FANGDA PARTNERS 方達津師事務所

# PRC FINANCIAL REGULATION 2022

**Annual Report** 

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## Preamble

2021 was a year of significance, as in 2021, China embarked on its Fourteenth Five-Year Plan and marched on from its first centenary goal towards its second centenary goal of becoming a great modern socialist country and achieving the rejuvenation of the Chinese nation. 2021 was also a year full of challenges, as China faced the recurrent menace of COVID-19 and the volatile intricacies of the international environment. Against the long-term coexistence of such opportunities and challenges, the financial regulators, in its regulation, continued to uphold the underlying principle of pursuing progress while ensuring stability and the overarching policy of reform and innovation, in further support of the high-quality development of China's economy.

With the deepening of reforms and continuing innovation of technology, the concept, framework and system of financial regulation in China will enter a new phase in 2022. This year is also the third year we present our *PRC Financial Regulation Annual Report*. For this new edition of the *PRC Financial Regulation Annual Report (2022)* series, we provide a comprehensive review of the principal themes of 2021 covering milestone events, main regulatory developments and key trends in the banking, securities, asset management/ wealth management, financial technology and insurance sectors, as well

as looking ahead to the likely developments in 2022 in financial regulations, to provide practical and forward-looking guidance for all those engaged in financial services.

We are dedicated to provide effective, creative and timely legal services to meet the commercial needs of our clients. We have been working in the financial services sector for many years, advising both domestic and overseas clients on their most cutting-edge and complex legal issues in China's financial services sector. We offer an in-depth understanding of the market and considerable transaction experience to deliver a highly valued service to our clients. We look forward to discussing with you the recent reforms in China's financial policy and direction of development of financial regulations.

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

To review the old and gain the new, we look forward to stepping into the new journey of 2022 with you!



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## PRC Financial Regulation: Annual Report (2022) General

### 2021 Key Dates



### **2021 Regulatory Observations**

### "Economic Development" served as the main theme and financial regulation focused more on the real economy

Having the financial sector focus more on financing the "real economy" (as opposed to the "fictitious economy") and improving the institutional arrangements to provide medium and long-term funding to the real economy were set out as one of the long-term development objectives for the PRC economy in the 14th Five-year Plan for National Economic and Social Development and the Outline for Perspective Goals in 2035 (《十四五规划和 2035 年远景目标纲 要》). This served as the principal guide for regulators in 2021.

In the 2021 Government Work Report (《2021 年 政 府 工 作 报 告 》), the State Council pointed out that we needed to give more prominence to the real economy, and the relationship between economic recovery and risk prevention needed to be well managed. The specific measures promulgated in 2021 echoed the above policy:

- continuing to strictly control the real estate sector (to avoid the real economy's fund resources being squeezed by the real estate sector),
- guaranteeing sufficient supply and stable prices of bulk commodities
- reducing transaction fees charged by payment agencies and banks
- increasing credit loans and first-time loans
- promoting the pay-as-you-go lending model
- developing new models for providing supply chain financial services
- deferring repayment of loans granted to micro, small and medium-sized enterprises, and increasing credit loans to micro, small and medium-sized enterprises

These policies underlined the approach taken by decision-makers and regulators to give more support to the real economy and that the financial system should be geared more towards benefitting the real economy.

In terms of the groups who will benefit from the changing policy and regulatory focus, in addition to the traditional "inclusive finance" entities (small and micro enterprises and individual businesses), "green development entities" and agricultural entities in line with the concept of "green finance" and "rural finance", manufacturing enterprises, science and technology innovation enterprises, and small and medium-sized enterprises equipped with special and sophisticated techniques to produce unique and novel products ( 专 精 特 新 ) have all received policy support in 2021. Among them, small and medium-sized enterprises that apply special and sophisticated techniques to produce unique and novel products have enjoyed special treatment after they were granted with a strategic position to break the global technical foreclosure. We anticipate there will be more policies in favor such enterprises.

02

### Stringent regulation maintained and heightened law enforcement remained

There are increasingly stringent regulations applying to the financial sector, a process that began a few years ago and showed no sign of easing in 2021.

In terms of legislation, the Administrative Penalties Law (《 行政处罚法》) revised in July 2021 extended the time period for punishing illegal acts "involving financial security and causing harmful consequences" to five years (the general time period for administrative penalties is two years), reflecting the trend that regulatory actions against illegal financial conduct are gradually being strengthened. New regulations such as the Measures for Administrative Penalties against Illegal Activities relating to Securities and Futures (《证券期货违法行为行政处罚办法》) have been issued to provide support for law enforcement by financial regulators.

**In terms of law enforcement**, regulators are imposing heavier fines for transgressions. In the first nine months of 2021, CBIRC and its branches levied administrative fines of RMB1.9 billion (compared with RMB 2.3 billion for the whole of 2020). In May, the CBIRC imposed a total fine of RMB366 million on five major banks (including state-owned banks, foreign banks and joint-stock banks). Eleven trust companies were fined in total RMB45 million in 2021, an indication that the authorities are addressing failings in the trust sector.

The capital markets (which are mainly governed by CSRC) have

also been subject to more stringent regulation. At the start of 2021, the CSRC noted that there were quite a few problems in PRC's capital markets, such as the increasing frequency of financial fraud, market manipulation, insider trading and lack of due diligence by intermediaries. Zero tolerance was shown to a number of financial institutions for violating laws and regulations, including Since LeTV, Brilliance Bonds, and Yongmei Bonds.

The CSRC expanded its scope of regulation and has started to regulate overseas listings of Chinese companies and the use of (Variable-Interest Entity) VIE structures. The delisting of Kangdexin and the verdict rendered against Kangmei Pharmaceutical for its accounting fraud and false disclosure are further indications that the CSRC is taking a tough line on securities-related violations.

Over the past year, we have seen a greater focus on data protection and consumer protection. Because of the nature of the business conducted by financial services companies, both data protection and consumer protection are key concerns because of the volumes of data processed. Regulators have come down hard on those found to have been in breach of data protection and consumer protection laws. For example, the Ministry of Industry and Information Technology (MIIT) has repeatedly issued reprimands on mobile APPs for "illegal collection of personal information", and a number of banks and internet financial institutions (e.g., WeChat, PPDai, WeLab) have been publicly criticized.

At the start of 2021, the PBOC set out a number of further measures that it proposed to introduce to boost data and consumer protection for the benefit of financial service consumers. These concerned financial advertisements and a better system for reporting complaints. Among the transgressions reported by the CBIRC in 2021 are illegal tied sales (where consumers were forced to buy linked financial products), excessive charges, standard form contracts, non-compliance in providing joint loans, and inadequate management of collections.

There has been closer cooperation between administrative authorities and criminal judicial authorities in securities-related activities in law enforcement. In September 2021, the CSRC, according to the Opinions on Strictly Cracking Down on Securities-related Illegal Activities (《关于依法从严打击证券违法活动的意见》) issued by the General Office of the Central Committee of the CPC and the General Office of the State Council, took the lead in establishing a coordination working group for cracking down on illegal activities

in the capital markets, consisting of the Ministry of Public Security, the Supreme Court and the Supreme Procuratorate. Subsequently, the Supreme Procuratorate set up a procuratorial office branch in the CSRC, and the CSRC, together with public security authorities and procuratorial authorities, investigated 19 major cases in 2021, including several major cases involving market manipulation (including Nanling Minbao, KTK Group and Haozhi Industrial).

## 03

### Governance of local financial institutions strengthened and new structure emerged between central and local financial regulations

In 2021, the central government introduced differentiated financial regulations from one locality to another, significantly strengthened the regulation of local financial markets and institutions, and further delineated the responsibilities of local regulators.

The central government lent greater encouragement and support towards local financial activities and financial innovation. As a result, many policies favorable to local financial institutions (including quasi-financial institutions) were introduced:

- the innovation policies in Hainan and Guangdong-Hong Kong-Macao Greater Bay Area effectively broadened the policy frameworks for local pilot financial activities;
- the Standing Committee of the National People's Congress made an exceptional delegation for the Shanghai Municipal People's Congress to independently formulate regulations specifically for Pudong New Area, positioning Pudong New Area as a quasi-Special Economic Zone;
- Hainan, Chongqing, Guangdong (outside Shenzhen) and Jiangsu were all approved to carry out Qualified Domestic Limited Partners ("QDLP") business and were each approved with an overseas investment quota of US\$5 billion;
- Qingdao was once again approved with an overseas investment quota of US\$3 billion
- Shenzhen Qualified Domestic Investment Enterprise (QDIE) pilot system was updated and restarted;
- Guangdong-Hong Kong-Macao Greater Bay Area "Cross-Border Wealth Management Connect" had its first batch of businesses;
- Shanghai was approved to pilot a regional equity market for transfer of interest in private equity funds and venture funds.

At the same time, local licensed financial institutions became subject to greater regulation. While granting more flexible disposal tools, greater responsibilities were put on local regulatory authorities.

Firstly, local governments are responsible for dealing with, and disposing of, financial risk. At the meeting of the Political Bureau of the Central Committee on July 30, the implementation of "the fiscal and financial risks disposal mechanism under the responsibility of local governmental leaders" was specifically introduced. The special local government bonds specifically for capital replenishment of small and medium-sized banks is a good example. Many provincial governments have injected capital into small and medium-sized banks by virtue of issuing such bonds (for example, Henan Province invested RMB 25.7 billion into18 rural credit cooperatives and 22 rural commercial banks). As of September 2021, the RMB200 billion quota of special local government bonds provided by the Ministry of Finance had been nearly exhausted.

