the pricing of China's primary product futures, enhancing the representativeness and influence of China's futures prices, and providing more accurate price signals for industrial enterprises.

Meanwhile, the *Provisions on the Administration of Domestic Securities and Futures Investment Funds of Foreign Institutional Investors (Consultation Draft)* issued in November 2023 abolished the administrative approval requirements for QFII and RQFII to register their funds with the State Administration of Foreign Exchange (SAFE),

and further simplified the exchange administration requirements. The formal implementation of this regulation should encourage foreign institutional investors to carry out securities and futures investments in China.

So far as cross-border listing is concerned, in June 2023 one official of the SFC delivered a keynote speech entitled *Reconnecting with the Mainland Market*, in which, apart from mentioning the aforementioned deepening of the Interconnection Mechanism, the official mentioned that SFC would establish flexible regulatory approaches to accommodate more mainland companies listing in Hong Kong and thereby assist China's economic restructuring. At the same time one CSRC official also mentioned in a media interview in the middle of 2023 that further practical measures would be adopted to support the development of the Hong Kong market and to co-ordinate the enhancement of the activity of A-shares and Hong Kong stocks. He also called for the support of dual listing of US-listed shares in Hong Kong. In recent years, through new initiatives such as the different voting rights structure, the return of US-listed Chinese companies, and the listing measures for biotechnology companies, the Hong Kong securities market has absorbed many mainland enterprises to list in Hong Kong. It is expected that by 2024, the Mainland and Hong Kong securities markets will have further close ties in cross-border listing.

In addition, in order to attract more foreign investment as well as international cooperation, we will need to look out for regulatory adjustment allowing for integrated group operation and cross-border data transfer while the risk is controllable, which has given rise to concern among international investors.

02 Improving bond market rules and promoting the functioning of the exchange bond market

The bond market has introduced a number of new rules and deepened the reform regarding the bond registration system in 2023. It is expected that the CSRC will introduce more measures to stabilize expectations and confidence and stimulate bond market activities in 2024, including strengthening the investment side regulations of the bond market, giving permission to banking institutions to participate fully in the trading of the exchange bond market, further advancing the reform of the inquiry and quotation system, and granting more access to international participants of China's bond market.

In addition, we expect that in 2024, the authorities will further promote the exchange bond market to reduce the cost of financing,

smooth financing channels, optimize the financing structure and other functions, and raise the standards of the bond market to serve the real economy, so as to better serve the overall situation of the smooth operation of the economy through the bond market. In terms of specific bond categories, in regard of REITs, it is expected to have new categories of REITs including consumer infrastructure, to promote REITs market for high-quality expansion, and to press ahead the supply of high-quality REITs projects. The CSRC also revealed that it is studying the launch of REITs-related index and ETF products, as well as promoting the interconnection of the REITs market with the Hong Kong market. We await announcements on this score in the coming year. The main focus of real estate, urban investment related bond is expected to remain on risk resolution, prevention and control, supporting the reasonable financing needs of normally operating real estate enterprises while focusing on the steady resolution of the risk of bond defaults by large real estate enterprises and strengthening the monitoring and early warning of urban investment bond risks. Finally, we should expect emerging bond products including science and technology innovation bonds and green bonds that will further develop and have a positive effect on China's economy.

03 Possible further changes in the securities sector and the Matthew effect further intensified

On October 31, the Central Financial Work Conference called for the creation of first-class investment banks and investment institutions. The CSRC followed this up by calling for the top securities firms in China to enhance themselves through business innovation, group operation, mergers and acquisitions, etc., so as to build first-class investment banks, to help support the real economy and to act as the ballast for maintaining the financial stability.

According to the SAC, there are currently 146 securities companies in China. There is a lot of competition between brokerages. The Matthew effect is also more pronounced. If the top securities firms focus on business innovation, group operation and mergers and acquisitions, they can better fulfill resource allocation and further enhance the influence of China's local securities firms on the world stage. With the encouragement of policies, it cannot be ruled out that China's securities sector will be changed in 2024.

04 Stabilizing market confidence and enhancing investment attractiveness of listed companies

According to statistics, a total of 313 new companies were listed on the A-share IPO market in 2023, down by more than a quarter (26%) on 2022. More enterprises than 2022 withdrew their application to list. It can be seen that the pace of IPOs in the A-Share market is gradually slowing down, which could possibly be related to the CSRC's emphasis since the end of August 2023 on strengthening counter-cyclical regulation, phased tightening of IPO to ensure a good quality of company listing.

"Enhancing the investment attractiveness of listed companies and promoting the stable development of the capital market" is a constant theme that has been emphasized by the regulators. In September 2023, the CSRC convened three symposiums to analyze the situation of the capital markets, exchanging views on how best to invigorate China's capital markets and to boost investor confidence, as well as on the hotspot issues that are of concern to the market. According to an article in *China Securities Journal*, the CSRC has been in the early stage of brainstorming a number of initiatives around the invigoration of the capital market, the next step will be continuing to study and validate the policy initiatives have not yet been launched and to sweeten market expectations. Combined with the recent speech of the relevant official of the CSRC, it is expected that specific initiatives to be issued may include the establishment and improvement of the listing and financing of science and technology-based enterprises, more bond issuances, green channel for M&A and reorganization, the introduction of the capital market reform action plan of the investment side to increase the introduction of medium- and long-term funds, improving the listed companies dividends binding mechanism, amending the rules of the system of share repurchase to relax the relevant conditions for the repurchase, the introduction of rules on the restructuring of the directional convertible bond, improving the review mechanism for the micro restructuring of listed companies, enriching the payment and financing tools for restructuring, pushing forward the construction of a valuation system with Chinese characteristics, and reasonably grasping the pace of IPOs and refinancing.

We expect overall the CSRC and the stock exchanges to adopt a prudent attitude towards new IPO projects to address the imbalance between the supply and demand of the capital in the secondary market, and, on this basis, accelerate the implementation of relevant policy initiatives in order to boost investor confidence and invigorate the capital markets.

05 Ongoing regulatory transformation, with focus on regulatory responsibility and accountability

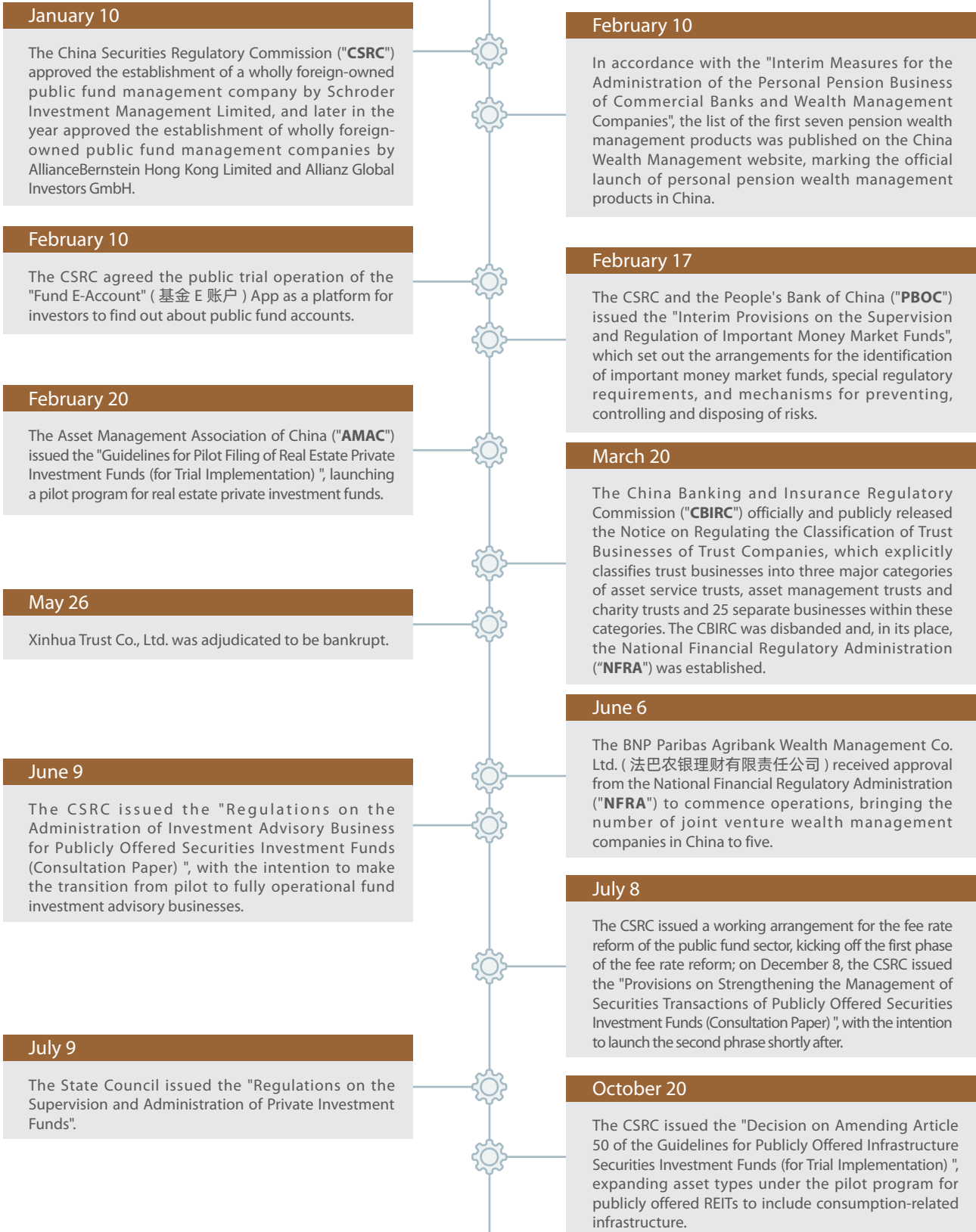
After the reform of the issuance registration system, it will continue to be a strong focus on the transformation of all-round supervision by the CSRC, including corporate supervision, institutional supervision, inspection and punishment, and scientific and technological supervision. Among them, in recent years, particular emphasis has been placed on cracking down on illegal activities in securities and futures market, strengthening the implementation of regulatory responsibility and accountability, and improving the regulatory system and mechanism for inspections and penalties. It is expected that these issues will continue to be an important topic in the regulatory transformation of the CSRC in 2024.

The relevant official of the CSRC said in a recent speech that the CSRC will strengthen its collaboration with the public security and judicial organs, continue to improve the capital market system and mechanism to prevent and combat fraud, promote the administrative, civil and criminal three-dimensional accountability system, increase the financial counterfeiting, fraudulent issuance, market manipulation and other violations, and penalize the intermediary institutions who fail to perform their duties. It is expected that in 2024, the CSRC will still adhere to the regulatory idea of "treating the root of the problem with seriousness" and crack down on violations in the securities and futures market.

PRC Financial Regulation:
Annual Report (2024)

Asset Management and Wealth Management

2023 Regulatory Milestones



2023 Regulatory Mainline Review

01 **New Asset and Wealth Management Institution Supervision Department established by NFRA for unified supervision of trust, wealth management and insurance asset management companies**

With the overall reshaping of the top-level framework for financial regulation, there was also put in place a dedicated regulatory structure for the trust, wealth management, and insurance asset management sectors. The "Provisions on the Functions, Structure, and Staffing of the National Financial Regulatory Administration", released in November 2023, made significant changes to how asset management businesses were regulated. This took the form of a new Department called "Asset and Wealth Management Institution Supervision Department" under NFRA, which took over some of the functions of the previous Trust Department, Insurance Fund Operation Department and Innovation Department under the then CBIRC, and brought the trust companies, bank wealth management and insurance asset management companies all under a unified regulatory framework.

On December 27, 2023, the Asset and Wealth Management Institution Supervision Department published an article, emphasizing the attributes of the role of asset and wealth management as "entrusted by people, managing wealth on behalf of people". The article further clarified the regulatory direction and determination to "enhance the effectiveness of supervision, build first-class asset management institutions, and improve the quality and efficiency of service to the real economy". In effect, the establishment of the Asset and Wealth Management Institution Supervision Department unifies the supervisory standards of the trust, wealth management and insurance asset management sectors. The objective was to eliminate the arbitrage space due to the inconsistency of supervisory standards and, by having a unified set of regulations, bring about healthy competition within the sectors. The Asset and Wealth Management Institution Supervision Department was also charged with strengthening risk control and improving the efficiency of regulation.

These measures should help protect the legitimate rights and interests of investors, maintain the stability of the financial market and promote the development of the real economy.

The impact of the Asset and Wealth Management Institution Supervision Department on the development of the trust, wealth management and insurance asset management sectors is without doubt significant. These changes will help promote a much more efficient, well-regulated and safer investment environment, as well as acting as a good platform for China's asset and wealth management sectors to flourish.

02 **An improved regulatory environment enabled the asset management sector to benefit the real economy**

The role of the asset management sector to serve the real economy was underscored during 2023.

Private Equity

At the State Council's regular policy briefing in July 2023, Zhang Qingsong, vice-governor of the PBOC, proposed an expansion of funding by venture capital funds into start-ups and small enterprises. The State Council's "Opinions on the Implementation of Promoting the High-quality Development of Inclusive Finance", issued in October 2023, went further than this, calling for the "raising, investing, managing and withdrawing" of private equity and venture capital funds to be made more efficient, and encouraging the investment in start-ups, small businesses, science and technology, and agricultural enterprises, bringing regulations in line with commercial practice.

For example, at the beginning of the year, the revised "Measures for the Administration of the Privately Offered Asset Management Business of Securities and Futures Business Institutions" made changes to the regulations governing issues such as installment payments, the charging of expenses and private equity portfolio investments to re-focus private equity asset management in start-ups and small enterprises. In September 2023, the AMAC issued the "Private Investment Fund Filing Guideline No. 2 - Private Equity and Venture Capital Funds", which lowered the threshold for private equity funds to allow them to increase their fundraising, removing certain restrictions and facilitating debt-to-equity conversions of convertible bonds.

Asset-backed securities (ABS)

The benefits of the use of ABSs continued to be seen throughout 2023, with a greater range of ABS products. In June, the National Association of Financial Market Institutional Investors highlighted three products that could be of particular value: real estate trust asset-backed notes (interbank quasi-REITs), asset-backed commercial paper (ABCP), and covered bonds (CBs). The CSRC directed the stock exchanges to issue guidelines to support insurance asset management companies to carry out ABS and REITs business on the stock exchanges.

Real estate finance

In order to support the leasehold sector in the housing market, in

February 2023, the PBOC and the NFRA solicited opinions on their consultation paper on this area. The objective is to encourage real estate leasing companies and professional asset management institutions to hold and operate leased housing for a long period of time through real estate investment trusts. In February 2023, the AMAC launched a pilot program for real estate private equity funds, with the twin objective of making it possible for private equity funds to diversify their assets and to make it easier for real estate leasing companies to access funds. In October 2023, the CSRC expanded the asset classes of the pilot REITs to include consumption-related infrastructure. All of these initiatives should help restore and revitalize the real estate sector.

03 Strengthening consumer protection in the finance sector

Protecting consumer interests in the financial sector was a key part of the Party and State institutional reform launched in March 2023. There was some institutional reform: the investor protection duties, which came within the CSRC, were transferred to the NFRA. The NFRA was tasked with overall financial consumer protection, financial consumer education and establishment of a unified financial consumer complaint and reporting process, among many other responsibilities.

There were also several policy initiatives, covering everything from the sale of financial products, information disclosure, and reporting of consumer complaints to dispute resolution. In September 2023, the NFRA issued the "Circular on the Further Standardization of Financial Product Advertisement and Endorsement Activity" to all supervisory bureaus, banks, insurance companies and other institutions. The circular set out standards regarding financial product advertising and endorsement activities, negative public opinion response plans, advertising partners, and product displays. The State Council's "Opinions on the Implementation of Promoting the High-quality Development of Inclusive Finance", issued in October 2023, called for the establishment of regulations to regulate the sale of financial products, the sales processes of financial institutions, complaints procedures and how financial disputes should be resolved. In December 2023, the NFRA issued "Doing a good job of '8+5+5+3' - asset management for a strong financial country in the 21st century", which called for a strengthening of consumer protection in all client groups, from high-net-worth clients through to ordinary clients. Various measures set out in the document included better information disclosure and timely handling of investor complaints.

Administrative enforcement (which is separate from judicial enforcement) was handed down in a number of instances during the year, both by the CBIRC and the CSRC. The types of misbehavior in relation to asset management institutions included the use of unlicensed salespeople, misleading sales, irregularities in management, failure to disclose and absence of internal controls within companies. Both institutions and the responsible people within them were sanctioned under the "dual-punishment system".

In December 2023, the Shanghai Financial Court publicized five typical private equity cases that the court had heard in recent years. The relevant cases reflect adequate protection of the legitimate rights and interests of private equity investors.

04 Trust sector regulation focused on a unified approach and on risk prevention and control

There was further refinement of the classification of trust businesses in 2023. At the beginning of the year, the then CBIRC issued the official version of the "Notice on Regulating the Classification of Trust Businesses of Trust Companies" (the "**Trust Classification Notice**"), which came into effect on June 1, 2023. Trust businesses were formally classified into three major categories: asset service trusts, asset management trusts, and charity trusts, broken down into 25 different types of business. The Trust Classification Notice marked the formal launch of the regulatory reshaping of the trust sector and set out a three-year transition period during which trust businesses have been given an opportunity to restructure to come in line with the new classifications.

