FANGDA PARTNERS
方達律師事務所

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

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

2020 Key Dates

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

July 17
The CBIRC published the *Interim Measures on Internet Loans of Commercial Banks*.

August 20
In a judicial interpretation, the Supreme Court set the ceiling on the legal private lending rate at four times that of the loan prime rate (LPR).

September 18
The People's Bank of China (PBOC) published the *Measures on Financial Consumer Protection*.

November 16
Baoshang Bank announced that it wrote down the full RMB6.5 billion tier-two capital bonds, due to the fact of it being "insolvent and unable to survive". November 23: The CBIRC agreed in principle that Baoshang Bank could enter into bankruptcy proceedings.

December 11 and December 21
New license of direct banks with independent legal person status was issued again after three years: China Merchants Topology Bank and China Post Hui Wanjia Bank were approved for establishment.

July 4
The China Banking and Insurance Regulatory Commission (CBIRC) published the first list of "banking and insurance institutions shareholders in major violation of laws and regulations".

August 11
BlackRock, CCB Wealth Management, and Fullerton were approved to establish the second foreign-controlled wealth management company in China; September 24: Huihua Wealth Management, the first foreign-controlled wealth management company in China created by Amundi and Bank of China Wealth Management, was approved to open for business, and on December 10 it launched its first publicly offered product.

September 9
The CBIRC approved the preparation for the establishment of Sichuan Bank through the merger of two pre-existing local institutions.

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

December 3
The PBOC and the CBIRC jointly issued the *Assessment Measures for Systemically Important Banks*.

December 25
The CBIRC published the consultation paper of *Interim Measures on Sales of Wealth Management Products by Wealth Management Subsidiaries of Commercial Banks* for public comment.

2020 Regulatory Observations

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2021 Regulatory Outlook

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

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

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

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

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

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

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

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

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

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

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

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

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

Authors

FANG Jian

Partner, Fangda Partners
jian.fang@fangdalaw.com

Grace Yu

Partner, Fangda Partners
grace.yu@fangdalaw.com

Ada Zou

Counsel, Fangda Partners
ada.zou@fangdalaw.com

Tracy Lin

Fangda Partners
yuan.lin@fangdalaw.com

Yao Zhang

Fangda Partners
yao.zhang@fangdalaw.com

Qifei Zhang

Fangda Partners
qifei.zhang@fangdalaw.com