Secondly, the principle of "one institution, one policy" and "one place, one policy" was put forward to encourage the merger and restructuring of small and medium-sized financial institutions. The CBIRC issued the Notice on Further Promoting the Reform and Restructuring of Township and Village Banks to Resolve Risks (《关于进一步推动村镇银行化解风险改革重组有关事项的通知》) at the beginning of 2021. On April 8, the Financial Stability Board called on well-performing institutions to merge with risky institutions. Examples of this include Sichuan Bank, Shanxi Bank and Liaoshen Bank.

The corporate governance of local financial institutions was another area to which regulators paid attention and was the subject of a meeting held on April 8 by the Financial Stability Board. At that meeting, there was a discussion about the financial weaknesses of a number of financial institutions, poor internal governance and a need to enforce regulations against leaders of such institutions who had been in breach of the law - the regulations obviously focused on the major violations of laws and regulations caused by insider control that were common in local financial institutions.. We understand that further reform of local small and medium-sized financial institutions has been put on the agenda. In addition, the meeting of the Financial Stability Board decreed that it was necessary to "support and guide local financial institutions to focus on their main business, establish their business based on local conditions, return to their roots, and serve local small and micro-sized businesses". With the increasingly strict enforcement of policy governing the financial services sector, small and medium banks have been required to support local businesses and been restricted from conducting business outside their localities, including accepting deposits from those outside their area. In this connection, the *Regulations on Local Financial Supervision and Administration*(《地方金融监督管理条例》), were also published at the end of the year to invite public comment.

## 04

### Targeted regulation on FinTech applied while applicable measures adopted to promote and regulate the sector

Financial technology (FinTech) businesses have seen a twin-tracked approach in 2021. On the one hand, the authorities have clamped down on financial activities using internet platforms, while on the other hand, they have been encouraging licensed institutions which were traditionally trusted by the regulators to continue with innovation.

As was the case in 2020, regulators continued to operate on the basis that the "the essential attribute of FinTech is finance" and that "the conduct of financial business must be licensed". They continued to rein in internet companies attempting to break into the financial sector under the banner of FinTech. The 2021 government work meeting called for "strengthening the regulation on financial holding companies and FinTech to ensure financial innovation to be carried out under the premise of prudent regulation". The meeting further required Internet companies to operate FinTech with necessary financial licenses (including the licenses of financial holding company or licenses of credit rating).

Those internet companies carrying out financial technology business have been required by the regulations to comply with regulations governing data security, anti-monopoly, protection of financial consumers' rights and interests, and clarification of the boundaries between different financial products on the Internet platform. Other controls were placed on specific FinTech products, for example:

- the STAR Market in April explicitly restricted FinTech companies from listing;
- prohibitions from carrying out cryptocurrency-related business; and
- cutting off the direct information connection (信息断直连) between internet platforms and financial institutions proposed in mid-2021

In 2021, there were a number of regulations introduced to cover distribution of financial products on Internet platforms (including deposit loans, wealth management products and insurance):

- Internet deposits: the regulators issued the Notice on Regulating the Relevant Matters of Commercial Banks' Personal Deposit Business (《关于规范商业银行通过互联网开展个人存款业务有关事项的 通知》) through the Internet on January 13 2011, putting an end to the practice by commercial banks of soliciting deposits through third-party Internet channels;
- Internet loans: the Interim Measures for the Administration of Internet Loans of Commercial Banks (《商业银行互联网贷款管理暂行办 法》) promulgated at the end of 2020 and the Notice on Further Standardizing Internet Loan Business of Commercial Banks (《关于 进一步规范商业银行互联网贷款业务的通知》) promulgated on February 19 prohibited locally incorporated banks from conducting Internet loan business "beyond the place of registration";
- Wealth management products of banks: The Interim Measures for Sales Management of Wealth Management Companies' Wealth Management Products (《理财公司理财产品销售管理暂行办法》)
  , officially released on May 27 limited the institutions qualified to distribute wealth management products to wealth management subsidiaries of banks and banks. Neither Internet platforms nor third-party distribution institutions were allowed to distribute wealth management products. Although the CBIRC also proposed to extend the scope of qualified distributors of wealth management products to cover other financial institutions on an informal basis, it is expected that such institutions will only include professional financial institutions such as securities companies.
- Internet insurance business; the Measures for the Supervision of Internet Insurance Business (《互联网保险业务监管办法》) came into effect in February, abolishing the "client diverting cooperation mode between insurance institutions and third-party network platforms in the previous rules, and instead requiring the Internet insurance product distribution and service platforms to be the selfoperated platforms of the insurance companies themselves.

At the same time, the regulators have been keen to promote FinTech innovation by traditional financial institutions (such as banks), in several ways.

First, there was good progress in the use of "regulatory sandboxes". More than 90% of the innovative applications of nearly 120 PBOC regulated sandboxes announced as of November 2021 were initiated by banks or jointly by banks and third parties; all seven participants in the "out-of-box" projects announced as of November 2021 were banks. As regulators

encouraged the use of regulatory sandboxes in respect of innovations in the capital markets, again securities companies and fund management companies are the primary applicants.

Second, the CBIRC at its annual work meeting in January also encouraged large banks to pass on their FinTech knowledge to small and mediumsized banks so as to reduce the dependence of small and medium-sized banks on Internet companies engaged in FinTech.

Third, in addition to relying on licensed institutions such as large banks to carry out FinTech business, the regulators have also been active in helping to develop FinTech. For example, the digital currency research institute of the PBOC has set up a number of FinTech subsidiaries all over the country. In addition to its continued promotion of research and development of digital currency and electronic payments, it will be worth watching whether the PBOC will leverage its FinTech subsidiaries in various localities for regulation.

## 05

### Regulators remained determined to dissolve risks while facing increasing challenges

In 2020, there were a number of high-profile restructurings or disposals of financial institutions, such as Jinzhou Bank and Baoshang Bank, as the authorities endeavored to remove high-risk institutions. This process continued in 2021 as regulators continued to eliminate risk from the system. A number of actions were taken:

- certain institutions such as Dajia Insurance were constantly soliciting strategic investors;
- risk dissolution in respect of a few trust companies, including Sichuan Trust, was closely planned or implemented;
- the 1-year takeover period of the nine members of the Tomorrow Group (which was taken over in July 2020 by CBIRC and CSRC) was prolonged after the asset audits and capital verification was completed;
- certain large private enterprises at risk of default on repaying debts had their situations resolved;
- the remediation of financial exchanges was delayed due to the impact of COVID-19, but restarted in December 2021.

As mentioned in the 2020 PBOC Work Conference, the focus of regulators is now shifting to prevention, control and management of financial risk on a regular basis. As a result, some certain areas thought to be of high risk continued to be closely monitored.

First, regulators addressed a number of activities that were considered to be high-risk. These included reducing the number of shadow banks, targeting "irregularities" in the trust sector, stepping up the disposal of non-performing assets, and cooperating with local governments to resolve hidden debt risks;

Second, in order to prevent the spread of risks from large enterprises (such as HNA and Evergrande) spreading to the financial sector, financial regulators have also been closely involved in helping debtridden enterprises to manage their debts;

Third, regulators aimed to improve financial institutions' ability to handle risks by themselves. Regulators stepped up their supervision of "systemically important" financial institutions to ensure they manage risks properly and enhance their capability to resolve risks by themselves, while also putting in place a frame on banks and insurers formulating their resolution and recovery plans;

Fourth, regulators were remorseless in targeting internet finance and illegal fundraising. The primary target of the *Regulations on the Prevention and Disposal of Illegal Fundraising* (《防范和处置非法 集资条例》) issued in 2021 was illegal fundraising in the guise of "internet finance" or "financial technology". Other activities such as P2P, blockchain, cryptocurrencies, mutual insurance, crowdfunding and pension finance were also included in the risk prevention targets, and regulators adopted the approach of preventing or addressing stage problem areas at an early stage in respect of illegal fund-raising.

## 06

### More reforms introduced to the capital markets, and remarkable developments for derivatives occurred

In 2021, regulators made a number of significant changes to the way in which capital markets operate with a view to making them operate more efficiently. This was additional to the continued enforcement against securities violations. There have been moves to simplify administrative procedures, fill in regulatory gaps, and promote market-oriented reforms in the regulatory regimes and law enforcement . A "white list" of quality securities companies was introduced, regulations on listing companies were consolidated, and administration on equity management of securities companies was relaxed to some extent, reflecting the regulators' determination to "simplify administration, delegate power, improve regulation and upgrade services".

The gaps in regulation were being filled in. The draft of *Futures* and *Derivatives Law* (《 期 货 和 衍 生 品 法 ( 草 案 ) 》) went through a second review, the draft of Interim Regulations on the Administration of Private Equity Investment Funds was nearly ready to start the review process, the credit rating system was substantially restructured and there will be new regulations covering overseas listings by companies with VIE structures.

The CSRC demonstrated its determination to reform its securities regulation. The scope of pilot projects covering fund investment advisory businesses was widened, 10 securities companies were approved to carry out lead underwriting services for the issue of corporate credit bonds in the interbank market, new delisting rules were frequently put into practice, and the first Securities Arbitration Center was established in Shenzhen – all these actions help to shape a more market-oriented capital market.