The Trust Classification Notice was followed by the "Notice on Issues Concerning Regulating the Departments of Trust Companies in Other Places". This aimed to create a more cohesive sector, eliminating a series of issues arising from the off-site operation within the trusts sector. In November, the "Interim Measures for the Regulatory Rating and Tiered and Categorized Regulation of Trust Companies" issued by the NFRA set up five rating modules by which trust companies are assessed, including corporate governance, capital requirements, risk management, behavioral management and business transformation. The goal is to develop a better rating system and to bring about improved supervision by regulators of trust companies.

Regulators also addressed the pressing issue of risk disposal and management within the trust sector (as they have across the financial services sector generally). In the trust regulatory work conference held in February 2023, the then CBIRC said that the

industry-wide target for risky asset disposal in 2023 would amount to RMB300 billion. The Report of the State Council on the Financial Work Situation published in October 2023 and the Sixth Central Financial Work Conference both emphasized the need to address and resolve risk in the financial sector, proposing to "resolutely fight the tough battle of preventing and resolving major risks" and "risk prevention and control should be considered as an eternal theme of financial work".

Disposing of risk for trust companies remains a challenge because of their legacy businesses. While many trust companies were able successfully to offload risk – including the equity restructuring of Huarong Trust, the renaming of Anxin Trust as Jianyuan Trust, the bankruptcy of Xinhua Trust and the preliminary steps to reorganize Sichuan Trust – progress on other fronts has been slower, especially those with real estate assets. This is bound to take time to resolve.

05 Private investment fund regulation was revamped in order to crack down on illegal behavior

2023 was a year that ushered in a comprehensive change in the regulation of China's private investment fund sector. In July 2023, the State Council issued the "Regulations on the Supervision and Administration of Private Investment Funds", which is the first administrative regulation of the private fund sector and is a significant milestone. The Regulations consolidated and reiterated the existing regulatory requirements of the CSRC, the AMAC and other institutions so far as they related to private funds, brought the regulatory authority of private funds within the purview of the CSRC, and set out the punishments for those found to be in violation of the laws and regulations. In December 2023, the CSRC issued a consultation paper on the "Supervision and Administration Measures for Private Investment Funds" to seek public opinions. The document in effect refined previous documents. There were other important documents issued by the AMAC, including: the "Measures for the Registration and Filing of Private Investment Funds" and the supporting guidelines; the "List of Application Materials for the Registration of Private Fund Managers (Revised in 2023)"; the "Guidelines for the Operation of Private Securities Investment Funds (Consultation Paper)"; the "Guidelines for Handling the Loss of Connection of Private Fund Managers"; and the "Guidelines for Filing of Private Investment Funds".

The above series of regulatory rules reflected the implementation of differentiated supervision of different types of private funds and further improvement of the regulatory supervision of the private fund sector. All of this should lead to the healthy and stable

development of the private fund sector.

As part of the process of tighter supervision, there was greater enforcement against private fund companies in breach of the laws and regulations. In December, the CSRC Shanghai branch released details of five typical cases of administrative violation. Also in December, the Supreme People's Procuratorate and the Supreme People's Court jointly issued the "Typical Cases of Stringent Combating of Private Fund Crimes According to Law", spelling out common and frequent crimes in the field of private funds such as illegal taking of public deposits, fundraising frauds, misappropriation of assets, and bribery. These cases also delineated a "red line" and a "bottom line" for the practitioners in the private fund sector, to make sure they operate to the highest standards.

06 Buy-side reform benefited the public fund sector and helped to boost market activity

As one of the key measures for the reform of the investment side of the capital markets, on July 7, 2023, the CSRC issued and implemented the "Work Plan for the Fee Rate Reform of Public Fund Industry", which started the process of reforms to fee rates and charging in connection with public funds. The CSRC looked to achieve 15 steps over a period of two years to address the range of fees, including management fees, transaction fees and sales fees, and to steadily reduce the fees being charged. In the first phase, the CSRC targeted management fees and custody fees, and launched the first batch of 20 floating fee rate pilot products. This process was deemed to be successful.

On December 8, 2023, the CSRC sought opinions from the public on its consultation paper, the "Provisions on Strengthening the Management of Securities Transactions of Publicly Offered Securities Investment Funds" – thus launching the second phase of fee rate reform. The main contents of the consultation paper included proposals to lower the commission rates on securities transactions carried out by public funds.

These changes effectively helped to reduce the costs to investors of investing in public funds. They also had the result of encouraging asset management companies to improve their research and development capabilities, to invest more in equities and generally to bring about a more settled public funds sector.

On September 12, 2023, the CSRC issued the "Circular on Matters Relating to Further Optimization of Securities Trading Models of Public Fund Managers", which allowed for the fact that smaller

and medium-sized asset managers trading in public funds might be disadvantaged through the lower fees they could charge. The Circular suggested that these asset managers might have greater flexibility and should have lower operating costs.

The CSRC proposed reducing the registration conditions for index funds, suggesting to heads of public fund management companies that they issue more public funds comprising equities and broaden the investment scope and strategy of public funds. The CSRC also proposed supporting the National Social Security Fund, the Basic Pension Fund, and the Annuity Fund, expanding the scope of investments in the capital markets, and creating a policy environment conducive to the entry of medium- and long-term funds into the market.

By supporting the investment side of the market, the reforms are intended to draw on the advantages of the asset management sector and boost investor confidence, thus further stimulating the capital markets.

07 Pension finance became one of the five “significant sectors” and a key part of wealth management

Pension finance was formally listed as one of the five significant sectors at the Central Financial Work Conference in October 2023. What this means is that pension finance is seen as one of the key areas of wealth management.

Policies developments

The NFRA issued a series of documents relating to pension insurance at the end of 2023. First, the release of the "Interim Measures for the Supervision and Administration of Pension Companies" filled a regulatory gap that existed, meaning that there was no specialized supervisory regulations for pension insurance companies. The Measures set out applicable regulatory requirements for pension insurance companies in terms of asset management, business scope, and risk control, among others, which provided clear guidance on how pension insurance companies should focus on their main business. Secondly, the "Notice on Matters Concerning Promoting the Development of Exclusive Commercial Pension Insurance" was another step in creating a multi-level and multi-pillar pension insurance system; and the "Notice on Relevant Matters Concerning the Transition from the Pilot Program of Individual Tax-Deferred Commercial Pension Insurance into Private Pensions" provides more incentives for individuals to participate in privately run pension

plans by offering tax inducements.

Market developments

As personal pension schemes have gradually been introduced, these has encouraged a range of businesses to enter the market, including insurance companies, securities companies, banks and trust companies, who have launched a range of personal pension products. As of December 31, 2023, there were 50 personal pension fund sales institutions, including 19 commercial banks, 24 securities companies and seven independent fund sales institutions. There were 178 personal pension products, 49 more than existed in 2022.

So far as pension finance was concerned, at the beginning of 2023, the Banking Wealth Management Registration and Depository Center issued the "Implementation Measures for the Management of the Industry Information Platform for Personal Pension Financial Products (for Trial Implementation)" and the "Notice on the Formal Implementation of the Information Reporting of Personal Pension Investment Financial Products", which explicitly required commercial banks and wealth management companies selling personal pension investment financial products to use a dedicated financial management industry platform. As of the end of 2023, six wealth management companies had issued 23 personal pension financial products.

With the support of policies and active participation of market players, there has been an appreciable growth in the market of pension products.

08 Steady progress in opening up the wealth management sector with several policies favoring cross-border collaboration

In 2023, the asset management and wealth management sector continue to make steady progress. A number of foreign-funded institutions successfully started their business in China. For example, BNP Paribas Agribank Wealth Management Co. Ltd. (法巴农银理财有限责任公司) opened in June, becoming the fifth joint venture wealth management company in China. The CSRC approved the establishment of Schroders Fund (施罗德基金), Allianz Fund (安联基金) and Lianbo Fund (联博基金), which are wholly owned by foreign investors, and also approved the 100% control by JPMorgan Asset Management Holdings Inc. over China International Fund Management Co., Ltd. (上投摩根基金) and the 100% control by Morgan Stanley over Morgan Stanley Huaxin Fund Management Company Limited.

Opening-up favorable policies

Favorable policies conducive to the entry of foreign capital into China's asset management market and facilitating cross-border cooperation were also introduced. In August 2023, the CSRC updated the service guide for administrative licensing matters regarding the approval of the establishment of public fund management companies, and shortened the time that it would take for public fund management companies to set up in business (to 120 days).

In addition, local favorable policies for the opening up of the asset management sector are frequently issued. These included "Several Opinions on Accelerating the Construction of the Core Functional Area of the Global Asset Management Center in Lujiazui Financial City of Pudong New Area". The Shanghai Pudong New Area passed policies to make Pudong a global asset management center to attract institutional investors and asset management institutions from all over the world and encourage the world's top asset management service companies to base themselves in Pudong; Shenzhen released the "Shenzhen Local Financial Supervision Bureau on Accelerating the Construction of Shenzhen International Wealth Management Center's Opinions", which seeks to attract up to 300 wealth management companies to the Shenzhen International Wealth Management Center before end of 2025, including Qualified Foreign Limited Partners (QFLPs), Qualified Domestic Investors Overseas Investment (QDIE), and Wholly Foreign-Owned Private Equity Institutions.

Other initiatives also have ambitious objectives. The "Opinions on Financial Support for Comprehensively Deepening Reform and Opening Up of Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone" have the goal of allowing Hong Kong private banks and family wealth management companies and Hong Kong asset management companies to set up joint venture wealth management companies in the Qianhai Cooperation Zone.

As can be seen, China is very keen to open up its asset management and wealth management sector and to attract high-quality foreign institutions.

Cross-border cooperation

Two years after the launch of the Cross-border Wealth Management Connect pilot, the regulators have refined the rules to optimize the conditions for investor access, including securities companies in the scope of participating institutions, expanding the scope of qualified investment products for "Southbound Connect" and "Northbound Connect", and increase the quota for individual investors, among other measures, all intended to facilitate the interconnection of the

wealth management sector in Guangdong, Hong Kong and Macao Bay Area. The Northbound Swap Connect was officially launched in May 2023, allowing overseas investors from the different countries and regions to participate in the Mainland interbank derivatives market.



2024 Regulatory Outlook

01 The Trust Law is expected to be revised alongside with asset management being characterized as a trust structure

Since the release of the Minutes of the National Courts' Civil and Commercial Trial Work Conference (the "Minutes") in 2019, there have been definite moves to designate asset management businesses as a trust relationship. The Minutes set out requirements for asset management companies, such as the prohibition of rigid payment, fiduciary obligations of managers, and the prohibition of capital pooling, all of which are line with the principles of the Trust Law. In particular, after the establishment of the Asset and Wealth Management Institution Supervision Department (see above), wealth management, trust and insurance asset management have been unified into the same institution for supervision, emphasizing the role of the institution of "entrusted by people, managing wealth on behalf of people".

The Trust Law has been in force for more than 20 years since its promulgation in 2001, and some of its provisions have not kept pace with changing business requirements. In October 2023, PBOC Governor Pan Gongsheng mentioned in the State Council's report on the status of the financial work that one of the priorities of the financial work in the next step is to strengthen the financial legal system, specifically mentioning the plan of revising the Trust Law. We can therefore expect to see the Trust Law revised in 2024 and we expect the revision of the Trust Law will focus on the following aspects: first, refining the obligations of trustees, distinguishing between active management and administrative management types of trust business, and stipulating the duties of trustees in various business segments; second, in the context of the transformation of the three classifications of business in the trust sector, the Trust Law is likely to improve the trust property registration process and offer preferential tax policies for public welfare trusts. This will enable trust organizations to carry out non-cash asset management trusts, asset service trusts and public charity trusts.

02 Common regulatory standards for wealth, trust and insurance asset management will better protect wealth management customers

The establishment of the Asset and Wealth Management Institution Supervision Department means that the supervision of the asset management sector has become more centralized and unified. We expect that, in 2024, the unified regulatory rules for the three types of institutions may be issued, which will gradually align the

regulatory standards of trust, wealth management and insurance asset management institutions in terms of institutional access and business. As for insurance asset management organizations, they will gradually develop to manage insurance funds for individual investors, enabling them to further enhance their asset management and wealth management capabilities. All financial consumers will benefit from legal protection, from very high net worth individuals to those who have very small investments. We expect that, under the new regulatory structure, generally applicable financial consumer protection rules for the three types of institutions will be introduced, covering matters such as customer suitability and information disclosure.

03 Transformation of trust business still progressing, boosted by innovative new opportunities

With the implementation of the Trust Classification Notice (see above), the future development of trust companies will have clear norms to follow. In the process of business transformation, asset management trusts will be an important area for regulators. There will be new opportunities for public welfare charity trusts. In particular, the amendment to the Charity Law passed at the end of 2023 has improved the chapter on charity trusts, stipulating that individuals, legal persons and unincorporated organizations will enjoy tax incentives when they set up charity trusts to carry out charitable activities. This initiative should play a positive role in promoting charity trusts in the future. We expect the "Measures for the Administration of Trust Companies (the "Measures")" to be revised in 2024. We expect that the newly revised Measures will echo the requirements of the Trust Classification Notice, emphasizing the legal obligations of trustees and spelling out prohibited acts in trust business. The new Measures are also likely to strengthen the regulatory requirements on risk management and internal controls adopted by trust companies, while guarding against undue interference by shareholders.

04 "Survival of the fittest" continues to drive the goals of regulators in supporting the high-quality development of the private fund sector

In the coming year, we expect more consultation papers, including the "Measures for the Supervision and Administration of Private Investment Funds" and the "Guidelines for the Operation of Private Securities Investment Funds", will be issued to round up the system of rules for the supervision and administration of private funds.

Only the fittest and best private fund managers will survive – that is the intention of the regulators and the desired outcome of new regulatory rules. The private fund sector will also benefit from the introduction in early 2023 of the registration system for capital markets. Private securities investment companies will have more scope for the businesses in which they invest. Those with specializations may be able to capitalize on gaining market share. Exit channels will become more open for private equity investment companies. As a result of the narrowing of the valuation premium between the primary and second markets, which means there is less incentive to have short-term gains, private equity investment companies will look for longer-term gains, requiring them to be better informed about companies' longer-term prospects.

In 2023, Beijing, Shanghai, Guangzhou, Jiangsu, Zhejiang and other more developed private equity investment regions introduced policies to support the local private equity investment sector. We believe that in 2024, these and other localities will continue to introduce policies to refine the regulatory rules governing private equity investment funds. Supportive policies will include guiding investment into start-ups, small, and science-and-technology enterprises, encouraging the use of bank wealth management funds, corporate annuities and pensions, piloting the allocation of shares in kind for equity investment funds, extending the pilot of Qualified Foreign Limited Partners (QFLPs), and supporting equity investment fund managers to improve their professional expertise.

05 Further development of the financial infrastructure of the asset management/wealth management sector

In 2023, there were significant developments in the financial regulatory structures covering both the public fund sector and personal pension financial products. On February 10, 2023, to implement the "Opinions of the China Securities Regulatory Commission on Accelerating the High-Quality Development of the Public Fund Industry", the CSRC agreed the public trial operation of the "Fund E-Account" (基金E账户) App, which provided individual investors with a "one-stop" enquiry service for public fund accounts. On January 20, 2023, the Banking Industry Financial Management Registration and Custody Center issued the "Implementation Measures for the Management of the Industry Information Platform for Personal Pension Financial Products (for Trial Implementation)", specifying which information needed to be made publicly available in respect of personal pension wealth management products.

At the same time, improvements to the financial infrastructure were included in national financial policy objectives. The State Council's "Opinions on the Implementation of Promoting the High-quality Development of Inclusive Finance", issued in October 2023, identified new improvements in financial infrastructure as one of the main objectives of promoting the high-quality development of inclusive finance over the next five years. The State Council's report on the status of financial work, issued in October 2023, also pointed out that it is necessary to strengthen financial infrastructure and promote integrated regulatory supervision over all aspects of financial assets, including registration and depository, clearing and settlement, trading facilities, and transaction reporting.