Meanwhile, the Measures for the Implementation of the Rules for the Undertakings Made by the Parties to Securities and Futures Administrative Law Enforcement (《证券期货行政执法当事人承诺 制度实施办法》) and the detailed implementation rules came into effect. The tenor of these rules is to encourage compliance rather than penalizing those in breach, pointing to the direction of marketoriented law enforcement and civil law enforcement.

Added to the various reforming measures, special attention should be given to the following developments in the derivatives regime:

- the draft of *Futures and Derivatives Law* (《期货和衍生品法(草案)》) underwent second review;
- in October, three new types of financial derivatives transactions were open to QFIs;
- in November, support was given to the concept of close-out netting in applicable regulations with the aim of promoting China as a applicable jurisdiction to the close-out netting in the international market;
- in December, the consultation draft of *Guiding Opinions on Promoting the Standardized Development of Derivatives Business* (《关于促进衍生品业务规范发展的指导意见》的征求意见
  稿) was published to seek public comment, with the goal of unifying regulatory requirements for OTC derivatives.

It is therefore quite likely that the above rules will provide a foundation for financial institutions to participate in derivatives transactions and promote the development of the OTC derivatives market.

In response to the problems that emerged in the wake of previous reforms designed to boost the market, the CSRC revisited details of some of the previous reform measures. In 2021 March, the Chairman of CSRC publicly pointed out the market and intermediary agencies were "unprepared" for the "registration-based IPO", and emphasized that the quality of companies listing should not be compromised by the implementation of the registration-based IPO regime. The authorities subsequently slowed down the process of promoting the registration-based IPO regime. The CSRC took remedial actions against the previous fast-paced reform by imposing on the STAR market more stringent qualifications for "Sci-tech" and "innovative" issuers, promulgating new information disclosure rules, and prolonging the lock-up period for new shareholders who invest within certain period before IPO. The CSRC stated again that smooth reforms to IPO registration require solid and careful political, ideological, professional and technical preparations.

## 07

Regulatory regime for new financial areas such as Green Finance and Rural Finance were further established and launched

As an important part of the 14th Five-Year Plan, new financial concepts such as carbon neutrality, green finance, rural revitalization and common prosperity were gradually landed in 2021, becoming more and more systematic.

The blueprint for green finance and rural finance was depicted in the Guiding Opinions on Accelerating the Establishment of a Sound Economic System with Green, Low-carbon and Circular Development (《关于加快建立健全绿色低碳循环发展经济体系的指导意见》) promulgated on 2 February and the Opinions on Comprehensively Promoting Rural Revitalization and Accelerating Agricultural and Rural Modernization (《关于全面推进乡村振兴加快农业农村现代化的意 见》) promulgated on 21 February. The Government Work Report published on 5 March stated that the beneficiaries of government's benefit concessions should include green development, small and micro enterprises, individual businesses and new agricultural operators. The Law on the Promotion of Revitalization of Rural Areas (《乡村振兴促进法》) promulgated in April directly defined the responsibility framework of financial institutions in rural finance from legal level. The Financial Stability Committee meeting held on 21 May emphasized the direction of "deepening the reform of financial institutions" and encouraging financial institutions to "return to the origin, adhere to their positioning, and follow a green approach in investment and financing". Meanwhile, a series of new regulations on rural revitalization bills (inheriting poverty alleviation bills) and carbon neutrality debt products were issued in 2021.

The above new financial concepts have been gradually transformed from abstract policies into specific implementing rules. Take "carbon neutrality" as an example, traditional green financial products mainly include green credit products, with few capital market products or tools for green finance. In 2021, green bonds, green funds and carbon futures boomed, highlighting the gradual introduction and improvement of green finance in the capital market system. And more regulatory initiatives are expected to follow (such as opening a convenient channel for green enterprises to get prioritized listing guidance, guiding the reduction of green stock fees, and so on.). The concept of "common prosperity" subtly influencing the asset management/wealth management industry is also worth noting. This concept originated in the 1990s as a national policy, and was reintroduced in 2021 in encouraging developments of financial products tailored to household wealth management needs and emphasizing the importance of financial products involving individuals.

According to the 2022 PBOC Work Conference held on 27 December 2021, financial support for the "four key areas - small and micro enterprises, science and innovation, green economy and rural economy" will still be increased in 2022. We anticipate that the directions of the above policies will become increasingly clear in 2022 and beyond, prompting the regulatory authorities to introduce more specific regulations to achieve policy alignment. As the opening year for the 14th Five-Year Plan, 2021 is undoubtedly a starting point for relevant regulatory efforts.



### A preliminary anti-foreign sanctions legal framework was in place, new fields of financial compliance emerged

Following the promulgation of the *Provisions on the Unreliable Entity List* 《不可靠实体清单规定》, the *Export Control Law* 《出口管制法》 and other relevant laws and regulations in the second half of 2020, the *Rules on Blocking Unjustified Extra-territorial Application of Foreign Legislation and Measures* (《阻断外国法律与措施不当域外适用办 法》)(the "**Blocking Rules**") and the *Anti-foreign Sanctions Law* (《反 外国制裁法》) came into force in 2021, which together constitute the preliminary framework of China's anti-foreign sanctions laws and regulations.

On the whole, China's anti-foreign sanctions laws and regulations are "countermeasures"-oriented, the starting point of which is to oppose "hegemonism and power politics", especially to take countermeasures against the abuse of sanctions and long-arm jurisdiction by other countries, rather than taking initiatives to impose long-arm jurisdiction over various cross-border transactions. Despite that, there is still much to be clarified, the overall framework is in place as can be seen from the laws and regulations that have been promulgated so far. For financial institutions (especially those operating in a multinational jurisdiction), U.S. and European sanctions-related laws,, including sanctions lists established by the U.S. Department of Treasury's Office of Foreign Assets Control ("**OFAC**") (SDN, CSL, etc.) have long been recognized as an important compliance guideline for conducting cross-border businesses, while with the introduction of the *Anti-foreign Sanctions Law*, the **Blocking Rules** and the *Provisions on the Unreliable Entity List*, financial institutions now have to consider both the PRC and overseas sanctions-related legislation, and may even face a dilemma in certain situations.

The existing anti-sanctions laws and regulations are, to a certain extent, more declarative than for intended for actual implementation, so there still exists uncertainty in the specific application by financial institutions in practice. For example, the issues that are subject to further detailed provisions include but are not limited to the detailed procedures for issuing or revoking relevant countermeasures or injunction, the reconciliation between the sanctioned persons listed by the Ministry of Foreign Affairs and the AML, anti-terrorism and anti-tax evasion lists maintained by the PBOC, and the specific scope of the affiliates of sanctioned persons (e.g. "organizations actually controlled by, or established and operated by, any individual or organization on the counter checklist") that are subject to restriction measures.

### 2022 Regulatory Outlook

### Construction of financial rule of law will be strengthened, and financial regulatory policies will seek progress while keeping stable

The 2021 Central Economic Work Conference called for strengthening the construction of financial rule of law and set the tone of "seeking progress while keeping stable ", which means that the financial regulatory policies in 2022 will maintain full continuity on each major policy, but will also be improved and adjusted on the micro level.

Financial risk disposal will progress in an orderly way, and shift to "organically combining risk disposal and reform and development". From the legislative perspective, in 2022, the Financial Stability Law (《金融稳定法》) is expected to be issued, the measures for identification and assessment of systemically important insurance and securities institutions and additional regulations applicable to such institutions are expected to be released, and the formulation of regulations related to the market-oriented bankruptcy or reorganization of financial institutions will also be initiated. From the perspective of law enforcement, systems such as major financial risk accountability and financial risk notification will be further implemented and play a more important role, conforming to the position of "compacting the responsibilities of local authorities, financial regulatory authorities, industry authorities and other parties, and compacting the self-rescue responsibility of enterprises" of the 2021 Central Economic Work Conference.

It is also worth mentioning that, according to the 2021 Central Economic Work Conference, from the regulatory perspective, risk disposal is no longer just a passive crisis response, instead, regulators are seeking to "combine risk disposal with deepening reform and promoting high-quality development". Sole risk prevention will gradually give way to promoting risk disposal through reform, so as to achieve "fundamentally prevent and resolve various risks with high-quality development" Liu He, *Must Achieve High-Quality Development* (《必须实现高质量发展》), in November).

In respect of financial institutions system reform, after the intensive rectification of corporate governance of banking, insurance and securities institutions in the past two years, the focus in 2022 will be summarizing the previous experience, solidifying relevant rules, and solving problems relating to diversified incentives for employees. At the same time, one of the cores of reforming financial institutions regulated by the CBIRC lies in the continuous application

of traditional policies to some small or new financial institutions which previously were not covered, such as establishing risk isolation mechanism between wealth management subsidiaries and parent companies, improving quantitative regulatory requirements for nonbanking financial institutions, and continuously improving microgovernance of local small and medium-sized financial institutions. In addition, the related systems of traditional large financial institutions will also usher in innovation. In addition to the Financial Stability Law to be promulgated as mentioned above, the revised drafts of the Commercial Bank Law (《商业银行法》), the Law of the People's Bank of China (《中国人民银行法》) and the Anti-Money Laundering Law (《反洗钱法》), which have been specified in the legislative plan of the National People's Congress in 2021, have sought public opinions and been effectively reviewed in 2021, and are highly expected to come into effect in 2022. And the revised draft of the Insurance Law (《保险法》) is expected to be published for public comments. The promulgation of several "fundamental laws" in the financial industry is expected to change the fundamental regime governing the financial industry, and 2022 is be expected to be a new "year of rule of law in financial regulation".