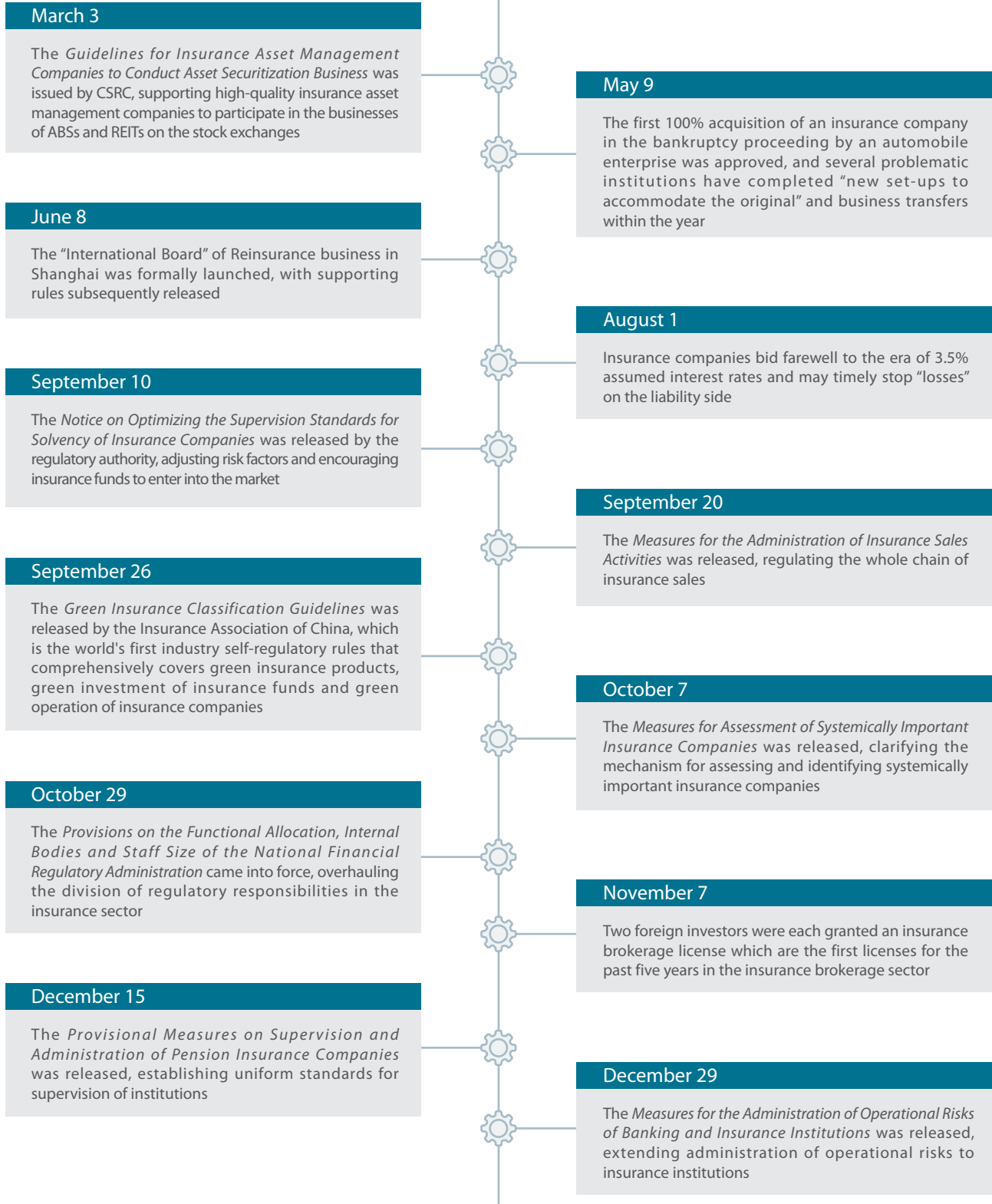
We expect that the structures of the asset management/wealth management sector will be further improved with policy support in 2024. The "Fund E-Account" (基金E账户) is expected to move from being a trial operation to becoming officially operational and there will be one platform set up which will contain all information relating to public funds.

We believe that more and more industries will launch corresponding information platforms to make it easier for investors to access information about their accounts, share dealings, transactions and other investment and financial information. In addition, we expect financial institutions to improve barrier-free service facilities for special groups such as older persons so that they can have access to financial services.

PRC Financial Regulation:
Annual Report (2024)

Insurance

2023 Regulatory Milestones



2023 Regulatory Mainline Review

01 Institutional reforms reshaping the regulatory landscape of the insurance sector

Since the merger of the former China Banking Regulatory Commission (“CBRC”) and China Insurance Regulatory Commission (“CIRC”) to form the China Banking and Insurance Regulatory Commission (“former CBIRC”) in 2018, the regulatory authority has gradually built and strengthened the institutional safeguards for the unified regulation of the banking and insurance sectors through these substantial institutional innovations. Five years later, the CPC Central Committee and the State Council issued the Reform Plan for Party and State Institutions in March 2023, reshaping the financial regulatory framework and the division of labor between central and local supervision. The National Financial Regulatory Administration (“NFRA”) was established on the basis of the former CBIRC, and the day-to-day supervisory responsibilities of the People’s Bank of China (“PBOC”) for financial holding companies and other financial groups, as well as the responsibilities for financial consumer protection, and the investor protection responsibilities of the China Securities Regulatory Commission (“CSRC”), were transferred to the NFRA. The *Provisions on the Functional Allocation, Internal Bodies and Staff Size of the NFRA* (“三定”方案) was released a few months later, in which the resetting of the functional departments and the division of responsibilities brought about a new normal for the supervision of the insurance sector.

With respect to market entry, a new Financial Institution Authorization Department has been established, transferring market entry and administrative licensing responsibilities previously dispersed among the various internal regulatory bodies to one special department. This may cause some short-term difficulties and challenges during any switchover period – since one special department may have information gap internally about any particular applicant’s situation. However, in the long term, one special department can effectively align the form and substance requirements of different types of applications and improve the quality of approval work; at the same time, the unified regulatory standards can also effectively preposition the risk supervision gate and raise the threshold of market entry for the insurance industry.

With regard to regulatory bodies, the most notable changes are the merger of the former Department of Insurance Intermediary Supervision into the Department of Property and Casualty Insurance Supervision, and the merger of the former Department of Insurance Funds Utilization Supervision, the Department of Trust Supervision and the Department of Innovation to form the Asset and Wealth Management Institution Supervision Department. The former merge has aroused heated discussions in the market for a

number of reasons. However, this adjustment certainly helped to confirm the positioning of insurance intermediaries as “channels”, and creates convenience for regulatory activities and space for policy implementation from the perspective of “unity of reporting and behavior” and strengthening the regulation of sales practices. Amid such an atmosphere, the regulation of intermediaries in the life insurance sector is expected to take shape soon. The Asset and Wealth Management Institution Supervision Department, establishment of which echoes the Guiding Opinions on Regulating Asset Management Business of Financial Institutions (the “**New Asset Management Rules**”), is dedicated to bring about unification of the regulatory standards applying to asset management products and thereby eliminate the space for regulatory arbitrage. As a corollary, it may have a more thorough penetrating review on the indirect investment of insurance funds through trusts, funds and other asset management products in supervising the use of insurance funds. Comparing with rules applicable to common asset management companies, those applicable to insurance asset management companies place an emphasis on the usage of insurance funds. In May 2022, the *Standardization in the Insurance Industry during the 14th Five-Year Plan Period* issued by the former CBIRC proposed to “promote the unification of standards for the asset management business of banks, securities, insurance and other industries”. Once the unification of the higher-level laws and the regulatory organization structure has happened, it will be necessary to systematically analyze and align the rules covering the insurance sector.

02 Insurance sector serving economic and social development, devoted to the “five grand papers”

The Central Financial Work Conference held in November 2023 proposed that the financial sector should get devoted to the “five grand papers”, promoting the high-quality development of science and technology finance, green finance, inclusive finance, pension finance and digital finance. In the past year, the insurance industry left a strong mark in the five areas around the theme of serving economic and social development.

With respect to science and technology finance and digital finance, the regulatory authority encourages leading insurance institutions to take the lead in researching and developing science and technology insurance products to underwrite various risks in the process of R&D and operation of enterprises; a lot of institutions also provide financial support for science and technology enterprises through private equity investment funds and equity investment plans, etc. In July, in response to the national governance upgrade

on data security and cyber security, the Ministry of Industry and Information Technology and the NFRA jointly issued the Opinions on Promoting the Standardized and Healthy Development of Cybersecurity Insurance, which encourages insurance institutions to overcome technical difficulties and enrich cybersecurity insurance products and proposes opinions on measures to reduce insurance taxes and subsidize insurance purchases.

With regard to green finance, following the issuance of the Guidelines for Green Finance and related statistical systems by the former CBIRC in 2022, the Insurance Association of China (the "IAC") issued the *Green Insurance Classification Guidelines* and the *Guidelines for Disclosure of Environmental, Social and Governance Information by Insurance Institutions* in 2023, the former of which is also the world's first industry self-regulatory rule that comprehensively covers green insurance products, green investment of insurance funds and green operation of insurance companies. The above industry guidelines categorize many green scenarios with a very fine granularity, which facilitates the industry players to take the right place and start practicing.

With respect to inclusive finance and pension finance, a, various types of pilots in the previous period gradually entered into the stage of institutionalization and commercialization. The exclusive commercial pension insurance scheme launched as a pilot in 2021 became a regular business in 2023 successfully, with product terms and rates uniformly filed and administered, as with other personal insurance products. The scope of personal pension pilot products has been further expanded, and according to the China Banking Insurance Information Technology Management Company Limited (the "CBIITMC"), the number of personal pension insurance products on the market has greatly increased (there were just seven launched by six companies in 2022). The individual tax-deferred commercial pension insurance pilot products ceased to be sold from September 1, and the existing products were switched to personal pension products under the closed-loop management. At the same time, supervision of insurance companies follows the steps of supervision of the products. On December 15, the NFRA issued the *Interim Measures for the Supervision and Administration of Pension Insurance Companies*, emphasizing that pension insurance companies should focus on the main business of pensions (and not, for example, on short-term health insurance) and should not manage insurance funds or asset management products as a fiduciary. Following the opening of Guomin Pension Insurance Co. in 2022, there are now ten pension insurance companies in China. Compared with other types of life insurance companies, the regulatory requirements covering pension insurance companies are much stricter – covering everything from equity management, registered capital, corporate governance, and management of connected transactions to business concentration, which is also

in line with the special function and important role of pension insurance companies to manage people's "pension money".

03

Tightening risk control on liability, unifying reporting and behavior

Investment yields on the asset side declined due to factors such as debt overdue storms and capital market shocks; however, channel costs are rising with fierce market competition, further weighing on the liability side and leaving some insurance companies with a more prominent risk of loss from difference of interest. In order to improve the asset quality of the liability side and resolve potential risks, the regulatory authority has repeatedly stepped on the brakes and introduced significant policy adjustments in 2023.

As required by the Ministry of Finance, eligible domestic and overseas listed insurance companies implemented the *Accounting Standards for Business Enterprises No. 25 - Insurance Contracts* as from January 1, 2023, which is aligned with IFRS17. The new standard adjusts the calculation method of premium income, requiring insurance companies to exclude the corresponding investment components and other non-insurance service components from premium income, whereby insurance companies are unable to adjust actuarial assumptions on an ad hoc basis to whitewash statements for the current period. The application of the new standard will have a direct impact on the performance of insurance companies, but it will also provide a truer picture of the company's operations and improve the quality of information on the liability side.

In January, NFRA fired the first shot in calling for the "unity of reporting and behavior" for the bank distribution channel of insurance companies, thereby uniformly setting the upper limit of the fee rate for bank distribution channel and reducing the cost of the liability side of the insurance institution. The information fee, billing fee and other fees of various names, previously widely used to circumvent the regulation, are required to be strictly integrated into the management of channel costs, hence achieving the true "unity of reporting and behavior".

In March, the regulatory authority released a significant signal to the market to lower the assumed interest rate, which caused a heated debate in the industry at once. The "assumed interest rate" is the interest rate used in pricing life insurance products, which has the characteristics similar to rigid redemption. In the context of reducing deposit interest rate and breaking the rigid redemption, this is a unique competitive advantage of insurance products in the

market. However, high interest rates will increase the pressure on the liability side, and even cause loss from difference of interest. The regulatory authority has timely put on the brakes before the risk exposure and reduced the assumed interest rate from 3.5% to 3%.

In addition, the documents issued in 2023 for a variety of products repeatedly emphasized expense management and the implementation of the requirement of "unity of reporting and behavior" for the whole distribution chain of products. Administrative penalties were imposed on those found to falsify financial data, commit commission rebates, conduct false advertising, or make false claims, among other falsehoods and number of penalized institutions were larger and the levels of fines were higher than in previous years. In November, Li Yunze, Secretary of the Party Committee and Minister of the NFRA, said the next step would be to focus on strong and strict supervision—equipping the supervision with "teeth and horn" in his words, and to continue to enhance the supervision in terms of foresight, precision, effectiveness, and synergy. Controlling costs should help to guard against risks and promote the healthy development of the sector. We expect there will continue to be actions dedicated to "unity of reporting and behavior" in the next stage.

04 Investments in equity encouraged, and more real estate investment

In March 2020, the CSRC issued guidelines for stock exchanges to support insurance asset management companies ("AMCs") to start asset securitization and real estate investment trust fund businesses. Up to then, only qualified securities companies and mutual funds could invest in ABS and real estate investment trusts ("REITs"). The guidelines open up a new business area for insurance asset management companies, which can now participate in the ABS and REITs products of stock exchanges both as originators or managers. However, insurance asset management companies still need to obtain the approval from the industry regulatory authority to expand their business scope. In addition, one of the competitive advantages of insurance asset management companies is that they are backed by powerful insurance funds, so regulatory coordination and guidance are required as to how to carry out related product investment by insurance fund and the complicated regulatory guidance on related party transactions.

The NFRA and the CSRC have both sent strong signals that they want insurance fund to be invested in the market. In September, the NFRA issued the *Circular on Optimizing the Solvency Regulatory Standards for Insurance Companies*, which aimed to reduce the risk

factors of investments in shares on the stock exchanges – such as CSI 300 Index constituent stocks, ordinary shares listed on the SSE STAR Market, and other equity investment instruments. The lower level of risk factors means that the relevant investment will occupy less capital, so as to guide insurance companies to make long-term layout in the capital market. According to the insurance business data released by the NFRA by December 2023, the investments by the insurance sector constituted some RMB27 trillion in total, of which investments in stocks and securities investment funds accounted for about 12.02%. This was a lower proportion than previously. The data explains the potential growth space on one hand, and on the other hand, tests how to further enhance the confidence of insurance enterprise investors in equity asset allocation.

Since the beginning of 2023, there has been a trend for insurance funds to invest in real estate, covering many types of properties such as commercial-office buildings, logistics parks, care homes and long-term rental apartments. The redemption risks and the withdrawal of external funds of some real estate enterprises caused the valuation of many projects being returned to a rational level, and created an investment window for insurance fund. The regulations related to real estate investment have been in service for more than ten years, but in practice, the investment structure and the regulatory rules on financial products have changed with each passing day. After the reform of the upper management, there have been no major adjustments to the relevant systems and regulatory means in the short term, but we do not exclude the possibility of medium and long-term reviews and revisiting the relevant regulatory rules on the use of funds.

05 Significant risk disposal of many insurance companies, but work still needs to be done on small and medium-sized insurance companies

After five years of action involving risk disposals and restructuring by the middle of 2023, much of this work had been completed, the disposal of a number of institutions in risks has come to the end. In June 2023, the NFRA approved the opening of the business of Zhonghui Life and Ruizhong Life and in September approved the opening of the business of Higang Life. The newly established entities took over the insurance business and corresponding assets and liabilities of Tianan Life, Huaxia Life and Evergrande Life, respectively. In September, regulators gave their approval to establish Shenneng, which, it was generally assumed, would take over the assets of Tianan Insurance. Establishing new business to carry on the old ones has become a mature tool in the risk disposal

of insurance industry, but each case requires a different approach, involving how much is invested in them and what their structures are. In certain cases, local state-owned enterprises and industrial organizations entered the market in different forms and insurance security funds participated therein in different degrees, which fully reflects the characteristic of adapting measures to the circumstances on a case-by-case basis in the risk disposal

The restructuring of E An P&C is the first time an insurance company in China has been restructured. The way it was done may serve as an example of how legislation is revised to deal with the bankruptcy of financial institutions. As revealed by the Beijing Financial Court, which sanctioned the bankruptcy, the China Insurance Security Fund acted for the first time as an agent after being legally authorized to declare claims on behalf of 7,641 policyholders. This provides a new approach to the disposal of insurance claims in follow-up projects. After the public recruitment of strategic investors in 2022, the wholly-owned acquisition of E An P&C by BYD was approved in May 2023. E An P&C's risk rating was subsequently upgraded from D to B which meets the standard.

In the latest comprehensive risk rating results of insurance companies (the second quarter of 2023) issued by the NFRA, 15 institutions were rated C (medium risk) and 12 institutions were rated D (high risk). All of them failed to meet the solvency standards. From this, we can see that China's insurance sector, particularly the small and medium-sized insurance companies, has some way to develop before the sector can claim to be mature. These sized companies are less exposed to risk and should therefore be easier to change to bring them in line with the overall approach to risk management and easy rectification. NFRA pointed out during its 2024 work conference that it will spare no effort to promote the reform and risk mitigation of small and medium-sized financial institutions, grasping the timing and effectiveness, and carrying out the work in a planned and step-by-step manner. At the same time, it is necessary to improve the normalization mechanism for financial risk disposal, implement the responsibilities of institutions, shareholders, senior management, regulators, local authorities, and industry participants, and promote the formation of collaborative efforts. Although the *Financial Stability Law* has not yet been formally enacted, this does not affect the active exploration of the government, industry regulators, judicial authorities, and market participants in risk disposal and mitigation models in practice.

06

License transactions are active, and foreign investors maintain confidence in China

In 2023, there was a certain amount of change of ownership in the insurance sector. Equities of several institutions are transferred publicly, and the changes to equities of several institutions have been successfully approved. The equity shares in these projects vary in size, but the underlying reasons share some commonality. Some state-owned shareholders, due to the requirement of "returning to the main business", have transferred their shareholdings in insurance companies; there are also some local state-owned assets acting in the opposite way and taking advantage of the situation to become the "blood transfusion" for insurance institutions.

Foreign investors have continued to be active in the M&A market. Overseas insurance giants Generali, ERGO, Allianz, AXA, and Chubb all increased their holdings or made major moves of internal restructuring in 2023, all of which reflect their confidence in and long-term planning for the Chinese business. What is also refreshing is that the regulator approved the licenses of two new insurance brokerage companies (i.e. BMW (China) Insurance Brokerage Co., Ltd. and ERGO Fangsheng Insurance Brokerage Co., Ltd.) on the same day of November 7. These two approvals break the five-year slump in the insurance brokerage market where no new licenses have been issued, and the background of the foreign shareholders has sent a strong signal of high-quality opening-up.

Through the activation of the equity investment exchange market, the survival of the fittest can be achieved through the market-oriented approach at the early stage, so that shareholders without the ability to continuously make capital contribution can exit in an orderly manner. The case of the acquisition of E An P&C by BYD not only has far-reaching significance for the risk disposal field of financial institutions, but also sends a positive signal. In addition to state-owned capital and foreign capital, there are still many opportunities for private capital to invest in the financial sector as long as the investors comply with shareholders' qualifications and comply with regulatory rules.

07 Shanghai Reinsurance Business International Board Launched to Enhance the Say on the Financial Infrastructure

Following the former CBIRC and the Shanghai Municipal Government jointly announced the goal of building Shanghai into an international reinsurance center in 2022, the former CBIRC Shanghai Branch and the Shanghai Municipal Financial Supervision and Administration jointly issued the *Implementing Rules for Accelerating the Development of Shanghai International Reinsurance Center* in June 2023. At the Shanghai International Reinsurance Conference held at the end of October, the supporting rules for the "Reinsurance International Board" were officially issued.

The Reinsurance International Board is operated and managed by the Shanghai Insurance Exchange, conducting international reinsurance ceded business, international reinsurance ceding business, and domestic reinsurance business. It acts as a central platform for market player access, information management and regulatory intervention, including digital registration, clearing and settlement. Based on blockchain technology, the platform achieves the encryption and tamper-proof of data of all parties. On this basis, all parties conduct price inquiry and quotation, contract signing and depository, financial settlement, cross-border settlement and other activities through the platform. The platform fully plays the role of financial infrastructure.

The first batch of business rules focus on international ceded reinsurance business, which refers to the reinsurance arrangement of risks ceded by overseas cedants to domestic insurance companies or reinsurance companies. The rules cover many aspects such as business registration, transaction processes, data statistics, fee arrangements, and specific operations for the platform to adapt the default risk characteristic coefficients of C-ROSS reinsurance counterparties. In addition to complying with the relevant rules, the parties accessing the platform also need to enter into a service agreement with the platform operators to clarify their rights and obligations.

At the Sixth China International Import Expo in November, the first international ceded reinsurance treaty of the Reinsurance International Board was signed, marking the official launch of the ceded business. Interestingly, the direct insurance policy corresponding to the reinsurance ceded treaty is a cross-border auto insurance under "equivalent priority" policy for the Hong Kong motor vehicles, which gives multi-level significance to the "first policy".

08 Redrawing the Boundaries of Insurance Sales Activities and Emphasizing Financial Consumer Protection

At the beginning of 2023, the regulators issued a "sky-high price" ticket to penalize illegal platform operations, one of the reasons for which was the illegal participation in the insurance intermediary business. Third-party platforms' illegal business is currently mainly concentrated in the sales process. The sales of insurance products shall be carried out by licensed insurance companies and insurance intermediaries in accordance with rules. In September 2020, the *Measures for the Administration of Insurance Sales Activities* was issued. Although the new measures will only be implemented on March 1, 2024, market discussion has been very heated since the publication of the exposure draft in 2022. The new Measures not only fill the gap of the provisions on insurance sales, but also expand the connotation and denotation of insurance sales activities, listing the sales activities at the "front, middle and back" stages, and proposing the requirements on license-holding for the whole insurance chain. The sales activities are the same as the sales activities in the general sense, including communication, negotiation, offer and acceptance for the purpose of entering into a contract. However, the pre-sales and post-sales activities literally overlap with the businesses routinely engaged in by third-party platforms. For example, the acts of soliciting contract counterparties are similar to the "drainage" business. Next are the obligations such as delivery of policies, return visits, information notification, etc. In the process of cooperation between insurance companies and third-party platforms, these steps are often completed through the platforms.

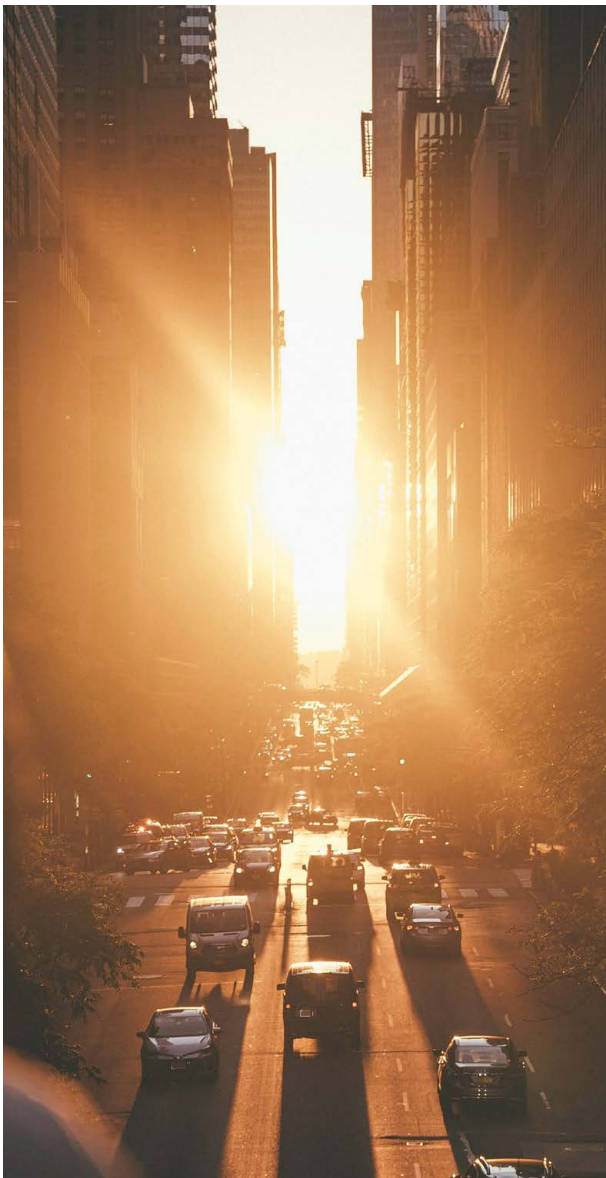
Since the applicable provisions on internet insurance were amended, how to clarify the behavior boundary of third-party platforms has been an important subject for the study of market players. In 2022, multiple ministries and commissions will jointly issue the rules for online sales of financial products for consultation, showing a cross-industry unified trend. However, the Measures have not yet been officially issued, and the separate provisions on the sales of insurance products will undoubtedly bring new perspectives and challenges to the market in this period. NFRA has added new outsourced functions of the regulatory authorities and information technology service intermediaries to the "Three Fixed Plan", and relevant regulation may be further strengthened in the future.

Closely linked to the regulation of sales activities is the consumer protection of financial products. In 2023, the regulatory authorities issued documents on short-term health insurance, life insurance with a term of more than one year, group life insurance, term life

2024 Regulatory Outlook

01 The Company Law Being Amended, Insurance Institution May Have More Choices in Governance Structure

insurance and whole life insurance, and vehicle insurance, among others. The documents require from a number of perspectives efforts on product disclosure, prohibit the "Magic Cube business", prohibit the use of misleading words such as "premium as low as (the minimum)" and "protection as high as (the highest)", and promote the standardization, popularization and simplification of the terms and conditions of products. In 2018, the APP of the BOC JinShiTong has opened an inquiry function called "sleeping insurance policy", which allows users to log in the platform to inquire about all the life insurance policies under their names in a one-stop manner. In the new round of institutional reform, the function of financial consumer protection will be closer to the NFRA. In the future, more unified provisions on financial consumer protection may be introduced.



At the end of 2023, the Seventh Session of the Fourteenth National People's Congress Standing Committee deliberated and passed the newly revised *Company Law of the People's Republic of China* (the "**new Company Law**"), which will be implemented from July 1, 2024. The revision of the new Company Law underwent three readings and numerous discussions. Among them, the adjustment to companies' capital requirements, which garnered the most discussion, has limited impact on insurance institutions implementing the paid-in capital system themselves. However, the new Company Law brings about new changes in various dimensions such as corporate governance.

Building upon the dual-tier governance structure of the original board of directors and supervisory board, the new Company Law provides market entities with more choices. "Qualified entities" may choose to establish only a board of directors without a supervisory board or supervisors. The supervisory functions can then be fulfilled by an audit committee established under the board of directors. However, within the current governance regulations covering the insurance sector, the supervisory board/supervisors are considered an indispensable component of the governance structure. Regulatory authorities may issue further guidance in the future to determine whether to provide insurance institutions with greater flexibility in choosing governance structures.

Furthermore, the new Company Law proposes a requirement for companies with more than 300 employees and no supervisory board or employee supervisors to have employee representatives on the board of directors. The concept of "employee directors" is not unfamiliar to insurance institutions, as there are provisions in the "Corporate Governance Guidelines for Banking and Insurance Institutions" encouraging the appointment of employee directors. However, in practice (especially for institutions in the form of limited liability companies), there are few cases of actually appointing employee directors. Insurance companies with a certain scale of branch network typically have a large employee base. In the process of implementing the requirements of the new Company Law, employee directors will undoubtedly have a more direct impact on company decisions at the board level compared to employee supervisors. How institutions will choose and how regulators will guide them is undoubtedly a topic of interest to the insurance market before the new Company Law officially takes effect.

In addition, the new Company Law has made modifications in the division of powers between different governance bodies

and adjustments to procedural rules, which carry greater legal weight than the "Corporate Governance Guidelines for Banking and Insurance Institutions" and the "Guidelines for Insurance Company Articles of Association," documents currently widely relied upon when designing governance structures for institutions in the insurance sector. In order to comply with the requirements of the new Company Law, there may be widespread revisions to governance documents in the near future, and it is worth watching out for whether specific rules for regulatory coordination will be introduced at the industry regulatory level.

02 Stocks and Bonds Issuance Together, Strong Demand for "Blood Infusion" in the Insurance Company

Since the completion of the "Phase II" of the "C-ROSS" project more than two years ago, the rules of the second phase aimed to eliminate the excess capital in the system, bringing greater pressure and challenges to insurance companies. Supervisory authorities have provided transitional policies based on the principle of "differentiated supervision for different insurance companies" and plan to fully implement the new requirements no later than 2025. Over the past year, through quarterly data comparisons, the impact of the declining solvency adequacy ratio of some insurance companies continues, while the fiercely competitive market environment also demands a higher level of capital supply capability from insurance companies.

To improve solvency, a large number of insurance companies increased their capital in 2023, with most being continuous "blood infusion" from existing shareholders, aligning with the regulatory emphasis on reinforcing shareholder responsibilities in recent years. However, there have been cases where shareholders are unable or unwilling to participate in capital increases. Regulatory requirements mandate insurance institutions to include shareholders' obligations to replenish capital in their articles of association and further solidify shareholders' responsibilities through measures such as issuing notices on the "Regulations on Supervision of Major Shareholders' Behavior in Banking and Insurance Institutions (Trial)" and requiring written commitments from major shareholders. According to regulations, when regulatory authorities order insurance institutions to replenish capital, major shareholders who lack the capacity for capital supplementation or do not participate in capital increases may not obstruct other shareholders or investors from adopting reasonable capital increase plans. This system ensures the institution's right and possibility to seek fresh capital, but finding new capital for timely infusion remains a challenge for many small and medium-sized institutions.

In recent years, issuing capital replenishment bonds and perpetual bonds in the interbank market has become a new choice for insurance companies. Compared to equity injections, debt investments do not have strict shareholder qualification thresholds, allowing insurance companies to maintain governance stability while replenishing capital. It is expected that bond issuance will become the preferred choice for more institutions in the future. However, it is also worth noting that, according to current rules, there are thresholds for insurance companies to issue these two types of bonds. The issuer's own solvency must meet certain standards, and affiliated parties may not subscribe to each other's bonds.

03 Strong Momentum in the Development of Catastrophe Insurance and Agricultural Insurance Calls for Regulatory and Industry Institutional Construction

From personal health, life, and property safety, to corporate property and liability risk prevention, and further to the risk management of overall social governance, insurance services permeate every crucial aspect of economic and social development. The Central Financial Work Conference held in November explicitly called for the insurance sector to play its key role as an economic and society stabilizer. In line with the "top-level design" and overall regulatory approach, insurance sectors such as catastrophe insurance and agricultural insurance are showing strong momentum for development.

Following significant disasters, governments often bear the primary responsibility for rescue and post-disaster reconstruction. Institutions, on the other hand, utilize big data, remote sensing technology, and other means to develop catastrophe insurance and reinsurance products that meet market demands. This effectively enhances pre-disaster prevention levels and provides timely protection for life and property losses resulting from disasters. However, the construction of a catastrophe risk protection system requires joint efforts from market entities and the government, with the establishment of risk-sharing mechanisms and clear risk-bearing priority being imperative. At the institutional level, research on industry funds, catastrophe risk bonds, etc., will continue to advance, while at the market level, there may be more specific guidelines for micro-level product development and service standards.

In September, the State Council issued the *Implementation Opinions on Promoting the High-Quality Development of Inclusive Finance*, emphasizing the role of insurance, focusing on the development of agricultural insurance, and supporting agricultural

production. Within the year, the China Insurance Association successively released the *Guidelines for Agricultural Insurance Product Development* and the *Standard for Electronic Underwriting and Claims Handling of Agricultural Insurance*. The former CBIRC issued the *Regulations on Agricultural Insurance Actuarial Practices (Trial)* in April, and later expanded the scope of implementation of full-cost insurance and crop income insurance for rice, wheat, and corn, from 13 major grain-producing provinces to all major grain-producing counties nationwide. Regulatory authorities further emphasized that the comprehensive premium rate for agricultural insurance should not exceed 20%, guiding more fiscal subsidies to be used for risk compensation. The future focus remains on the institutional design and policy support for agricultural insurance, and with the popularization of the market, there is an urgent need for further institutional safeguards for the "insurance + futures" financial product combination model.

04 Continuous Enhancement of Categorized Regulatory Mode Improves Management Quality and Efficiency

As early as 2009, regulatory authorities proposed the concept of "categorized regulatory supervision" for insurance companies. This approach evaluates and categorizes the risk levels of market entities from multiple perspectives, such as solvency, corporate governance, internal control compliance, fund utilization, and business operations, with corresponding differentiated regulatory measures. While categorized supervision may appear to increase the workload of regulatory information collection and reporting obligations for market entities, it effectively concentrates regulatory resources, provides more room for well-performing entities, and adopts more targeted measures for high-risk entities. This enhances the foresight, precision, effectiveness, and coordination of supervision.

Historically, at the end of 2008, regulations on categorized supervision of insurance professional intermediary institutions were introduced. After many years, regulatory authorities successively introduced categorized management systems in specific areas such as solvency and corporate governance. In 2021, they launched a regulatory rating method for insurance asset management companies. In 2023, draft opinions were issued for consultation on the categorized supervision methods for life insurance companies and the grading criteria for individual insurance agents. With the implementation of institutional reform plans, the model of categorized supervision and graded authorization may be implemented on a larger scale in the future. Among the existing categorized grading systems, there are overlaps in data requirements and reporting obligations. Whether or not there will

be some degree of convergence in the future remains to be further sorted out and demonstrated.

05 Huge Demand for Cross-Border Insurance, Seeking the Right Timing for Institutional Construction

According to the Insurance Authority of Hong Kong, mainland visitors to Hong Kong spent approximately HK\$59 billion on new insurance premiums in 2023, which surged by 27 times compared to 2022, marking a new high in nearly seven years.

Since the concept of "Insurance Connect" was first proposed in 2018, several years have passed. During this period, pilot programs for "equivalence recognition" of cross-border motor insurance, regional critical illness insurance, cross-border medical insurance, and other products have been conducted within the Greater Bay Area. However, the broader implementation of "Insurance Connect" has not been substantially realized.

Under current laws and regulations, domestic legal entities and other organizations that need to purchase insurance domestically are required to insure with domestic insurance companies. Moreover, if foreign insurance institutions wish to conduct insurance business operations in the mainland, they need to establish a commercial presence within the Mainland. The implementation of "Insurance Connect" requires coordination at the policy and institutional levels to address the differences in various aspects such as civil liability, industry regulation, tax supervision, and foreign exchange regulation across different jurisdictions. Previous initiatives such as "Stock Connect," "Bond Connect," "Wealth Management Connect," and "Swap Connect" have all faced similar challenges, to varying degrees. With the accumulation of experience from these interconnected products, regulatory authorities and market participants may jointly explore a practical and feasible path in the future.