In 2022, the opening-up of the financial industry will be more focused on "institutionalization" and "high level". As far as "institutionalization" is concerned, the existing market access for individual foreign institutions, commodities and other elements has reached a considerable magnitude. On this basis, it will undoubtedly become a new direction to "institutionalize" the opening-up which would primarily involve conforming with the international high-standard market rules and systems. As far as "high level" is concerned, considering the saturation of the market by foreign institutions, "highquality introduction" will be to actively introduce high-quality foreign institutions with professional advantages to operate in China. And the CSRC has repeatedly mentioned that it will strictly regulate "fake foreign investments". In terms of cross-border regulatory cooperation, Sino-US audit regulation cooperation is expected to make substantial progress.

With RMB internationalization (through international monetary cooperation and the development of offshore RMB market) and deepening of interconnection between the mainland and Hong Kong markets and other relevant matters progressing smoothly, 2022 will see the start of strict regulation of cross-border financial services.

### Cracking down on Illegal Financial Activities under "Administrative and Criminal Cooperation"

This current crackdown on illegal financial activities has been fully implemented with the parameters of the current regulatory system, and continuous legislative improvements and judicial safeguards have provided systemic protection and new "weapons" for cracking down on illegal financial activities. It is expected that in 2022, the legislative, law enforcement and judicial systems will continue to go hand in hand to crack down on relevant financial illegal activities including illegal activities related to securities and futures.

In terms of legislation, the reconciliation and integration of *the Administrative Penalty Law* (《 行 政 处 罚 法》) into the existing financial regulatory measures will be an important agenda for financial regulation legislation. However, this should not prevent financial regulators from invoking the provisions of the Administrative Penalty Law to enforce financial irregularities on a wider scale than before.

In terms of law enforcement, after the promulgation of the Amendment (XI) to the Criminal Law ( 刑法十一修正案), the CBIRC and the CSRC have also publicly stated that they will cooperate with the implementation of the Amendment (XI) to the Criminal Law and strengthen the coordination of law enforcement and justice. In light of the focus on the imposition of criminal liability in the Opinions on Strictly Cracking Down On Illegal Securities Activities in accordance with the Law and the Regulation (《关于依法从严打击证券违法活动的意 见》) on the Prevention and Treatment of Illegal Fund-raising (《防范 和处置非法集资条例》), it is expected that the enforcement efforts to impose criminal penalties on illegal financial activities constituting crimes will be further strengthened, and more joint enforcement actions are on the way. In terms of specific law enforcement, the 2021 Central Economic Work Conference proposed for the first time to "set a 'traffic light' for the capital". On this basis, the CSRC further proposed to "strictly supervise the financing and M&A activities in specific sensitive areas, and work with relevant parties to establish and perfect the institutional mechanism to prevent disorderly expansion of capital". We believe in 2022 the CSRC will take this as the general principle of having a targeted and strengthening supervision over the capital markets. In addition to traditional capital markets illegal activities such as fraudulent issuance, false statement and market manipulation, we understand that the regulatory authorities will also crack down on illegal activities in specific areas such as M&A, debt evasion in the bond

market, financial fraud, illegal private equity, cross-border financial services and virtual currencies.

In terms of judicial system, issues such as the liability of intermediaries in the capital market are still controversial (for example, there is a view that the criteria applied in the Kangmei case and the previous Wuyang case are not consistent). In 2022, more precedents will surface in the judicial practice of investors' litigation related to securities related illegal activities, making it a more mature and foreseeable judicial system.

### Continuous Promotion of Governance over Financial Institutions

High-quality, scientific and modern corporate governance is the basis for financial institutions to control risks. Since 2020, regulatory authorities have issued a large number of policy documents on corporate governance and other matters, including corporate governance guidelines for banking and insurance institutions, regulation of behaviors of major shareholders, management of related-party transactions, remuneration kickback, performance evaluation of directors and supervisors, etc. (some of which are still draft for comment). The CBIRC has released four batches of lists of shareholders who have seriously violated laws and regulations in 2021, and completed the regulatory assessment of corporate governance of banking and insurance institutions for 2021 in November. The CSRC launched a special campaign to improve governance of securities, futures and fund management institutions in August.

The year 2022 will be the completion year of the Three-year Action Plan for Improving Corporate Governance in Banking and Insurance Sectors (2020-2022) (《健全银行业保险业公司治理三年行动方案(2020-2022 年)》). The CBIRC disclosed on December 2 that although initial achievements have been made in the corporate governance of banking and insurance institutions, the situation is still complex and severe, and some typical corporate governance problems such as major shareholder manipulation and insider control still exist in some institutions. The CSRC also pointed out that important rules governing the equity management, internal control and senior management of the CSRC regulated institutions, such as fund companies and futures companies, are expected to be released or will be further modified. Therefore, we believe that the year 2022 is still in the strong regulatory cycle, and continuous improvement in the laws and regulations and further rectification activities for the relevant industries such as self-examinations by institutions and on- site inspections by the regulatory authorities are likely to occur in 2022.

In the "new stage" of enhancing governance of financial institutions, the regulatory emphasis on the governance of financial institutions will be different. The CBIRC and the CSRC will further require institutions to strengthen the organic integration of the Party's leadership and corporate governance. The follow-up microgovernance of financial institutions is likely to focus on close supervision and high-pressure supervision of local financial institutions, and adopt more specific and targeted measures such as restricting the behaviors of "top officers". In addition, the diversified employee incentive mechanisms of financial institutions will have a progress in 2022, however, against the political background of emphasizing the goal of "common prosperity" (共同富裕) and "reasonably adjusting excessively high income", the compensation system and incentive mechanism of financial institutions may face stronger regulatory pressure. We believe the "unreasonable assessment mechanism", guaranteed stable income, excessive incentive and other problems may be subject to strict inspection and regulation.

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### More Refined Regulations for Financial Consumer Protection

Financial consumer protection has become an increasing focus of financial regulation in recent years. *The Financial Stability Report* (2021) (《金融稳定报告 (2021)》) points out that protecting the legitimate rights and interests of financial consumers is an objective requirement in the era of Fintech, and the importance of financial consumer protection has become increasingly prominent in the internet wave. In addition, financial consumer protection inspections have been frequent in recent years and often accompanied by penalties along with a public criticism, making it a clear regulatory focus. Against this backdrop, it is expected to witness a considerable development with more refined regulations for financial consumer protection in 2022.

From the legislative perspective, the CBIRC Notice on Promulgation of the Measures for Regulatory Evaluation of Protection of Consumer Rights and Interests by Banking or Insurance Institutions (《中国银保监会 关于印发银行保险机构消费者权益保护监管评价办法的通知》) issued in July 2021 replaced the previous version, further clarified the specific evaluation system for annual supervisory inspections, and provided more operational guidance for financial institutions to deal with supervision and make corresponding rectification. It is expected that more guidance will be issued in 2022. In August 2021, Liu Guiping, deputy governor of the People's Bank of China, stated in a related meeting that "We should link with the State Administration of Market Supervision and strengthen special legislation to promote financial consumer protection... which should be supported by superordinate laws", signaling that high-level integrated regulations for financial consumer protection may be forthcoming. In addition, as the financial consumer protection field continues to be subdivided, it is possible that the financial consumer protection will be jointly promoted by the general provisions of the People's Bank of China and the detailed rules of other regulatory authorities. Moreover, The Measures for the Protection of Consumer Rights and Interests by Banking or Insurance Institutions (《银 行保险机构消费者权益保护管理办法》), which was originally listed in the legislative plan of the CBIRC in 2021 (which means it should have come out in 2021), is expected to come out in 2022.

In terms of financial products, in 2022, the regulatory system and compliance review of financial products will further focus on products that are "closely related to the average people". In October 2021, the CBIRC stated in a press conference of the State Information Office that the next step in the financial product structure would be to "continue to support commercial insurance institutions to meet the people's multi-level and personalized health protection needs through diversified product services." Further, in December 2021 when the pilot of pension financial products was conducted, the regulator stressed the need to properly design the products and protect investors, as well as to continually clean up financial products with the disguised name of "pension" but did not actually serve the purpose. The above regulatory direction is also in line with the grand mission of "Inclusive Finance" and "Common Prosperity", and should continue to be implemented in 2022.

### Increasingly tightening regulation of Financial Data and Data Regulatory Framework becoming further matured

With the promulgation and implementation of *the Data Security Law* (《数据安全法》) and *the Personal Information Protection Law* (《个 人信息保护法》) in 2021, data compliance regulation is becoming increasingly stringent.

At the general law level, *The Measures for the Security Assessment of Outbound Data*(《数据出境安全评估办法》) and *Network Data Security Management Regulation*(《网络数据安全管理条例》) are expected to be issued in 2022. Detailed regulations of financial data protection such as *the Financial Data Security-Data Security Assessment Regulation*(《金融数据安全数据安全评估规范》), which has been under consultation for a long time, and *the Pilot Measures for Personal Financial Information (Data) Protection*(《 个人金融信息(数据)保护试行办法》), which is included in the legislative work plan of the People's Bank of China in 2021, are also expected to come out. At the same time, we believe that financial regulatory authorities and data security management authorities will form an efficient and coordinated working mechanism on data protection in financial activities and give clearer guidance to financial institutions on their daily activities related to data.