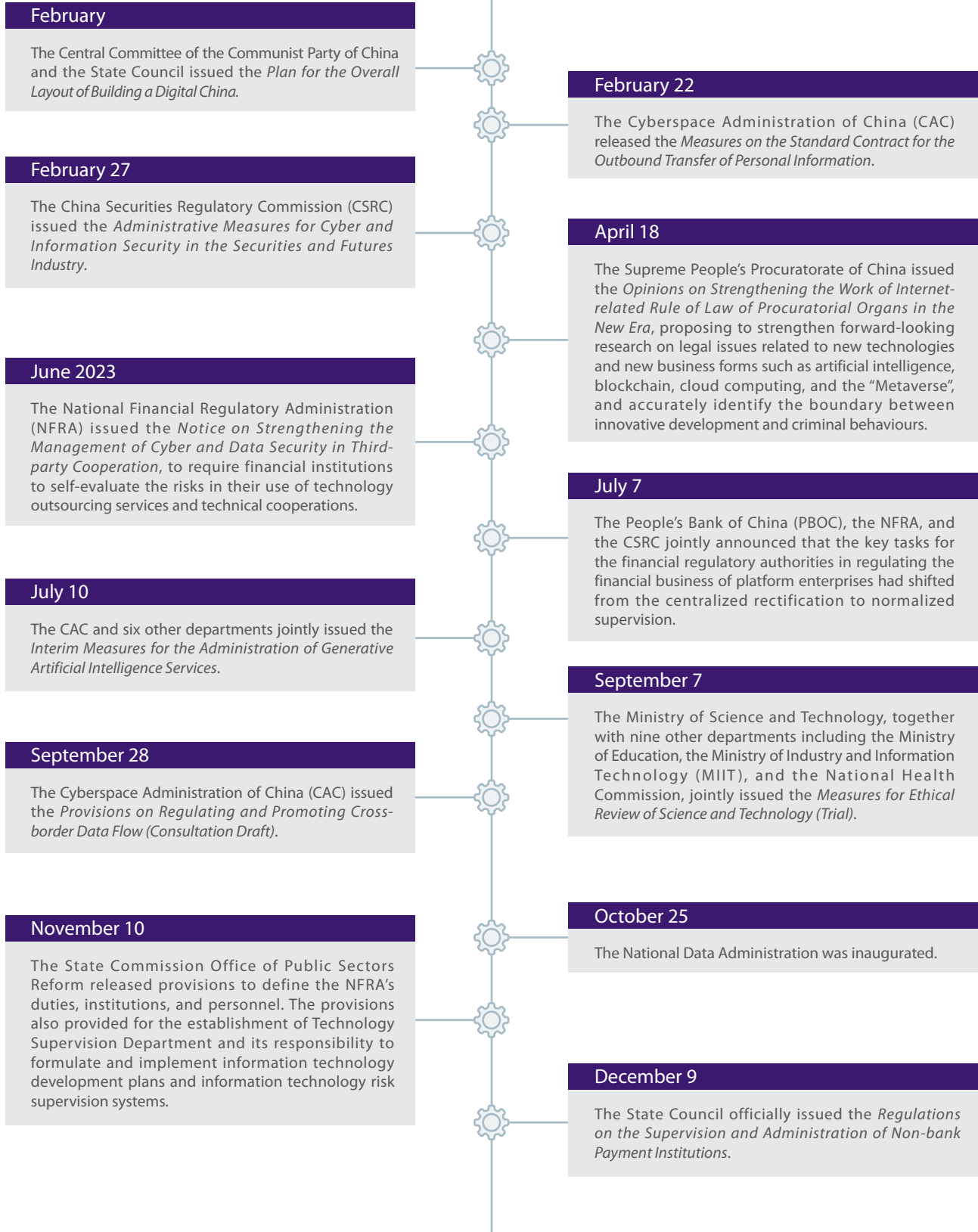
In the absence of the implementation of "Insurance Connect," the sale of cross-border insurance products, especially cross-border insurance products under wealth management, remains a focus area for regulatory supervision. There is a possibility of subsequent introduction of more explicit or stringent regulations, measures, or stronger regulatory measures.

PRC Financial Regulation:
Annual Report (2024)

FinTech



2023 Regulatory Milestones



2023 Regulatory Mainline Review

01 The fintech sector steps into the “normalized supervision” stage after centralized rectification.

Following PBOC’s official statement in January 2023 that a normalized supervision framework has been preliminarily established for platform enterprises’ financial business, and following multiple departments issuing penalty decisions on July 7, 2023, the PBOC, the NFRA, and the CSRC jointly announced that most of the prominent compliance issues concerning platform enterprises’ financial business operation had been rectified and the key tasks for the financial regulatory authorities had shifted from centralized rectification to normalized supervision. This statement means that the financial business of platform enterprises is officially under “comprehensive supervision”, which will improve the predictability, stability, uniformity, and standardization of the applicable regulatory mechanisms for platform enterprises.

At the same time, support mechanisms for normalized supervision are gradually being established and developed. At the departmental level, upon the financial regulatory revamp in March 2023, on November 10, 2023, the State Commission Office of Public Sectors Reform released the *Provisions on the Functions, Structure, and Staffing of the National Financial Regulatory Administration*, expressly providing for the establishment of the Technology Supervision Department (a new department in the NFRA). The Technology Supervision Department will be responsible for formulating and directing the implementation of information technology development plans and information technology risk supervision systems, supervising cybersecurity, data security, and critical information infrastructure to promote digital informatization. It is logical to expect that with the establishment of the Technology Supervision Department, regulatory work in fintech sector will be further centralized and professionalized.

02 Regulatory rules for technology ethics continue to evolve; governance mechanisms being improved

Rules and systems to regulate ethics in science and technology in the financial sector have been gradually established with the release of the *Opinions on Strengthening Ethical Governance of Science and Technology*, the *Guidelines for Science and Technology Ethics in the Financial Sector*, the *Self-discipline Convention on Science and Technology Ethics in the Financial Sector*, and other associated rules in recent years.

After the release of the *Opinions on Strengthening Ethical Governance*

of Science and Technology by the General Office of the CPC Central Committee and the General Office of the State Council in early 2022, on September 7, 2023, the Ministry of Science and Technology, together with nine other departments including the MIIT, the National Health Commission, jointly issued the *Measures for Ethical Review of Science and Technology (Trial)*. The measures serve as a comprehensive and generalized regulation covering the ethical review of science and technology in various fields and establish uniform requirements on the basic procedures, standards and conditions for the review.

In terms of fintech, in November 2023, the Beijing Fintech Industry Alliance released the *Self-discipline Convention on Science and Technology Ethics in the Financial Sector* at the 2023 Financial Street Forum. With the aim to promote self-discipline in science and technology ethics in the financial industry, the Convention establishes normative standards on the governance of key points such as algorithmic discrimination, big data discriminatory pricing, information leakage, digital divide, and disorderly competition. On November 27, 2023, the Shandong Branch of the PBOC issued a local group standard called the *Guidelines for Ethical Governance of Fintech*, proposing normative requirements for fintech ethical governance, such as forming fintech ethics committees, fintech ethical reviews, fintech ethical supervision, and fintech ethical education and promotion.

However, despite this rule development, ethical governance of science and technology has not yet been fully integrated into the internal management system of financial institutions and fintech enterprises. As Zeng Zhicheng, the deputy president of the PBOC Beijing Branch, mentioned in an exclusive media interview held at the end of 2023, the ethical governance of fintech is still in the exploratory stage, and the challenges of ethical governance of science and technology, such as the digital divide, algorithmic discrimination, privacy leakage, etc., are becoming increasingly prominent. Mr. Zeng added that these ethical issues may easily lead to discrimination in financial services and infringe on the rights and interests of financial consumers; moreover, they also contradict the original development idea of “maintaining integrity and seeking innovation” in fintech. Mr. Zeng ended by emphasizing that the financial industry should fully recognize the importance and urgency in establishing ethical governance over fintech; thus, the financial industry should establish a sound system of ethical governance in line with China’s national conditions and with international standards.

We expect that with regulatory development for ethics in science and technology, support mechanisms and related practices on ethics governance in science and technology in the fintech sector will be further improved as well.

03 Cyber and data security legislation and law enforcement further improved and strengthened in the financial industry

Cybersecurity and data security legislation in the financial sector continued to develop in 2023.

In February 2023, the CSRC formally issued the *Administrative Measures for Cyber and Information Security in the Securities and Futures Industry*, requiring core institutions (such as securities and futures trading venues, securities registration and settlement institutions, and futures margin depository and monitoring institutions) as well as operating institutions (such as securities companies, futures companies, and fund management companies) to establish sound cybersecurity management systems to enhance capacities in safeguarding network operation.

In June 2023, the NFRA issued to banks, insurance companies, wealth management companies and other institutions the *Notice on Strengthening the Management of Cyber and Data Security in Third-party Cooperation*. As a response to multiple security incidents caused by the outsourcing service providers used by banking and insurance institutions, the Notice required banking and insurance institutions to understand potential cyber and data security risks in digital ecological cooperation, and to formulate corresponding risk rectification plans.

On July 24, 2023, the PBOC issued the *Measures for the Administration on Data Security in People's Bank of China Business Areas (Consultation Draft)*, setting out protection requirements throughout the data lifecycle.

In August 2023, the NFRA, together with four other departments, jointly issued the *Notice on Matters related to Regulating the Data Service of Currency Brokerage Companies*, aiming to regulate data services provided by currency brokerage companies, encourage lawful and reasonable data use, ensure data security, and enhance market information transparency.

In terms of cybersecurity risk management products, on July 2, 2023, the MIIT and the NFRA announced the *Opinions on Promoting the Standard and Healthy Development of Cybersecurity Insurance*, providing various guiding opinions on the operation, development and management of cybersecurity insurance, and calling for the establishment of sound supporting policies and standard system.

In addition to these measures, notices and opinions enhancing cybersecurity and data security in legislation, law enforcement was active in cybersecurity and data security in 2023.

In the securities sector, law enforcement subjected many securities firms to regulatory measures due to their system failures. Among the enforcement actions taken by law enforcement bodies, a securities firm was subject to regulatory measures by the CSRC Shenzhen Branch, the Shanghai Stock Exchange, and the Shenzhen Stock Exchange due to a system failure incident in June 2023. Three regulators taking action against a securities firm for one incident is uncommon as compared to past regulatory practice.

In the banking and insurance sector, law enforcement penalized a number of banking or insurance companies for failing to comply with regulatory requirements on data security, such as failures in data security management, in reporting information security incidents, and in sufficient control over production data security.

04 AIGC regulations begin to emerge, industry develops under supervision

Driven by the rapid development in the artificial intelligence industry, regulatory rules on artificial intelligence have been gradually formulated and implemented.

On January 10, 2023, China's first specialized departmental regulation for deep synthesis services, the *Administrative Provisions on Deep Synthesis of Internet Information Services*, came into force. Subsequently, on June 20, 2023, the CAC released the first batch of domestic deep synthesis service algorithms (41 in total) that have completed filing with the CAC, covering a number of popular apps such as Meituan, Kuaishou, Taobao, Daimai, Kugou Music, and Baidu Wenxin Yige.

Further to these provisions, on July 10, 2023, the Cyberspace Administration of China (CAC) and six other departments jointly issued the *Interim Measures for the Administration of Generative Artificial Intelligence Services ("Interim Measures")*, which clarified the definition of artificial intelligence generated content (AIGC) and established specific compliance requirements for AIGC products and services.

On August 31, 2023, companies and organizations, including Baidu, Byte Dance, Sense time, Chinese Academy of Sciences, Baichuan Intelligence and Zhipu Huazhang, completed algorithms filing for their large-scale model products — the first batch of filed products announced after the Interim Measures came into effect. Among these filed products, Baidu's Ernie Bot has provided access to Shenwan Hongyuan, Guangfa Securities, Industrial Securities and other securities firms to pursue cooperation in wealth management

and other fields.

In addition to industry-specific regulations offering comprehensive compliance guidance for AIGC, additional regulatory documents, self-regulatory rules and industry norms were formulated and developed in response to industry concerns about data security and other derivative risks in the application of AIGC.

On April 10, 2023, the Payment and Clearing Association of China issued the *Proposal on the Cautious Use of ChatGPT and Other Tools by Payment Industry Participants*.

On April 18, 2023, the Supreme People's Procuratorate of China issued the *Opinions on Strengthening the Internet-related Rule of Law by Procuratorial Organs in the New Era*. The opinions proposed strengthening research on legal issues related to new technologies and new forms of business such as artificial intelligence. Further, the opinions proposed conducting timely detection and precise punishment of criminal activities using new technologies or new business as disguise.

In terms of risk prevention and control and security management mechanisms, on August 6, 2023, the State Administration for Market Supervision and Administration and the Standardization Administration issued the *Technical Requirements for Intelligent Risk Prevention and Control in Internet Finance*, setting out the required technical framework for intelligent risk prevention and control technology in Internet finance.

On October 11, 2023, the National Information Security Standardization Technical Committee (TC 260) issued the *Basic Requirements for the Security of Generative AI Services (Consultation Draft)*. The draft document provides basic guidelines on security matters faced by AIGC services providers, such as corpus security, model security, security measures, security assessments and filing applications, and offers standard implementation guidance for the security requirements provided under the Interim Measures.

05

Special department established to promote data development; accounting rules for data assets are further specified

In 2023, institutional reforms and rules were promulgated to promote the use and development of data resources.

In terms of institutional establishment, on October 25, 2023, the National Data Administration was inaugurated. In accordance with the *Plan on Reforming Party and State Institutions* issued in March 2023, the

National Data Administration's responsibilities include coordinating and promoting the construction of basic data systems; coordinating the integration, sharing, development, and application of data resources; and promoting the planning and building of Digital China, digital economy and digital society. In view of the responsibilities assigned to the National Data Administration and the positioning of the National Data Administration within the government hierarchy, it is reasonable to expect that the establishment of the National Data Administration will help coordinate the integration, development, and application of data resources and will facilitate focused exploration of feasible solutions to key issues such as data rights confirmation and data assetization.

In terms of rule promulgation, on August 1, 2023, the Ministry of Finance officially issued the *Interim Provisions on Accounting Treatment of Enterprise Data Resources*, further clarifying and specifying accounting rules for data assets. On September 8, 2023, the China Appraisal Society issued the *Guiding Opinions on Data Asset Appraisal*, which clarified data asset appraisal, including attributes and definitions, appraisal objects, operational requirements, appraisal methods and disclosure requirements, and provided useful guidance for standardized data asset appraisal activities. On December 31, 2023, the National Data Administration and 16 other departments jointly issued the *"Data Elements x" Three-Year Action Plan (2024-2026)*. The Plan refers to the application of "Data Elements and Financial Services" as one of the key actions in 12 areas, and explicitly supports financial institutions to share risk control data among each other and integrate and analyze multidimensional data such as financial markets, credit assets, and risk inspection to leverage the driving role of fintech and data elements. On the same day, the Ministry of Finance issued the *Guiding Opinions on Strengthening Data Asset Management*, which includes tasks such as "accelerating the construction of a data asset property rights system with scientific classification" and "promoting the construction of standards relating to data assets, such as technology, security, quality, classification, value evaluation, management, and operation standards."

Under the guidance of the aforementioned policies and rules, provinces such as Shandong, Guizhou, Guangdong, Beijing, and Shanghai also introduced corresponding policies to actively explore building local basic data element systems and methods of data rights confirmation and accounting approaches, and to encourage local pilot programs. These local efforts have achieved results. For example, in April 2023, Shenzhen Weiyang Technology Co., Ltd. obtained the first "no asset-pledge" data asset loan in the country, based on data assets listed on the Shenzhen Data Exchange for trading. In another example, in October 2023, Wenzhou Big Data Operation Co., Ltd. successfully registered its data product as a "data asset". This registration was the first publicly reported instance of enterprise's data assets recognition guided by financial authorities.

06 Outbound data transfer rules continue to develop, showing regulatory intention to “facilitate cross-border data transfer”

Rules for cross-border data transfer were further developed and improved in 2023.

In February 2023, the CAC issued the *Measures on the Standard Contract for the Outbound Transfer of Personal Information* (“**Standard Contract Measures**”). Later in May 2023, the CAC further issued the supporting *Guidelines for the Filing of the Standard Contracts for the Outbound Transfer of Personal Information* to clarify the applicable rules, standard contract terms and filing mechanisms for outbound data transfers using a “standard contract”. Based on these measures, Beijing, Shanghai, Fujian and other regions successively introduced guidelines for filing standard contracts for outbound personal information transfers to provide further local guidance for the orderly filing of the standard contracts. According to the Standard Contract Measures, outbound personal information transfers that do comply with its provisions need to complete relevant rectifications by November 30, 2023.

On July 25, 2023, the State Council issued *Opinions on Further Optimizing the Foreign Investment Environment and Increasing Efforts to Attract Foreign Investment*, which explicitly set “exploring a convenient security management mechanism for cross-border data flow” as a future task. On September 28, 2023, the CAC issued the *Provisions on Regulating and Promoting Cross-border Data Flow (Consultation Draft)*. These draft provisions set out exemptions for outbound data transfer scenarios that are of particular concern to multinational enterprises (including international financial groups) in terms of regulatory requirements such as security assessments and filings for standard contracts. These draft provisions also clarify that the scope of important data should be determined based on the catalogue/list declared by the competent authorities. Once implemented, the draft provisions will significantly reduce the cost of data export compliance for international institutions and will facilitate the efficient operation of multinational financial institutions and cross-border financial activities. On November 26, 2023, the State Council issued the *Overall Plan for Promoting High-level Institutional Opening-up in the China (Shanghai) Pilot Free Trade Zone by Comprehensively Aligning with International High-standard Economic and Trade Rules*. This plan provides clear instructions on the outbound transfers of financial data and supports the Shanghai Pilot Free Trade Zone in taking the lead in formulating important data catalogues. On December 13, 2023, the CAC and the Innovation, Technology and Industry Bureau of Hong Kong jointly issued the *Standard Contract for the Cross-boundary Flow of Personal Information Within the Guangdong-Hong Kong-Macao Greater Bay Area (Mainland,*

Hong Kong (the “Regional SCC for Greater Bay Area”)). The Regional SCC for Greater Bay Area sets out special rules and requirements for applicable standard contracts on the cross-border flow of personal information between the mainland area within the Guangdong-Hong Kong-Macao Greater Bay Area and Hong Kong, and aims at safeguarding personal information security while fully promoting reasonable cross-boundary personal information flows within the Greater Bay Area.

07 Regulations on non-bank payment institutions finally released, bank card clearing industry continues to open up

On December 9, 2023, nearly three years after the consultation draft was issued, the *Regulations on the Supervision and Administration of Non-bank Payment Institutions* (the “**Non-bank Payment Regulations**”) were finally released and will take effect on May 1, 2024. As the first administrative regulation governing the non-bank payment institutions, the Non-bank Payment Regulations recognize the significant role of the non-bank payment industry in promoting transactional activity and market prosperity, supporting the development of the real economy, and improving people’s livelihoods.

By reconstructing the payment business categories and the supporting regulatory rules in the payment sector on the basis of the existing regulatory rules and in conjunction with the characteristics of the industry’s development, the formal implementation of Non-bank Payment Regulations will help strengthen supervision of the payment industry, promote market standardization, prevent risks, and achieve the stable development of the payment industry.

Meanwhile, the opening-up of the payment and clearing sector continues to progress steadily. In November 2023, the PBOC approved the business commencement application submitted by MasterCard NUCC Information Technology (Beijing) Co., Ltd., and on November 17, 2023, issued to it the bankcard clearing business license. According to publicly available information, MasterCard NUCC Information Technology (Beijing) Co., Ltd. is a joint venture company in China initiated and established by MasterCard and NUCC. After obtaining the bank card clearing business license, the company, being the second joint venture bank card clearing institution in China, is qualified to authorize member institutions to issue and accept RMB bank cards under the MasterCard brand within China.

08 Credit reporting embraces standardized development

On June 30, 2023, the transition period of the *Measures for the Administration of Credit Reporting Business* ended. With that end, the credit reporting business officially enters a new period in which the direct connections between the financial institution and the credit information provider will be disconnected.

In addition, on August 16, 2023, the PBOC issued the revised *Regulations on Handling Credit Reporting Complaints (Consultation Draft)* — one of the normative documents in the credit reporting business sector. Compared with the current version issued in 2014, the new *Regulations on Handling Credit Reporting Complaints (Consultation Draft)* mainly revised and adjusted the existing provisions to create a more convenient and standard complaint filing and handling process.

At the same time, law enforcement in credit reporting was also progressing. Several penalties imposed on banking institutions for violating regulations on credit information collection, provision, inquiry, and credit reporting business management.

Furthermore, on August 4, 2023, the PBOC announced a penalty for Baihang Credit Services Corporation. According to this announcement of PBOC, Baihang Credit Services Corporation was warned and fined CNY 515,000 for violating regulatory rules for credit reporting agency and illegal acts such as violating regulations on credit information collection, provision, and inquiry. The persons at Baihang Credit Services Corporation responsible for the illegal acts were also punished accordingly.

2024 Regulatory Outlook

01 Fintech continues to empower ESG

As one of the key tasks set by the *Financial Technology Development Plan (2022-2025)*, green finance remained a key topic in the fintech sector in 2023. In February 2023, the Central Committee of the CPC and the State Council issued the *Plan for the Overall Layout of Building a Digital China*, explicitly stating that “digitalization” and “greening” have become the two important directions of post-epidemic economic recovery. And on October 31, 2023, the Central Financial Work Conference also set “green finance” as one of the five major “articles” on finance.

Meanwhile, driven by the development and application of ESG evaluation systems, fintech is undertaking a more prominent role in empowering financial institutions to implement ESG practices in recent years. For example, in December 2022, relying on fintech technology, the China Construction Bank was the first bank to successfully develop and apply an automated ESG rating tool for its full-range institution customers. And in December 2023, it further integrated ESG elements into its customer credit ratings.

According to the *2023 China Fintech Enterprise Chief Insight Report*, green finance and ESG investment have been ranked among the top three blue ocean business areas of fintech for two consecutive years.

With the further development and improvement of the fintech regulatory system, the synergistic development between fintech and ESG will inevitably become more prominent.

02 Top-level legislation may be released to protect financial consumers

In 2023, financial consumer protection continued to receive regulatory attention.

In terms of institutional establishment, according to the *Provisions on the Functions, Structure, and Staffing of the National Financial Regulatory Administration* issued on November 10, 2023, the Financial Consumer Protection Bureau will be established under the NFRA.

The Financial Consumer Protection Bureau will be responsible for formulating development plans and systems to protect financial consumers' rights and interests. It will also concurrently undertake

work related to the compliance and suitability management of financial products related to consumer protection, organize investigations, and handle cases involving infringement of the legitimate rights and interests of financial consumers.

The establishment of the Financial Consumer Protection Bureau will effectively resolve the issue of multiple and conflicting regulation from the PBOC, the CSRC and the former China Banking and Insurance Regulatory Commission. It will centralize and unify responsibilities for protecting financial consumers and will eliminate regulatory redundancy and arbitrage. Therefore, the Financial Consumer Protection Bureau will be conducive to the interconnection of regulatory resources and the improvement of regulatory efficiency.

In terms of rule formulation, following the official implementation of the *Administrative Measures for the Protection of Consumers' Rights and Interests of Banking and Insurance Institutions* in March 2023, the NFRA issued the *Notice on Work Arrangements for Handling Matters Reflected by Financial Consumers* in May 2023. The Notice requires financial institutions to actively and properly resolve conflicts and disputes with financial consumers in strict accordance with the complaint handling requirements. Being the first regulatory document issued after the NFRA's establishment, its issuance signals a regulatory intention to focus on protecting financial consumers and that the NFRA will place importance on protecting financial consumers in future regulatory work.

With an integrated regulatory powers and departments and the clear importance of financial customers protection in regulatory work, it is reasonable to expect that top-level legislation on financial consumer protection will be placed on the agenda. At the same time, as the fintech sector enters the stage of "normalized supervision", consumer protection in the online promotion and sale of financial products and in other e-commercial activities involving financial products will also become the focus of future law enforcement activities under "normalized supervision".

03 Rules for cross-border data transfer continue to be refined; regulations for data assetization are expected to be further improved

Although the *Provisions on Regulating and Promoting Cross-border Data Flow (Consultation Draft)* will significantly reduce the compliance thresholds for cross-border data flows (especially the outbound transfer of personal information), the new thresholds (as draft rules) cannot serve as an effective basis for an outbound data transfer. Given the regulators have shown a clear intention to remove barrier in and facilitate cross-border data transfer required for normal business operation, it is predictable that following the announcement of the *Provisions on Regulating and Promoting Cross-border Data Flow (Consultation Draft)*, the legislative department will focus on formulating or finalizing rules on cross-border data transfers that aim at "facilitating cross-border data transfer", as well as issuing catalogues and identification criteria for important data.

Meanwhile, with intensified explorations in the data element market and the importance of "data assetization" being further highlighted in the development of the data economy, we believe that starting with the establishment of the National Data Administration, top-level system design and supporting measures for data assetization may already be on the agenda.

04 Detailed regulations for third-party payment businesses to be introduced; business scenarios further broadened for cross-border payments and e-CNY

Although the Non-bank Payment Regulations reclassified and re-set regulatory requirements for third-party payment business, implementation details have yet to be clarified. Examples of those unclarified implementation details include the identification criterion for different types of payment businesses and the transition between new and old licenses. Therefore, to fill these gaps, further implementation rules and regulatory documents will likely be introduced to ensure proper operation of third-party payment business under the Non-bank Payment Regulations.

Meanwhile, with the joint release of the *Opinions on Providing Financial Support to the Building of the Guangdong-Macao In-Depth Cooperation Zone in Hengqin* by the PBOC and four other departments in February 2023, business scenarios in the cross-border payment sector are expected to further expand, considering

that the opinions propose regional pilot initiatives such as “supporting banks and non-bank payment institutions to collaborate in providing facilitated cross-border services for the remittance and payment of personal salaries based on the actual salary level” and “promoting the universal use of mobile electronic payment tools in the cooperation areas”.

Additionally, for cross-border payment and clearing, the development and policy support of e-CNY in bulk commodities trading is also noteworthy. According to information publicly reported in July 2023, Industrial Bank, as a spot clearing member of the Shanghai Clearing House, successfully launched the first e-CNY settlement service for spot clearing of bulk commodities at its Qingdao branch. As one of the first eight commercial banks to implement this e-CNY settlement service, Industrial Bank has laid the groundwork for e-CNY to be used in bulk commodity spot trading scenarios.

Furthermore, during the “Cross-border Application and Prospect of e-CNY in Hong Kong” forum at Hong Kong Technology Week, Di Gang, deputy director of e-CNY Research Institute of the PBOC, also indicated that the regulator will study the use of e-CNY for cross-border payments in commodity and services trading, such as in oil and gas industry, under the framework of bilateral cooperation in the future.

05 Fintech innovation presents a stable development trend; supporting regulatory rules are expected to be further improved

In 2023, fintech innovation pilot programs were steadily promoted.

On May 16, 2023, Beijing Zhongguancun National Innovation Demonstration Zone became the seventh pilot financial reform zones for scientific and technological innovation. This designation was announced in the *Overall Plan for the Construction of a Pilot Zone for Science and Technology Innovation Finance Reforms in the Beijing Zhongguancun National Innovation Demonstration Zone*, jointly issued by nine ministries and commissions, including the PBOC, the National Development and Reform Commission, the Ministry of Science and Technology, the MIIT, the Ministry of Finance, the China Banking and Insurance Regulatory Commission, the CSRC, the State Administration of Foreign Exchange, and the National Intellectual Property Administration. In having a pilot zone located in the city, Beijing follows Jinan in Shandong Province and five cities in Yangtze River Delta, Shanghai, Nanjing, Hangzhou, Hefei and Jiaxing.

On June 7, 2023, the CSRC issued the *Letter on Supporting the Pilot*

Project of Capital Market Fintech Innovation in Jinan City, making Jinan the sixth city approved to conduct the pilot project for capital market fintech innovation. Jinan follows Beijing, Shanghai, Guangzhou, Shenzhen, and Nanjing.

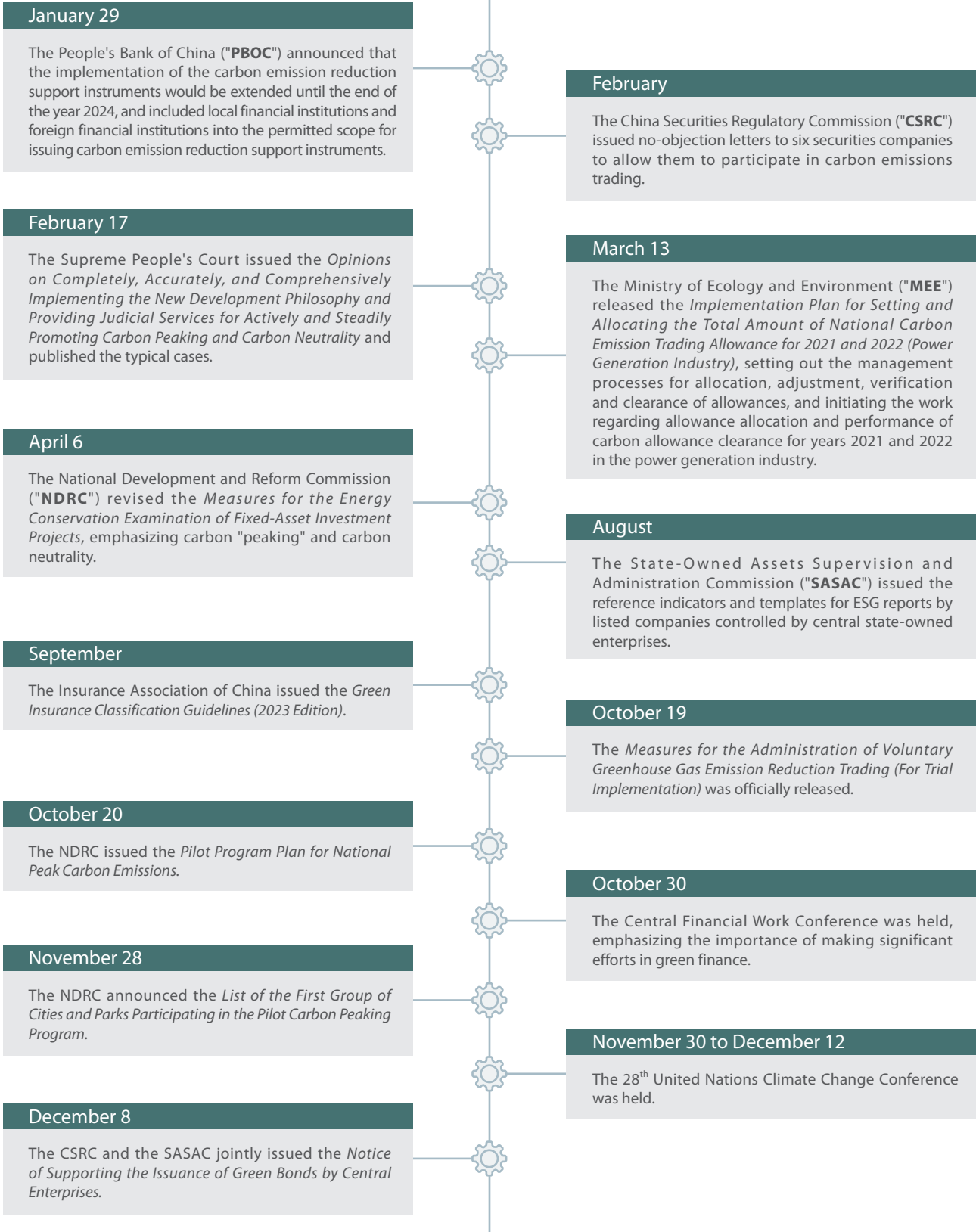
Soon afterwards, in November 2023, Chengdu was the seventh city approved to conduct a pilot project for capital market fintech innovation.

It is foreseeable that with the further expansion of the fintech innovation pilot programs and with the gradual popularization of innovative products and business models, regulatory rules will be correspondingly developed for financial innovations incorporating AIGC, cloud computing, big data, blockchain and other technologies. Similarly, IT-related legislation and law enforcement of financial innovation will be steadily promoted with the establishment of the Department of Science and Technology Supervision of the National Administration of Financial Regulation.

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Green Finance and Carbon Markets

2023 Regulatory Milestones



2023 Regulatory Mainline Review

01 Significant regulatory breakthroughs in peak carbon and carbon neutrality; interplay of legislative initiatives and changes respond to market needs

In 2023, a number of regulations, documents or consultation drafts in relation to climate change and "Carbon Peaking and Carbon Neutrality" were introduced to provide legislative support for sustainable development. The measures taken were:

- firstly, the legislative hierarchy has been improved. After continuous refinement of the draft in 2023, the *Interim Regulation on the Administration of Carbon Emission Trading* was formally adopted at the executive meeting of the State Council on January 5, 2024. This is the first domestic administrative regulation for administration of carbon emission trading and addresses the issues that had arisen from existing regulations and rules for carbon emissions trading (i.e. the goals of regulating trading activities, guaranteeing trading data quality and punishing illegal behaviors were only somewhat erratically supervised by the relatively low-level (i.e. not central level) legislative hierarchy of such existing regulations and rules).
- secondly, on October 19, 2023, the long-awaited *Measures for the Administration of Voluntary Greenhouse Gas Emission Reduction Trading (For Trial Implementation)* (the "**New CCER Regulation**") was officially released, as the basis and guideline for the systems of the restarted national greenhouse gas voluntary emissions reduction trading market (the "**CCER Market**").
- thirdly, in April 2023, the NDRC revised the *Measures for the Energy Conservation Examination of Fixed-Asset Investment Projects*, emphasizing the integration of energy conservation with the goal of "Carbon Peaking and Carbon Neutrality"; on March 16, 2023, the NDRC issued a consultation draft of the revised *Guiding Catalog of Green Industries*, which is expected to be formally promulgated and implemented in 2024; moreover, the NDRC issued a revised version of the *Catalogue for Guiding Industry Restructuring* at the end of 2023, which became effective on February 1, 2024 and emphasized the energy saving, carbon emission reduction and green transition.

The promulgation or update of the foregoing regulations and documents not only responds to the development and practice of the goal of "Carbon Peaking and Carbon Neutrality", but also provides strong support for achievement of such goal.

According to the legislative plan released by the Standing

Committee of the 14th National People's Congress in September 2023, the legislation with aims of addressing climate change and achieving Carbon Peaking and Carbon Neutrality is still considered as a legislative project which lacks certain legislative conditions and requires further research. Therefore, the enactment of laws to be promulgated by the National People's Congress such as *Climate Change Law*, *Carbon Emission Reduction Law* or *Carbon Financial Inclusion Law* may take more time; while the revisions to be made on some other laws such as the *Energy Law*, the *Renewable Energy Law*, and the *Marine Environmental Protection Law* have been put on the agenda, with the expectation of incorporating the applicable contents to address climate change and ensure the realization of the goal of "Carbon Peaking and Carbon Neutrality".

02 "1+N" Policy Framework Upgraded; Transition Finance and Inclusive Carbon Financeng

The policies and guidelines issued by applicable authorities and central and local governments remain as the important tools for addressing climate change and achieving the goal of "Carbon Peaking and Carbon Neutrality".