As for cross-border data transmission, with the promulgation of regulations related to data exporting, the circumstances of cross-border data transmission that should be subject to security assessment will soon be clarified and the relevant provisions will be further refined. For financial institutions, especially those large financial institutions with cross-border business or foreign financial institutions requiring support from their parent companies, the progressively stricter legal requirements may overturn the past practice of relatively lenient data cross-border regulation and prompt them to re-structure their customary group data governance framework. In fact, several foreign financial institutions have already been required to provide more details in 2021 about the arrangements for cross-border integrated deployment of systems and cross-border data transmission, in their applications for financial licenses.

While strengthening the supervision and management of data, local pilot programs to promote cross-border data transmission are getting underway, such as the opening of a dedicated international Internet data channel in Hainan Free Trade Port in 2021, and the announcement of Shanghai's plan to build an international data port. We believe that in 2022, there will be a breakthrough in the supporting infrastructure and industrial system for the safe crossborder transmission of data, and China will continue to explore the global transmission of data under the premise of ensuring data security and controllability with some pilot programs to be extended to financial institutions.

In addition, as the digital economy industry continues to develop and mature, local legislation in some regions has started to provide top-level design guidelines for "Data Elementization", "Data Assetization", "Data Rights Confirmation" and "Data Trading" in 2021, and data trading models have been explored in the data exchanges established in Beijing and Shanghai. To meet the practical needs of data application, it is expected that national and local laws and regulations along with the supporting systems for data ownership identification and data trading will be gradually issued in 2022. With the development of above legislation as well as further promotion and application of digital currency, it is expected that financial services and financial products related to data assets such as data asset pledged financing, data asset insurance, data asset security and data asset-backed securities will come into being.

## PRC Financial Regulation: Annual Report (2022) Banking<sup>1</sup>

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1."Banking Sector" as discussed in this Chapter includes commercial banks, rural cooperative banks, rural credit cooperatives, policy banks and the China Development Bank and 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 as approved by the banking regulatory authorities and established in the People's Republic of China.

### 2021 Key Dates

### **January 7**

The General Office of the China Banking and Insurance Regulatory Commission (CBIRC) published the *Notice* on Launching the Pilot Program for the Transfer of Nonperforming Loans, implementing the transfer of singlehousehold corporate non-performing loans (NPLs) and batch transfer of personal non-performing loans on a pilot basis.

#### February 19

The General Office of the CBIRC published the *Notice* on *Further Regulating the Internet Loan Business of Commercial Banks*, specifying the requirement that the capital contributed by the cooperative party of the banks in a single internet loan should be no less than 30% of the total loan amount.

#### April 16

The PBOC published the Measures for the Supervision and Administration of Anti-money Laundering and Counterterrorism Financing of Financial Institutions, which follows the Guidelines for Self-assessment of Money Laundering and Terrorist Financing Risks by Corporate Financial Institutions and the Guidelines for Anti-money Laundering and Counterterrorism Financing in Cross-border Business of Banks (For Trial Implementation) by the PBOC released in mid-January, continuing the regulation over anti-money laundering activities of financial institutions.

#### May 25

The Supreme People's Court published the *Provisions on Several Issues concerning the Trial of Cases for Civil Disputes over Bank Cards*, specifying the no-fault liability for losses incurred after a bank card is stolen and used without card owner's permission to support consumers' claims against the card-issuing banks. In December 2021, the CBIRC sought comments from the public on the Notice on Further Promoting the Standardization and Healthy Development of Credit Card Business, tightening the regulation on interest charges and fees, excessive granting of credit and other issues of credit cards, and strengthening consumer protection.

#### September 15

The PBOC published the *Notice on Further Preventing and Disposing of Speculation Risks in Virtual Currency Trading*, specifying that financial institutions and non-banking payment institutions are not allowed to provide services for virtual currency-related business activities.

#### September 30

The PBOC and the CBIRC jointly published the *Provisions on Additional Regulation on Systemically Important Banks (For Trial Implementation)* and promulgated the list of "Systemically Important Banks" and the *Administrative Measures on Total Loss-absorbing Capacity of Global Systemically Important Banks* on October 15 and October 27, respectively, in order to strengthen the regulation of systemically important banks and improve the macroprudential policy framework.

#### January 13

The General Office of the CBIRC and the General Office of the People's Bank of China (PBOC) published the *Notice on Issues Concerning Regulating the Personal Deposit Service Provided by Commercial Banks via the Internet.* 

#### March 26

The General Office of the CBIRC, the General Office of the Ministry of Housing and Urban-Rural Development and the General Office of the PBOC jointly published the *Notice on Preventing the flow of Loans for Business Purposes illegally into the Real Estate Industry*, to strengthen the supervision over the illegal inflow of loans for business purposes into real estate.

#### April 20

CBIRC Shenzhen Office approved the subscription by DBS Bank (Singapore) of about 13% of shares in Shenzhen Rural Commercial Bank, which makes DBS Bank the first foreign bank to invest in small and medium-sized domestic banks since 2010.

### June 3

The CBIRC published the Interim Measures for Implementation of the Recovery and Disposal Plan for Banking and Insurance Institutions, which sets out the steps institutions need to take in the event of major risks, increasing the need for financial institutions to operate prudently and as part of the overall desire to reduce risk in the system.

#### June 8

The CBIRC published the Notice on Launching the Activity of "Year for Developing Internal Control and Compliance Management" in Banking and Insurance Sectors. In the same month, the CBIRC issued the Guidelines on Corporate Governance of Banking and Insurance Institutions and also sought public comments on the Regulatory Measures on Behavior of Main Shareholders of Banking and Insurance Institutions (For Trial Implementation) (Consultation Paper) (officially released on September 30, 2021) and the Administrative Measures on Related-party Transactions of Banking and Insurance Institutions (Consultation Paper)" (officially released on January 14, 2022) which overcame some systematic constraints and all aimed at ensuring banks have better internal controls and effective compliance management rather than merely focusing on compliance of their business operations.

#### November 20

The State Administration for Market Regulation imposed the most severe penalties on Fujian Baidu Borui Network Technology Co., Ltd. and China CITIC Bank because of their failure to fulfill their reporting obligations under the *Anti-Monopoly Law* when establishing the first direct selling bank, Baixin Bank. This is the first anti-monopoly punishment taken in the banking sector.

### 2021 Banking Industry Regulatory Observations



### Banking sector continues to open up, cross-border businesses expand

In 2021, there were further refinements of regulatory policies aimed at further opening up of China's banking sector and improving supervision of foreign investment. In April, the CBIRC issued the *Notice by the General Office of the CBIRC on Specifying the Regulatory Requirements on Large Exposures of Foreign-invested Banks to Parent Bank Groups*, exempting foreign-invested banks from then-applying regulatory ratio requirements relating to large exposure to their parent bank groups.

In November, the government of Hainan province issued the 14th Five-year Plan for the Development of Hainan's Financial Sector, specifically supporting financial institutions incorporated in Hainan province to attract foreign strategic investors.

Encouraged by these policies, foreign capital continued to flow into the China banking market in 2021. Examples include:

(i) Schroder in alliance with the wealth management subsidiary of Bank of Communications getting approval to establish their wealth management joint venture, which is the third foreign-controlled wealth management company in China;

(ii) J.P. Morgan Asset Management making its strategic investment into the wealth management subsidiary of China Merchants Bank Co;

(iii) BlackRock CCB Wealth Management (the wealth management joint venture of BlackRock and China Construction Bank) being approved to start its business; and

(iv) DBS Bank making its strategic investment into Shenzhen Rural Commercial Bank.

In terms of cross-border businesses, the Notice on Further Optimizing Cross-border RMB Policy to Support Stable Foreign Trade and Stable Foreign Investment (effective February 2021) simplified cross-border RMB business in terms of settlement, investment and financing management, account use and other different perspectives, while at the same time removing some inconsistencies between the RMB policy and foreign currency policy and generally making it easier to conduct cross-border business.

The implementation of the Cross-boundary Wealth Management Connect Pilot Scheme in Guangdong-Hong Kong-Macao Greater Bay Area has increased the number of cross-border channels for banks' wealth management business. The *Provisions on Matters Related to Overseas Loan Business of Banking Financial Institutions (Consultation Paper)* may, in future, offer more scope for domestic banking financial institutions to conduct overseas loan businesses.



### Tighter regulation of banking sector, erratic and disorderly events in the market further addressed and stricter enforcement of rules and internal accountability

In 2021, banking regulators reviewed the progress made since 2017 in addressing the "erratic and disorderly" events in the market and were very active in dealing with repeated failings. In 2021, this focused mainly on failings in ordinary loans as well as perceived failings in wealth management, interbank business, internal controls and compliance, related party transaction management, and financial consumer protection, among others.

So far as the reasons for penalties were concerned, the CBIRC paid particular attention to a number of recurring activities and activities that were felt to have "profound negative social impacts". Among the particular transgressions were those covering abuse of poor management of credit lines, non-compliance in wealth management business, illegal inflow of funds into the real estate sector, poor corporate governance, and unjustified charging of fees. As well as introducing reforms to the operation of wealth management by banks, banking regulators stepped up the enforcement on those falling foul of the regulations. Some types of penalties were introduced for the first time in 2021, such as penalties imposed for issuing structured deposits where there is no real underlying transaction, imposing unfair trading terms for derivative products, inaccurate valuation of wealth management products, and failure to report those with whom banks have been collaborating on business.

So far as the level of penalties is concerned, according to incomplete information published by the CBIRC, as of September 30, 2021, the total amount of fines imposed on banking institutions by the CBIRC reached about RMB1.5 billion, which has already exceeded the total amount of fines imposed for comparable offences in 2020 (about RMB1.4 billion). Further analysis on fines imposed on senior management/key position personnel shows that fines were imposed on people operating at a senior level of organizations, the number of penalty cases is larger and the amount for fines imposed is larger. For example, the CBRIC Shanxi Office banned a former executive officer of the Taiyuan branch of a commercial bank from working in the banking sector for life because the bank illegally provided an undertaking of return guarantees, which are forbidden. It is relatively rare to witness a c-suite officer of a bank receiving a lifetime ban. Previously, the CBIRC only tended to impose lifelong bans from working in the banking sector on those of relatively low seniority.

Over and above this, in November 2021, the CBIRC noted in the Notice by the General Office of the CBIRC on Continuously Implementing Work in relation to Year of Internal Control and Compliance Management for Banking Institutions that it tended to be relatively low-level officials who were held accountable for transgressions. The Notice required banks to step up their accountability controls, to establish satisfactory procedures to increase accountability, and to have accountability extend from headquarters to all bank branches.

From this, we can easily conclude that the CBIRC is serious in its determination to break through long held operating practices of the banking sector and to make banking institutions fully aware of their need to comply with all regulations.

Focus on corporate governance continues, with some progress made but further to go to stop unwarranted activity; regulators address issues relating to equity-related transactions and related party transactions

There has been a greater focus on internal corporate governance since a campaign began in 2017 to "rectify erratic and disorderly events" in the market. In 2021, the CBIRC took a closer look at the equity interests held in banks and related party transactions. Banks were instructed that they needed to review shareholder (equity) interests annually and to ensure they reduced or eliminated the risks of regular equity transactions being bypassed, for example illegitimately transferring interests to shareholders via interbank operations, wealth management transactions, and off-balance sheet business or fraudulently through shell businesses. The CBIRC also expressly mentioned that banks must ensure they know the identity of all their shareholders, especially knowing who holds shares on the "look-through" basis (i.e. who the real beneficial shareholders are) and strengthen the management of related party transactions. The clear objective is to prevent the company's main shareholders manipulating companies, illegitimate transfer of interests or interfering with the operation and management of banking and insurance institutions beyond their authority.

Accordingly, in 2021 the CBIRC enacted a series of new rules and/ or consultation papers, including the *Guidelines on Corporate Governance of Banking and Insurance Institutions*, the *Regulatory Measures on Behavior of Main Shareholders of Banking and Insurance Institutions (For Trial Implementation)*, and the *Administrative Measures on Related-Party Transactions of Banking and Insurance Institutions (Consultation Paper)*(officially released on January 14, 2022), to emphasize the responsibility of those in charge of governance to carry out their duties fully and efficiently, to prevent embezzlement by main shareholders and manipulation of operations by insiders, and to reinforce the need for absolute compliance.

The CBIRC defined for the first time the term "main shareholder (大股东 in Chinese)" and imposed on main shareholders higher obligations to restrain "irregular behavior" of shareholders in general.

The CBIRC reported on its annual review of corporate governance across the sector in the *Year of Internal Control Compliance Management*. There have been improvements when it comes to corporate governance. However, the regulators say there is still some way to go, particularly when it comes to the behavior of main shareholders, management of related party transactions and the overall management by the board of directors. We can expect the CBIRC to continue to compel banking institutions to set up more effective internal controls.



### Regulations covering online deposits and loans at central and local levels address a problem area

In 2021, rules relating to online deposits were implemented and the regulatory authorities continued to take a firm line on internet financial products.

#### At the **central government** level:

(i) in January the CBIRC and the General Office of the PBOC issued the *Notice on Issues Concerning Regulating the Personal Deposit Service Provided by Commercial Banks via the Internet*, specifying that commercial banks are not allowed to offer time deposits through online platforms that are not operated by the banks themselves;

(ii) in February, the General Office of the CBIRC released the *Notice* on *Further Regulating the Internet Loan Business of Commercial Banks*, specifically setting the strict requirements on the minimum funding ratio of any collaborating party in a single loan case, the balance of internet loans, and the scope of permitted business; and

(iii) in February, the CBIRC issued the *Notice on Further Regulating the Administration of Internet Consumer Loans for College Students*, requiring banking financial institutions to act more prudently in extending student loans via the internet, for example by carrying out better due diligence.

### At the **local** level:

Central government regulations have been supported at the local level. There are different types of supervision for different types of banks, and some of these policies impose more strict requirements than those of the CBIRC. For example, in the *Specific Implementation Rules of Jiangxi Province on Regulating Internet Loan Business of Commercial Banks* released by the CBIRC Jiangxi Office on May 18, the regulatory funding ratio of the collaborating party in a single loan of rural small and medium-sized banks in the province was raised to 40%, compared with the 30% threshold set by the CBIRC. Instead of the requirement set by the CBIRC that the balance of loans issued by a bank with a single collaborating party (including its affiliates) should not exceed 25% of the bank's tier 1 net capital, in Jiangxi this ratio was set at 20% for urban commercial banks and privately owned banks and 15% for small and medium-sized rural banks. These differences reflect the actual nature of

the sector as determined by local regulators.

Regulators have come down hard on those who do not comply with regulations relating to non-compliant online deposits and loan products. For example: in March, the CBIRC made public the breach of regulations by Xinwang Bank in connection with internet auto loans. In April, the financial regulators held regulatory talks with the representatives and *de facto* controllers of 13 enterprises which operate internet deposit and loan product platforms such as Tencent, Duxiaoman Finance, and Jingdong Finance. In November, the State Administration for Market Regulation announced the first case of antimonopoly penalties in the banking sector, which also covered the internet business.

The regulators are moving to a position where internet products and services will be classified as "licensed" and "non-licensed" and to eliminate the scope for regulatory arbitrage. When this happens, this should offer both opportunities and challenges for banking financial institutions.

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## Financial consumer protection remains the focus of regulators, with banks having to be more diligent in light of new changes

Protecting consumers buying or taking out financial products remains a top priority of the PBOC and the CBIRC. Many regulatory rules were issued in 2021. These included:

(i) the Measures for Regulatory Evaluation on Financial Consumer Protection of Banking and Insurance Institutions, which laid down evaluation procedures required for commercial banks, wealth management companies, trust companies, auto financing companies, and consumer finance companies in respect of consumer protection. The regulations set out what steps would be taken against institutions with poor evaluation results (e.g. Band 3 or Band 4);

(ii) in March, the CBIRC promulgated the *Notice on Effectively Solving the Difficulties of the Elderly in Using Intelligent Technology by Banking and Insurance Institutions*, guiding the banking industry to focus on providing services suitable for the elderly, proposing 16 measures and establishing a "list of prohibited behaviors";

(iii) in November, the CBIRC invited comments from the public on the *Guidance on Standardizing the Management of Market Adjustment Prices for Banking Services*, reiterating that for financing businesses, fees should not be charged without providing substantive services and that banks are encouraged to cater specifically to the elderly and disabled with more favorable terms relating to account management, deposits and withdrawals, and payment and remittance services, and to provide appropriate fee discounts or exemptions based on their own business strategies; and

(iv) in December, the CBIRC sought comments on the *Notice on Further Promoting the Standardization and Healthy Development of Credit Card Business* with the aim of cutting down on easy and excessive credit.

#### **Stepping up punishments**

In 2021, the PBOC and the CBIRC punished and circulated notices of criticism on several banking financial institutions for constant violations of consumer rights. Transgressions included: exaggerated and misleading advertising, illegitimately increasing financing costs, heavy-handed debt collection, failing to check for suitability when extending products and tie-in sales. The PBOC and the CBIRC imposed large fines on financial institutions found to have harmed consumer rights. For example, in August, the PBOC issued fines adding up to more than RMB1 million to several banks, mainly for failing adequately to collect credit information.

In addition, the regulatory authorities took steps to make consumers more aware of their rights. In March, the PBOC branches had a publicity campaign to explain consumer rights. In November, the CBIRC issued the *Tips about Preventing the Risks of Insurance Surrender and Others by Agents*, to alert consumers to hidden traps in advertisements of agency service for financial products and the potential for fraud by unregulated agents and to guide consumers to strengthen their awareness of risk management and financial product investment and to safeguard their own rights in proper and legitimate ways.

Changes in court decisions and regulatory rules gave consumers additional benefits. In May, the Supreme People's Court issued the *Provisions on Several Issues Concerning the Trial of Cases for Civil Disputes over Bank Cards*, stipulating that the principle of nonfault liability applies to losses incurred after a bank card is stolen and used without the cardholder's permission. These provisions provided the means for consumers to reclaim such losses against the bank, while also imposing the burden of proof and notification on banks rather than consumers when determining such claims. Such judicial interpretation was further applied and confirmed in a guiding case (Guiding Case No. 169) issued by the Supreme People's Court in November (where a card issuing bank was held liable for the loss caused by misappropriation of funds in bank account due to its failure to provide evidence proving that the account holder violated the obligation of proper handling of information).