In 2023, under the established "1+N" policy framework for Carbon Peaking and Carbon Neutrality, the supporting policies were further refined by the appropriate regulatory authorities :

- following the promulgation of provincial-level implementation plans for Carbon Peaking in many provinces in 2022, some sector-specific Carbon Peaking implementation plans were further introduced in 2023 in some provinces/municipalities (e.g. those issued in Hebei, Inner Mongolia, Zhejiang, Fujian, Chongqing, Tibet, Shaanxi and Qinghai, and the Carbon Peaking implementation plans for the urban-and-rural construction sector issued in Hebei, Shanxi, Jiangsu, Fujian, Shandong, Henan, Hubei, Hunan, Chongqing, Guizhou, Qinghai and Xinjiang);
- at the end of October, the NDRC issued the *Pilot Program Plan for National Peak Carbon Emissions*, proposing that "financial institutions shall be encouraged to support the construction of cities and industrial parks implementing the peak carbon dioxide emissions pilot program, comprehensively use financial tools such as green credit, green bonds and green funds, and increase support for relevant green and low-carbon projects in a market-oriented manner", and also announced the list of first group of national "carbon peaking" pilots at the end of November;

- on December 8, the CSRC and the SASAC jointly issued the *Notice of Supporting the Issuance of Green Bonds by Central Enterprises*, guiding and supporting the central enterprises to raise funds through the green bonds market, and boosting the development of the green industry.

Climate finance is an important policy instrument in achieving the goal of "Carbon Peaking and Carbon Neutrality". After the jointly announced list of climate finance pilots (i.e. a total of 23 approved pilot cities/areas) by MEE and eight other applicable authorities in August 2022, these pilot cities/areas have issued a series of policies to promote the implementation of the pilot programs, the majority of which have already established the climate finance project databases and platforms to match governments, banks and enterprises in 2023. Certain pilots such as Nansha District in Guangzhou, have put in place specific and quantitative financial incentive policies for enterprises, projects and talented persons.

In addition to climate finance, the promulgation of *G20 Transition Finance Framework* issued in the end of 2022, which was led by the PBOC (as one of the co-chairs of the G20 Sustainable Finance Working Group), marks the first international consensus reached between major countries on the development of transition finance. In March 2023, the government work report of the 14th National People's Congress emphasized the importance of the role of finance in bringing about green transition. At the end of March, the vice-governor of the PBOC was also quoted as saying that the PBOC would actively promote the promulgation and implementation of transition finance standards as soon as practicable. The PBOC has taken the lead in drafting transition finance standards for four industries (i.e. the industries of coal and electricity, iron and steel, building materials and agriculture) and would publish consultation drafts in due course. The finance work plans and green finance policies by local regulatory authorities also mentioned the promotion of the linkage between green finance and transition finance. As for the market practice, the Bank of China issued the first steel transition finance bond (the first in the world) on October 12 with all the funds raised being used to support the green transition projects of the iron and steel industry in Hebei province.

In 2023, the local governments actively explored policies of carbon financial inclusion. For example:

- the *Key Tasks List for the 2023 Municipal Government Work Report* of Beijing proposed improving incentives for carbon financial inclusion and incorporating low-carbon travel scenarios such as replacing fuel-powered motor vehicles with electric ones into the scope of carbon financial inclusion incentives;
- several work plans (or drafts) to create a carbon financial

inclusion system were published in some provinces, such as Shandong and Anhui, proposing the establishment of personal carbon accounts and offset channels for certified emission reduction of carbon financial inclusion, the formation of expert committees for carbon financial inclusion, and the development of appropriate institutional standards and methodologies;

- the authorities in Hainan and Guangzhou issued implementation/administration measures on carbon financial inclusion;
- the *Cooperation Framework Agreement for the Construction of the Carbon Financial Inclusion Platform in the Greater Bay Area* was entered into by two organizations in Guangdong Province and the Macau Special Administrative Region, aiming to cooperate in the exploration of carbon financial inclusion;
- the Shanghai Municipal Bureau of Ecology and Environment issued the *Administration Measures for Carbon Financial Inclusion in Shanghai Municipality (for Trial Implementation)* in November, and also published a series of ancillary guidelines such as the development and application guidelines for methodologies, and carbon financial inclusion projects and carbon emission reduction scenarios, as well as the guidelines on the use of carbon financial inclusion credits. These efforts have laid the foundation for establishing a local carbon financial inclusion system.

03 New Green Finance Policies Open Up to New Participants and Products

In 2023, more regulations and policies related to green finance were implemented:

- with the expiration of the one-year transition period in May 2023 as provided in the *Guidelines on Green Finance for the Banking Industry and the Insurance Industry*, the banking and insurance institutions have set up and refined their internal green finance-related management systems and processes;
- in September, the Insurance Association of China issued the *Green Insurance Classification Guidelines (2023 Edition)*, which provides self-regulation in three aspects: green insurance products; green investment of insurance funds; and green operation of insurance companies;
- The central and local regulators issued policies to encourage and support the local development of green finance and

carbon finance. For example, (i) the former CBIRC, the CSRC and the State Administration of Foreign Exchange ("SAFE") and some other authorities, together with the Guangdong Province Government, jointly issued the policy to support the development of green finance in Guangdong-Macao In-Depth Cooperation Zone in Hengqin and Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone and strengthen the green finance cooperation in the GBA; (ii) the financial regulators in a number of provinces/municipalities such as Shanghai, Beijing, Tianjin, and Hebei introduced policies to actively promote the healthy development of the local green finance market; and (iii) the Shandong Province Government launched a three-year action plan to promote the development of carbon finance.

It is expected that the green finance related regulations will be further revised and refined under the existing institutional framework in the coming period.

With the ongoing development of the domestic sustainable finance market, the policies have become increasingly open to attract various types of market participants to participate in sustainable finance. For example, at the end of January 2023, the PBOC not only decided to extend the effective period for the implementation of the carbon emission reduction support instruments to the end of 2024, but also extended the scope of institutions permitted to issue such instruments to include local financial institutions and foreign financial institutions, as well as national financial institutions, aiming at encouraging more financial institutions to participate in the financing of such areas as clean energy, energy conservation and environmental protection, and carbon emission reduction technologies by using monetary policy tools.

In terms of the carbon market, in February 2023, six securities company announced that they had received no-objection letters from the CSRC to allow them to participate on their own account in carbon emissions trading. To date, eight securities company have successfully obtained such official no-objection letters and are permitted to carry out proprietary trading in the carbon emissions trading market.

While the market for single green-themed financial products has become more mature, there is more activity when it comes to exploring new products which combine greenness with something else. For example, the first domestic green and energy supply dual-themed asset-backed security ("ABS") was issued in April 2023, followed by the issuance of the first domestic green and low-carbon transition-linked ABS in June. Green financial products have also been developed to cover sectors such as rural revitalization: for example, in March, the Agricultural Bank of China took the lead

in underwriting the first domestic carbon emission right asset-backed bond with four themes (i.e. carbon neutrality, carbon assets, rural revitalization and old revolutionary base areas). Currently, innovations in the green finance market are still mainly about investments, i.e., incorporating green investment targets and sustainable elements such as green and/or low-carbon performance indicators into more traditional and mature transaction and product structures. We expect that innovations in product structures will gradually emerge as the market deepens its understanding of green finance in the future.

04

Carbon Quotas: Stable Nationwide Market with Continued Regional Growth

In terms of the "top-level" legal framework, the *Interim Regulation on the Administration of Carbon Emission Trading* ("**Interim Regulation**") was formally adopted at the executive meeting of the State Council on January 5, 2024, laying out the basis of the institutional framework for administration of the carbon emission trading in the mandatory National Carbon Market. The Interim Regulation clarified the trading system of the national carbon market for the first time in the form of the administrative regulation. This addresses defects in the existing regulations and rules (such as the *Measures for the Administration of Carbon Emissions Trading (for Trial Implementation)*) but also coordinates the efforts of multiple applicable authorities (including ecological and environmental departments) to promote the development of the trading and management of carbon emissions trading. Another highlight of the Interim Regulation is that compared with the existing regulations, it strengthens the processes for punishing those acting illegally (such as falsifying carbon emission data) in order to safeguard quality of carbon emission data.

The second performance period of the national carbon emissions trading market (the "**National Carbon Market**") has finished. On July 17, the General Office of the MEE issued the *Notice on the Work Related to the Clearance of Carbon Emission Allowances for the Years 2021 and 2022 in the National Carbon Market*, according to which the second performance period of the National Carbon Market was two years (i.e. the relevant key emission entities were required to complete the settlement and clearance of carbon emission allowance allocated respectively for the years of 2021 and 2022 before December 31, 2023). The policies for the second performance period will introduce differentiated allowance allocation and performance and also introduces flexibility when it comes to allocations of carbon emission allowances, to make adjustments for those with allocation shortfalls or facing clearance difficulties.

Regional carbon markets continued to play a role in 2023. Some regional carbon markets have made significant adjustments, for example lowering the entry threshold for market participants, expanding the scope of industries affected and introducing innovative products. The current version of the Interim Regulation does not require existing regional carbon markets to be incorporated into the National Carbon Market. These regional carbon markets must be aligned with the Interim Regulation. Although regional carbon markets will gradually be phased out as the national carbon market takes over, they can still serve as useful policy testing grounds.

05 Voluntary Carbon Market: CCER Market Relunched with Regulatory Framework Beginning to Take Shape

The voluntary greenhouse gas emission reduction trading market ("**CCER Market**") and the National Carbon Market complement each other. Together, they are the two basic pillars of the carbon market in China. On October 19, 2023, the long-awaited New CCER Regulation was formally released, serving as the foundation and guidance for the regulatory framework of the relaunched CCER Market. Based on that, the applicable regulatory authorities issued ancillary rules (such as the four methodologies for CCER projects in the categories of forestation carbon sinks, mangrove vegetation, grid-connected solar thermal power generation, and grid-connected offshore wind power generation; the guidelines for the design and implementation of CCER projects; the registration and trading settlement rules for CCER projects; and the implementation rules of approval and carbon emission reduction verification of CCER projects). All of this means that the preliminary regulatory framework of the national CCER Market has been set up.

Benefiting from the relaunch of the CCER Market, loan products linked to the registration or development progress of CCER projects have emerged. The Industrial Bank issued the first loan product linked to approval and verification of CCER projects. So far as the carbon sink market is concerned, the CPC Central Committee and the State Council proposed the inclusion of certified voluntary emission reductions from carbon sinks in relation to conservation of water and soil and forest resources in the voluntary carbon market in the *Opinions on Strengthening the Water and Soil Conservation Work in the New Era* and the *Reform Program on Deepening the Collective Forest Right System*. This points to the integration of the carbon sink market and carbon market.

06 Towards a Standardized System for Carbon Reduction; Carbon Footprint Regulatory Framework Taking Shape

In April 2023, the Standardization Administration and other 10 departments jointly issued the *Guideline for Establishing a System of Standards for Carbon Peaking and Carbon Neutrality*, which sets out a series of standardization construction work and objectives related to "Carbon Peaking and Carbon Neutrality" (including green finance product and service standards and green finance evaluation and assessment standards). In July, the National Technical Committee of Carbon Peaking and Carbon Neutrality Measurement and its technical sub-committees were set up, and one of their core tasks is to strengthen the requirements for measuring data on carbon emissions and carbon monitoring, and to research and formulate technical specifications. The objective is to ensure robust measurement of carbon trading and carbon verification. Standards for environmental assessment, carbon emissions and energy consumption for various industries are gradually being formulated and released.

In 2023, the applicable authorities outlined the framework for how the carbon footprint in China is managed. On October 12, 2023, the State Administration for Market Regulation issued the *Implementation Opinions of the State Administration for Market Regulation on Coordinating the Use of Quality Certification to Serve the Work of Achieving Carbon Dioxide Peaking and Carbon Neutrality*, which requires that carbon identification certification (such as the product carbon footprints) to be carried out gradually. On October 20, the NDRC issued the *Pilot Program Plan for National Peak Carbon Emissions*, proposing to explore the ancillary policies such as product carbon footprint management. On November 13, the NDRC and other four departments jointly issued the document guiding the establishment of the domestic product carbon footprint management system, (*Opinions on Accelerating the Establishment of a Product Carbon Footprint Management System*). The document clarifies the overall requirements, key tasks, safeguard measures and organizational implementation requirements for enhancing the management level of key product carbon footprint in China, builds up the overall framework of the product carbon footprint management system, and expressly supports enterprises to voluntarily carry out product carbon footprint certification, as required by the market. In terms of general standards, in November 2023, the applicable departments issued the consultation draft of the recommended national standard of *Requirements and Guidelines for Quantification on the Greenhouse Gases Carbon Footprint of Products*. In addition, the China National Accreditation Service for Conformity Assessment issued the consultation draft of the *Accreditation Scheme for Product Carbon Footprint Validation and Verification Bodies* on January 4, 2024.

07

ESG Disclosure Brought in Line with International Standards

In recent years, although China's companies have made progress in their ESG development and the scope and quality of ESG disclosure, the lack of unified, standardized and localized rules has long been a pain point hindering their development of ESG. In response to the requirements of the *Work Plan for Improving the Quality of Listed Companies Controlled by Central SOEs* issued by the SASAC of the State Council in 2022, the General Office of the SASAC issued the *Notice on Research on the Preparation of ESG Special Reports of Listed Companies Controlled by Central SOEs* in August 2023, in order to facilitate the preparation of ESG special reports by listed companies controlled by central state-owned enterprises (SOEs). This is the first time that the Chinese government has provided specific and systematic interpretations of ESG disclosure standards. The appendix includes the *Reference Indicator System for ESG Special Reports of Listed Companies Controlled by Central SOEs* and the *Reference Template for ESG Special Reports of Listed Companies Controlled by Central SOEs*, which provide basic references for state-owned listed companies in the preparation of ESG special reports. The selected ESG indicators align with the international common standards such as GRI, TCFD, SDGs (United Nations Sustainable Development Goals) and ISO, and are conceptually consistent with the new ISSB standards.

In terms of industries, the Insurance Association of China issued the *Guideline on Disclosure of Environmental, Social and Governance (ESG) Information for Insurance Institutions* on December 13, 2023. The guideline is the first domestic industrial self-regulatory document focusing on the framework and content of ESG disclosure in the insurance sector, which combines China's particular circumstances with international advanced practice, with special emphasis on disclosure requirements related to rural revitalization and financial inclusion. The Beijing Private Equity Association released the *General Principles for Disclosure of Sustainable Investment Information for Private Investment Fund Managers* on September 4, 2023, which became the world's first group standard in the private investment fund sector in terms of sustainable investment/ESG.

08

Judicial Practice In Step with the Times

As the goal of "Carbon Peaking and Carbon Neutrality" continues to advance, the judicial practice in China related to green finance and the carbon market is also keeping up. In February 2023, the Supreme People's Court issued the *Opinions on Completely, Accurately, and*

Comprehensively Implementing the New Development Philosophy and Providing Judicial Services for Actively and Steadily Promoting Carbon Peaking and Carbon Neutrality. This document requires China's judicial systems to "adjudicate the cases related to energy conservation and emission reduction, low-carbon technologies, carbon trading, green finance and other related matters in accordance with the law; to promote climate change mitigation and adaptation", emphasizes the "establishment and improvement of the trial mechanism for carbon-related cases", and puts forward specific opinions on the trial methods and key points of the 17 types of cases closely related to the goal of "Carbon Peaking and Carbon Neutrality" (such as the cases relating to economic and social green transition, industrial restructuring, low-carbon energy system construction, and carbon market trading). On the same day, the Supreme People's Court also released new types of cases in relation to environmental resource trials in recent years, involving (among others) environmental infringement cases arising from greenhouse gas emissions, disputes over carbon emission allowances transfer contracts, disputes over CCER technical service contracts, enforcement of administrative penalties for the settlement of carbon emission allowances, and enforcement of carbon emission allowances. Such cases reflect the active exploration and practice of the judicial system on the protection of new types of environmental rights and interests, and will provide important reference for the subsequent relevant cases across the country.

In terms of the criminal cases, the *Interpretation of Several Issues Concerning the Application of Law in Handling Criminal Cases Involving Environmental Pollution* issued by the Supreme People's Court and the Supreme People's Procuratorate on August 8, 2023, mentioned the issue of criminal liability for the authenticity of information related to carbon emissions, and stated that "where any employee of an intermediary organization charged with the duty of inspection and testing of greenhouse gas emissions, or preparation or inspection of emission reports intentionally provides a false supporting document" may be liable for the crime of providing false supporting documents.

So far as enforcement goes, in September 2023, China's first judicial case connected with CCER was completed in Sichuan province. The case marked the first attempt to extend the judicial enforcement of carbon assets to voluntary carbon emission reduction, based on the previous enforcement cases related to carbon emission allowances. The effectiveness of pledging carbon assets such as carbon emission allowances and CCER has long been a major concern preventing financial institutions from participating in carbon financial transactions and developing related products. Although the reasons for the enforcement of the abovementioned CCER were not disclosed publicly, this case not only provides useful experience for the enforcement of carbon assets in the future, but also boosts

market confidence in the liquidity and enforceability of CCER in the context of the relaunch of the CCER market. It should also provide a judicial basis for the further development of the financial business of carbon asset pledge by Chinese financial institutions in the future.



2024 Regulatory Outlook

01 With the Regulatory Framework in Place, Detailed Regulations Will Follow

The promulgation of the Interim Regulation fills the gap in the high-level legislation on carbon emission trading. We expect that the applicable authorities will engage in the formulation and updates of applicable ancillary regulations, measures, standards and other specific rules (e.g., the coordination process between the authorities, mechanisms for integrating with the green power system, the rules related to data quality, the formulation of lists of key emission entities in specific industries, the allocation and settlement of carbon emission allowances, the rules for statistical accounting of greenhouse gas emission data, and the rules for submission and verification of annual emission reports, and so on), and further consolidate the institutional framework content of carbon market under the regulatory framework of the Interim Regulation .