In addition, a series of laws and regulations related to personal information protection and credit reporting were issued and implemented in 2021, under which financial institutions are required to adapt how they process consumer information.



### Diversified methods help to reduce material risk in the system

Effectively forestalling major financial risks was one of the two themes of the 10th Meeting of the Financial and Economic Commission in the Central Committee of the Communist Party of China in August, which was also one of the core objectives of financial regulation in banking sector in 2021. On the one hand, work continues to restructure those banks deemed to be at risk. For example:

(i) the restructuring of Hengfeng Bank was all but completed;

(ii) in February, Beijing No. 1 Intermediate People's Court issued its verdict on Baoshang Bank's liquidation, which marked the end of the bank's risk restructuring process;

On the other hand, the measures of risk mitigation at an earlier stage served to address potential problems before they may manifest themselves. For example, Shanxi Bank, Liaoshen Bank and Zhongyuan Bank each merged several local urban commercial banks within their provinces, helping to take risk out of the system. In October, the PBOC and the CBIRC issued the *Provisions on Additional Regulation on Systemically Important Banks (For Trial Implementation)* and released a list of the first batch of 19 domestic systemically important banks, setting out higher capital standards and imposing more stringent leverage ratios on those banks, while requiring them to put in place responses to a range of risk management scenarios. The CBIRC also issued the *Interim Measures for Implementation of the Recovery and Disposal Plan for Banking and Insurance Institutions* and the *Notice on Matters Related to Further Promoting the Reform and Restructuring of Rural Banks to Forestall Risks*, and other rules regulating the advance risk mitigation and management work of banking institutions.

Additionally, in January, the CBIRC issued the *Notice on Launching the Pilot Program for the Transfer of Non-performing Loans*, lifting the restrictions on the transfer of single-household corporate NPLs and the batch transfer of personal NPLs for the banks named in the pilot list. From March, when the first personal NPL transfer transaction was completed, to mid-November, 365 banks and their branches, 108 national asset management companies and their branches, and 4 financial asset investment companies opened accounts to operate NPL transfers with the Banking Credit Assets Registration and Circulation Center. This pilot is significant as it indicates another means for dealing with NPLs to take more risk out of the system and improves the capability of banks to operate and manage their capital and business.



## Macroeconomic controls geared towards supporting the real economy and green finance

Against the background of global inflation, properly guiding the development of banking sector and relevant services is one of the keys in regulatory policies In 2021, and there were further moves towards supply-side structural reforms of finance.

On the one hand, the regulatory policies geared towards supporting the real economy, away from real estate speculation and away from the coal and electricity industries. After the action to limit the levels of real estate loans that banks could extend in 2020, many authorities were party to the *Notice on Preventing the flow of Loans*  for Business Purposes illegally into the Real Estate Industry in March 2021 to strengthen regulation preventing loans being made illegally into the real estate sector. Several banks were fined for illegal real estate loans, while genuine real estate loans which are for proper commercial needs in the industry still met with official approval.

In November, the PBOC issued a report emphasizing the importance of stabilizing land and house prices, encouraging prudent financial management of the real estate market and increasing financial support for the house rental market. In December, the Central Economic Work Conference put forward suggestions to nurture a market by way of "guiding the expectation in the industry and exploring new development models" on the basis that "property is intended for living in and not for speculation".

On the other hand, in order to meet the "30-60" goal (i.e. the goal for China to achieve no increase of carbon emission on and after 2030 and carbon neutrality on and after 2060), in November the PBOC launched a monetary policy tool to support carbon emission reduction. This encourages national financial institutions to grant loans to businesses that qualify for "carbon emission reduction loans". Banks and financial institutions can, in turn, borrow up to 60% of carbon reduction loans from the PBOC at a favorable interest rate of 1.75% to cover these loans. Combined with the further cut in the reserve ratio required to be adopted by banks by the end of 2021, the aim is to extend preferential policies to relevant green and low-carbon industries and real economy, and to support the issuance of green bonds and financial products.

In April, the PBOC, together with the National Development and Reform Commission and the China Securities Regulatory Commission (CSRC), issued the *Catalogue for Endorsed Projects of Green Bond (2021 Edition)*, which unified the standards of green bonds in the domestic market and deleted coal from eligible projects in order to align with international standards. In June, the PBOC issued the *Green Finance Evaluation Plan for Banking Financial Institutions* with both quantitative and qualitative indicators, which standardized the evaluation of green finance business of banking institutions to reduce the room for "green-washing( 漂绿)". In December, Shenzhen announced that it would pilot local standards for green finance, and gradually enforce such standards in the Guangdong-Hong Kong-Macao Greater Bay Area. In short, China's green finance standards are gradually becoming more stringent and are transitioning toward international standards. In December, the General Office of the State Council stressed the importance of enhancing sharing credit information to facilitate finance for SMEs. In the same month, the PBOC promulgated the *Measures for the Unified Registration of Movables and Rights for Guarantee*, further clarifying the rules for the registration of movable assets and rights as collateral when borrowing money. This shows the PBOC's growing support for the real economy and small and micro finance.



### Anti-money laundering (AML) regulation on financial institutions upgraded in line with international standards

In 2021, a series of AML-related regulations were promulgated, which addressed certain issues reflected in the fourth round of mutual assessment by the Financial Action Task Force on Money Laundering (FATF) in 2019 and also made AML rules in China more systematic:

(i) in March, the PBOC, the CBIRC and the CSRC issued the Administrative Measures for Due Diligence and Preservation of Clients' Identity Data and Transaction Records by Financial Institutions (Consultation Paper), providing more detailed and stricter regulatory provisions on the anti-money laundering responsibilities of financial institutions and payment institutions;

(ii) in April, the PBOC promulgated the *Measures for the Supervision and Administration of Anti-money Laundering and Counter-terrorism Financing of Financial Institutions*, improving the provisions on regulation scope, risk assessment and regulatory measures, increasing the requirements for financial institutions to manage their overseas branches and controlling subsidiaries, and extending the applicable scope to non-banking payment institutions and online small-loan companies, as well as to consumer finance companies, loan companies, wealth management subsidiaries of banks and other institutions;

(iii) in June, the PBOC published the *Anti-money Laundering Law* (*Revised Consultation Paper*), which changes the previous narrow definition of "money laundering" and expands money laundering activities to include "activities of disguising and concealing the

source and nature of criminal gains and benefits by various means". In addition, the consultation paper specifies the system for reporting and sharing "beneficiary information", sets up processes for reporting receipt and payment of large amounts of cash, and increases the levels of administrative penalties imposed under the *Anti-Money Laundering Law*, and generally switches the regulation of anti-money laundering from a rules-based approach (which is prescriptive and specific) to a more flexible risk-based approach.

In addition, the Amendment XI to the Criminal Law, which took effect in 2021, recognizes that the act of covering up or concealing the source and nature of criminal gains after committing a crime independently constitutes the crime of money laundering. In the same month, the Supreme People's Procuratorate and the PBOC jointly released typical cases on punishing money laundering crimes, revealing through six typical cases the means of money laundering used in various crimes and indicating that those who breach these laws will be severely punished.

There continue to be severe penalties imposed on those found to have been in breach of AML regulations. According to incomplete statistics, fines exceeding RMB400 million were imposed in 2021 against AML transgressors, mostly on banks. China continues to put in place tight AML regulations and to fine those in breach, with the aim of opening up the finance sector and bringing China in line with global AML governance, which will also bring challenges to the compliance practice of financial institutions in the future.

### 2022 Banking Industry Regulatory Outlook

### The banking sector will continue to open up and cross-border business will become easier

Despite the pandemic and the uncertain global economic environment, the Chinese government is still keen to attract foreign capital to enter and invest in China's financial market. We expect this process to continue in 2022. China will fully implement the principle of pre-establishment national treatment (i.e. granting to foreign investors and their investments, at the point of investment, treatment no less favorable than that granted to domestic investors and their investments) plus negative list management (i.e. special administrative measures restricting access of foreign investment in some specific fields as stipulated by the State) in the regime of foreign investment, while encouraging the steady development of foreign-invested banking institutions in China. Foreign investors will continue participating in the investment in China banking sector by investing in domestic banks and investing in/establishing wealth management subsidiaries.

The Provisions on Matters Related to Overseas Loan Business of Banking Financial Institutions may be officially published, as cross-border business and capital flows are encouraged. There will be more crossborder business channels and opportunities such as Cross-boundary Wealth Management Connect. Market entry qualifications, account management and other regulatory requirements will be simplified to encourage the participation of more market players. In light of various measures taken by regulators in 2021, the emphasis on strict regulation of financial institutions will continue through 2022. Following the spirit of the Central Economic Work Conference, regulators will continue to look closely at how banks manage their operations and to ensure full compliance with regulations. Key risk areas that regulators are sure to focus on are enforcement of macro policies, shadow banking, high-risk/ intersecting risk businesses, and new business models.

The regulatory rating of commercial banks will be closely tied to how good their corporate governance are and the evaluation system for corporate governance will be amended. Regulatory approaches which were used in the practice of some equity transactions and related party transactions and found to be of help will be reflected in the rules. Banks will be encouraged to take on professional managers. Further consideration will be given to the appointment of employee directors. There will be further examination of bankruptcy procedures and the rights of creditors as related to banks and insurance companies.