Although local regulatory authorities are actively exploring carbon financial inclusion policies, currently no national-level policy for carbon financial inclusion exists. On August 31, 2023, the MEE published its *Reply to Proposal No. 5859 of the First Session of the 14th National People's Congress*, to which, regarding the proposal to formulate the Carbon Financial Inclusion Promotion Law (Draft) and set up the pilots of carbon financial inclusion, the MEE replied that "it would collaborate with the other relevant authorities to conduct researches on the standardized construction, operation and management of carbon financial inclusion system, in conjunction with the construction of the greenhouse gas voluntary emission reduction trading market, and provide useful guidance for the healthy development of local carbon financial inclusion systems".

With respect to the establishment of ancillary rules and standards of carbon financial inclusion, the MEE said that it would apply the international standard ISO 14067:2018 (i.e. *Greenhouse gases — Carbon footprint of products — Requirements and guidelines for quantification*) as the common basic standard, and would work with relevant authorities to improve the measurement and standard systems for "Carbon Peaking and Carbon Neutrality", and conduct in-depth studies about the unified carbon financial inclusion platform and the necessity and feasibility of setting up a national carbon financial inclusion management and operation institution. In the *Opinions of the CPC Central Committee and the State Council on Comprehensively Promoting the Construction of Beautiful China* issued on January 11, 2024, there is explicit mention for the first time of "the exploration of establishing of public participation mechanisms such as Carbon Financial Inclusion" in such a central level policy. We therefore expect that the top regulatory framework on carbon financial inclusion will be introduced at some point.

02 Expansion of the National Carbon Market and Regulatory Innovation On Course

Although the current National Carbon Market only covers the power generation industry, we fully expect the industry coverage of the National Carbon Market to expand. The regulatory authorities have made this clear through frequent announcements. On October 27, 2023, Xia Yingxian, the head of the Department of Climate Change of the MEE, mentioned in a press conference that the next step is to include more eligible industries into the National Carbon Market. The MEE carries out annual verification of annual carbon emission accounting reports for industries such as petrochemicals, chemicals, building materials, iron and steel, non-ferrous metals, paper-making, civil aviation and other industries and will prioritize the inclusion of industries that contribute significantly to achieving the goal of "Carbon Peaking and Carbon Neutrality", have overcapacity, exhibit significant potential for pollution reduction and carbon reduction synergy, and have good data quality foundations. In November 2023, Zhao Yingmin, the vice-minister of the MEE, also publicly stated the intention to "actively and prudently" include more high-carbon industries in the National Carbon Market.

Also noteworthy is the approach being taken which involves enterprises bidding for carbon emission allowances. Since 2015, pilot regional carbon markets have been trying to organize paid bidding for carbon emission allowances. The regulatory provisions on paid allocation of carbon emission allowances have evolved from the previous provision of "paid allocation may be introduced in due time" as set out in the *Measures for the Administration of Carbon Emissions Trading (for Trial Implementation)* to the current provision of "a method combining free with paid allocation will be gradually promoted" as provided in the Interim Regulation. In December 2023, a seminar on paid allocation of carbon emission allocation in carbon market was held in Beijing, in which more than 30 experts from the MEE's Department of Climate Change, universities and research institutes, exchanges, certification agencies, and industries (such as power generation, iron and steel, petrochemicals, building materials, and nonferrous metals) discussed the necessity, urgency and feasibility of paid allocation of carbon emission allowances, design of paid allocation schemes, and the raising and use of paid allocation revenues, among other topics. This may lead to the development of a paid allocation scheme for carbon emission allowances in the National Carbon Market in the near future.

03 Carbon Markets to Gradually Link Up with Other Green Energy Regimes and Policy Tools

With the development of the carbon market, the connection between the carbon market and other green resource framework and policy tools is gradually happening. In September 2023, the Central Committee of the Communist Party of China and the State Council issued the *Reform Program on Deepening the Collective Forest Right System*, which emphasizes the connection between the reform of China's collective forest rights and the green finance and the carbon market. The document not only proposes giving full play to the leading role of green finance, studying the inclusion of eligible forest rights trading services and deep processing of forest products into the scope of green finance, and increasing financial support, but also mentions the possibilities of forestry carbon credit, supporting qualified forestry carbon sink projects to be developed into greenhouse gas voluntary emission reduction projects and to participate in market trading, and the creation of an ecological protection compensation system reflecting the value of carbon sinks. Although forestry carbon credits have not yet been included in the trading products of the National Carbon Market or include allowance for offset by key emission entities, we will watch out for integration of forestry carbon credits with green finance, carbon financial products and market mechanisms before too long.

The connection between the green power market, the carbon market and the green finance market is also worth watching. In early December 2023, Hubei Province took the lead in trying out a trading scheme that links the electricity, carbon and finance markets. In this scheme, enterprises can obtain low-interest green loans by pledging carbon emission allowances and using the funds to purchase green electricity, which in turn can be used to offset a certain amount of carbon emission allowances. In 2023, policies and programs for the connection between green electricity and the carbon market were issued in Beijing, Tianjin and Shanghai. Although these policies are currently only piloted in certain enterprises with limited coverage, they serve as a good demonstration of how the electricity and carbon markets can work together.

04 Unified ESG Disclosure Standards to Spur Regulation of ESG Rating Agencies

Although the establishment of unified ESG disclosure standards has been a long-standing topic, the release of the *Reference Indicator System for ESG Special Reports of Listed Companies Controlled by Central SOEs* and the *Reference Template for ESG Special Reports of Listed Companies Controlled by Central SOEs* by the General Office of the SASAC signifies a solid first step taken by top-level regulators towards applicable unified ESG disclosure standards for enterprises in different industries and sectors. Although these documents still only apply in scope to state-owned enterprises, with the accumulation of practical experience and feedback, it is certain that the authorities will further introduce ESG disclosure standards with a broader scope of application.

In addition to the lack of unified actions and disclosure standards, the inconsistency and lack of transparency in the evaluation standards of ESG rating agencies is also one of the reasons that makes it difficult for enterprises to engage in ESG development. Some other jurisdictions have already explored the regulation of ESG rating agencies in 2023. For example, the HM Treasury in the UK has launched a consultation on regulations to bring all ESG-related data and rating products (regardless of whether they are identified as ESG ratings) under the oversight of the Financial Conduct Authority ("FCA"); the European Commission has also followed suit by proposing regulation rules for ESG rating agencies that are roughly consistent with the EU's Benchmarks Regulation ("BMR") system; and the Monetary Authority of Singapore ("MAS") released an official version of *Code of Conduct for ESG Ratings and Data Product Providers* on December 7 and encourages ESG rating agencies to disclose how much their voluntary codes of conduct are being adopted locally. Given that the ESG-related regulatory framework for domestic enterprises has taken shape, at least in preliminary form, we expect that domestic regulatory authorities will explore the regulatory rules for ESG rating agencies in due course.

05 Perservering with Globalization of Standards amidst International Cooperation and Challenges

In 2023, China continued to promote international cooperation on sustainable finance. For example, the Monetary Authority of Singapore ("MAS") and the PBOC jointly set up the China-Singapore Green Finance Taskforce ("GFTF"); China and the United States,

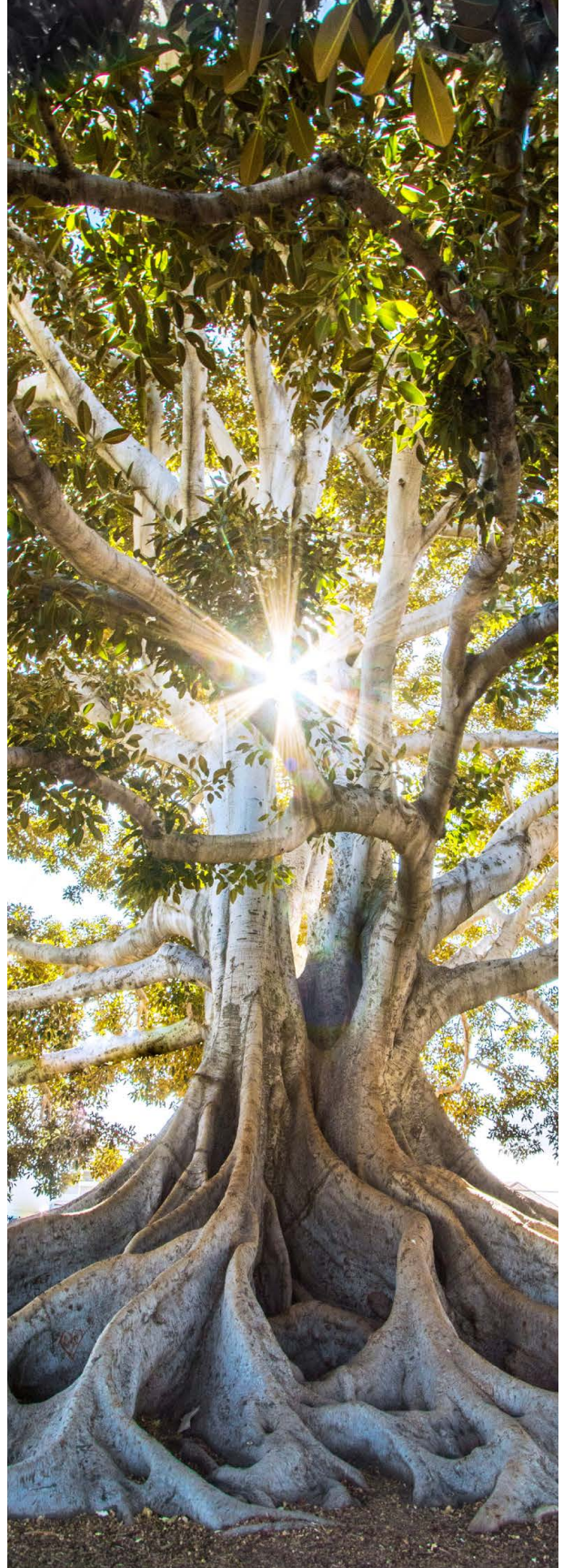
despite complicated international politics and diplomacy, still carried out the Track II Dialogue on Climate Finance and exchanges on climate change legislation, and after two meetings of the China-U.S. special envoy for climate change, China and the U.S. jointly issued the *Sunnylands Statement on Enhancing Cooperation to Address the Climate Crisis* and launched the *Working Group on Enhancing Climate Action in the 2020s* in November 2023. Following the 28th session of the Conference of the Parties ("COP 28") to the UN Framework Convention on Climate Change ("UNFCCC"), the Chinese government stated that it would continue to firmly promote green and sustainable development and "do its best part" in the global response to climate change. We also expect China will be more active in the arena of international cooperation on sustainable finance policies, standards and market practices.

In addition, as the international influence of sustainable finance, carbon emission reduction, and ESG concepts grows stronger, the impact of foreign legislation on domestic enterprises is increasingly significant. For example, the EU's Carbon Border Adjustment Mechanism (CBAM), known as the "carbon tariff", took effect as EU law in May 2023, which means that before the end of the transition period (i.e. the end of 2025), Chinese enterprises may face additional carbon tariffs if they are unable to effectively control the carbon emissions of their products - leading to a possible decline in the competitiveness of their products in the EU market. The environmental and sustainability requirements in the new version of the *Regulation Concerning Batteries and Waste Batteries* in EU, which entered into force in July 2023, also brings additional costs and challenges to the export of products from China's booming new energy enterprises. We will watch out to see whether China will introduce response policies and countermeasures.

The release of the New CCER Regulation and the relaunch of the CCER Market have left room for speculation about cross-border carbon trading, and businesses are looking forward to the authorities issuing policies to allow the mutual conversion between projects under other greenhouse gas emission reduction programs and CCER projects. During the COP28, an official from the MEE expressed "the emphasis on the importance of the internationalization of the carbon market for accelerating global climate action, and the willingness to explore feasible implementation paths and policy tools to promote greenhouse gas emission reduction jointly with various carbon market mechanisms", but also emphasized that "engaging in cross-border carbon trading involves aligning with applicable international rules, which will have an impact on China's fulfilment of its goal of nationally determined contributions (NDCs) and requires coordinated national management." In terms of the regulatory framework design of the future cross-border carbon market, how to achieve a balance between aligning with international standards to meet market expectations and

coordinating national management to safeguard national interests, will become a recurring topic for both policymakers and the market.

In recent years, there have been ongoing updates in sustainable finance-related standards in the international market, some of which have been incorporated into China's policies and standards, as appropriate. For example, on June 26, 2023, the International Sustainability Standards Board (ISSB) issued the final versions of two standards, i.e. *IFRS Sustainability Disclosure Standard: General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1)* and *IFRS Sustainability Disclosure Standard: Climate-related Disclosure (IFRS S2)*, and the abovementioned ESG information disclosure rules for listed companies controlled by central SOEs and the private investment fund sector explicitly state that these international standards will be taken into consideration. How to better align international standards with China's national conditions, so as to integrate into the international market and attract international investors within a safe and controllable scope, will be a long-term issue for domestic policymakers.



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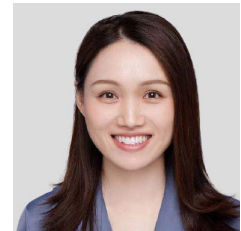
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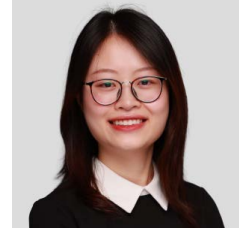
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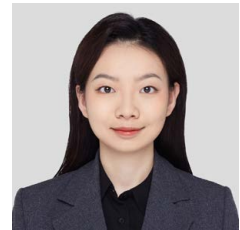
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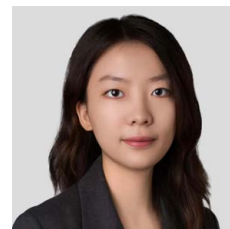
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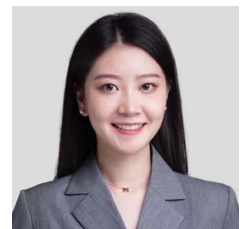
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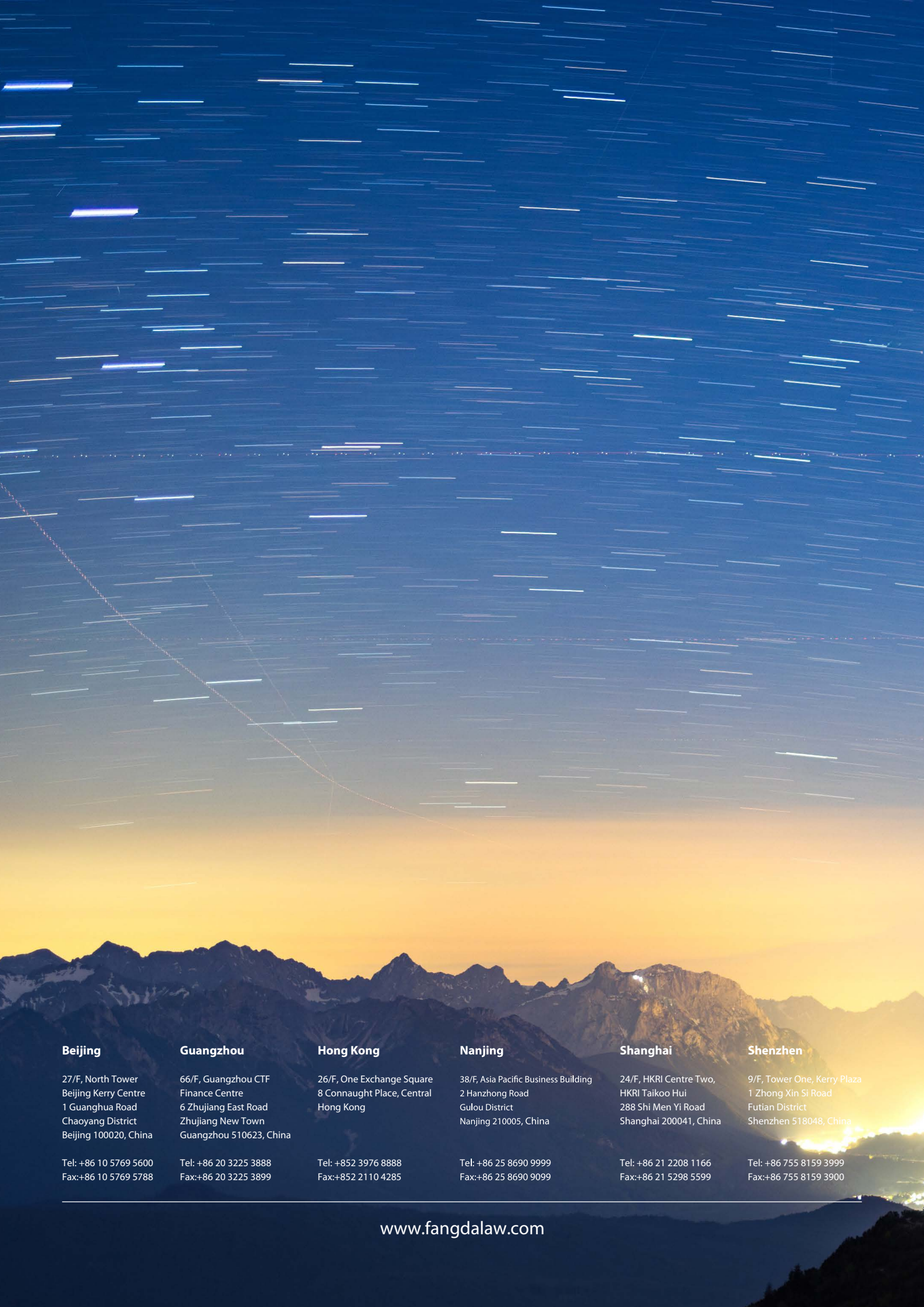
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