In the meanwhile, the regulatory authorities will continue to explore different ways of taking risk out of the system and accountability and correction will be enforced from different aspects. Market players have been given a grace period to address failings over the last three years. Those that continue to fail to comply with regulations (e.g. those falling foul of online lending restrictions), can expect to be severely punished, both at the institutional and individual level.

## 02

### Market failings will be addressed, all market participants will be required to improve compliance and institutional risk tackled

Although the CBIRC has made good progress in tackling the "erratic and disorderly events" in the market, there are still issues that need addressing, such as clearing the illegitimate practice of pooling and mixture of funds from different asset management products ("cash pooling"), achieving proper asset valuation, completing abolition of guaranteed return arrangements in asset management products, the screening and clearing of high-risk institutions, and establishment and improvement of financial infrastructure.

## 03

### Market players will be encouraged to serve the real economy and increase support for green finance, inclusive finance, and elderly care financial products

It is expected that the supply-side structural reform of finance will continue in 2022, and the State Council's requirement of "giving more prominence to serving the real economy" will continue to be uppermost in regulators' approach. Banks will be directed to lend to support manufacturing, SMEs, and private enterprises. As the pandemic continues, the government will support SMEs with financial relief. For real estate, energy and heavy industry, banks will tend to provide service on premise of reasonable demand rather than imposing "one size fits all" restrictions. Affordable housing and infrastructure and other financial services might bring most economic growth in these areas.

At the same time, banks will be encouraged to lend to green and low-carbon transport, environmentally sustainable buildings, renewable energy, innovative models of power system and carbon emission reduction technologies, as China seeks to achieve the "30•60" goal. Banking institutions are likely to be required to establish green-oriented incentive mechanisms, and financial institutions will be likely to be allowed to participate in carbon trading. In addition, in order to cope with the long-term demographic changes, regulatory policies will continue to be strengthened in the field of elderly care. It is expected that special pilot programs for elderly-care deposit businesses will be launched in the near future, and more detailed regulatory rules for elderly care wealth management products will come out.

### Top-level rules for "quasi-financial institutions" may be finalized and introduced

2017 witnessed the transition of regulatory power for "guasi-financial institutions" (such as small sum loan companies, financing guarantee companies, financial leasing companies, and factoring companies): the power to formulate the regulation falling on the CBIRC (central level) whereas the power to supervise and enforce the regulation falling on provisional governments, autonomous regions and centrally-administered municipalities (local level) and local financial regulatory and administrations bureaus. However, the upper-level law, the Regulations on Non-deposit Lending Organizations (the "Non-deposit Regulation"), has yet to be promulgated. This is necessary to address the abuses associated in recent years with online lending, false internet advertising and aggressive debt collection. Although the Interim Administrative Measures for Online Small-sum Lending Business (Consultation Paper) was solicited for public comments in late 2020, the CBIRC has made it clear that formal measures will be promulgated in due course after the Non-deposit Regulation is introduced. In light of that, the Non-deposit Regulation is expected to be published or solicited for public comment in early 2022, with the goal of improving the multi-level credit market, regulating private finance and strengthening the protections concerning the rights and interests of financial consumers. The practices by regulators at local level tend to be uniform as well.



### More protection for financial consumers which may reshape existing practices

Following the enforcement of the *Implementation Measures of the People's Bank of China for Protecting Financial Consumers' Rights and Interests* in 2020, in 2021, the PBOC and the CBIRC have repeatedly circulated cases of punishment imposed on banking financial institutions for harming consumer rights, including arbitrary charges, tied sales, and illegal operations on behalf of customers. However, there still remain gaps between the existing market practice and the general requirements newly introduced by regulators. It is expected that more rules relating to the protection of consumers' rights and interests will be promulgated in 2022, including specific rules compatible with the *Personal Information Protection Law* in the field of banking regulatory rules and rules involving cross-border flow of financial information. Enforcement measures for issues of concern will be taken as well.

It is expected that the court will further clarify such controversial issues as how to assume joint and several liabilities in the case of personal information rights being violated and how to evaluate whether a bank has properly performed its obligation of assessing the suitability of those applying for financial products.

The Administrative Measures for the Appropriateness of Banking and Insurance Institutional Consumers, which has been included in the CBIRC's legislative plan for 2021, is expected to be promulgated in 2022.

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### 2021 Key Dates

### March 18 The China Securities Regulatory Commission (CSRC) issued the Decision on Revising the Administrative Provisions on Equities of Securities Companies and supporting rules. April 19 Guangzhou Futures Exchange opened for business. May 28 The CSRC announced the first batch of securities companies to be included in the "white list". July 6 The General Office of the Central Committee of the Communist Party of China (CPC) and the General Office of the State Council issued the Opinions on Strictly Cracking Down on Securities-related Illegal Activities in accordance with Laws. August 6 J.P. Morgan announced that the CSRC had approved the registration of J.P. Morgan International Finance Limited taking 100% ownership of J.P. Morgan Securities (China) Company Limited, making it the first foreign firm to fully own a securities venture in China. September 24 Southbound trading of the Bond Connect scheme between the mainland and Hong Kong bond markets was officially launched. October 15 The CSRC and the Ministry of Justice issued the Opinions on Launching a Pilot Program of Arbitration in the Securities and Futures Sectors in accordance with Laws. October 15 The CSRC announced types of financial derivatives open for qualified foreign investors to trade. October 23 The Futures and Derivatives Law (Draft for the Second Reading) was released for public consultation. **November 12** The Guangzhou Intermediate Court handed down a first instance judgment in the special representative litigation case against Kangmei Pharmaceutical Company Limited (Kangmei Pharmaceutical), in which the CSI Small and Medium Investors Service Center was awarded approximately RMB2.459 billion on behalf of the investors. November 15 The Beijing Stock Exchange opened for trading. **November 26** The CSRC issued the Consultation Paper on the Relevant Rules Involved in the Integration of the Regulatory Framework of Listed Companies.

### **2021 Regulatory Observations**

### Regulators continue comprehensive sector reforms, notably the creation of multilevel capital markets with high levels of integration

As indicated in the 14th Five-Year Plan, the government has set as one of its main priorities the creation of multi-level capital markets. Reforms included establishing a sound process for delisting shares and putting in place the administrative infrastructure of the National Equities Exchange and Quotations (NEEQ, 新三板). Institutional investors are being encouraged to make use of capital markets and direct finance is another avenue of finance that regulators are keen to expand. In short, the process of reforming capital markets continues.

In February 2021, the CSRC approved the merger of the main board and the Small and Medium-sized Enterprise Board (SME board) of the Shenzhen Stock Exchange to create one single homogeneous board. To ensure the stability of the market, the overall arrangement of the merger involved the unification of business rules and regulations on the operation of the two boards, and keeping the same:

(i) issuance and listing conditions;(ii) criteria for investors;(iii) trading mechanisms; and(iv) stock codes and abbreviations.

In September 2021, the Beijing Stock Exchange was established, forming a pattern of synergized, complementary, and interconnected development with the Shanghai Stock Exchange, the Shenzhen Stock Exchange and the regional equity markets. The Beijing Stock Exchange was positioned to serve innovative small and medium-sized enterprises, taking in the NEEQ Select Tier as a whole, and maintaining the tiered structure consisting of the NEEQ Basic Tier, the Innovative Tier (of the NEEQ), and the Beijing Stock Exchange.

At the same time, the Beijing Stock Exchange simultaneously piloted registration-based IPOs and stimulated extra market trading by implementing less restrictive limits on price fluctuation and lowering investment thresholds. Eligible companies listed on the Beijing Stock Exchange can apply for transfer to the STAR Market of the Shanghai Stock Exchange or the ChiNext Market of the Shenzhen Stock Exchange, thanks to the connection between the Beijing Stock Exchange, the Shanghai Stock Exchange and the Shenzhen Stock Exchange at institutional level. With the completion of the merger of the main board and SME board of the Shenzhen Stock Exchange and the establishment of the Beijing Stock Exchange, China has formed a multi-level capital market comprising the regional equity trading markets, the NEEQ, the Beijing Stock Exchange, the Shanghai Stock Exchange and the Shenzhen Stock Exchange. Functions of these markets such as financing and trading are enhanced layer by layer to meet the needs of different types of financing entities and investors, and to keep the capital markets on course of serving the real economy. As these different levels are simultaneously optimized, we can expect to see greater efficiencies in China's capital markets.

### Focused effort on legislation for futures and derivatives markets is put in place, with aims to both strengthen the supervision of and further develop China's capital market

As an important component of the overall capital markets, there were significant developments in the futures and derivatives markets in China in 2021 covering the legal framework, products and market operation.

The Standing Committee of the National People's Congress conducted two readings on the draft futures market legislation in April and October 2021, and the second reading draft further highlighted the advanced legislative concepts including:

(i) changing the proposed name of "Futures Law" (in the first reading draft) to "Futures and Derivatives Law", adding relevant definitions for futures trading and derivatives trading, further elevating the legal status of the derivatives market, clarifying the legal enforceability of netting arrangements meeting certain conditions in the case of the debtor's bankruptcy (thereby clarifying the critical concept which has long hindered the development of the Over-The-Counter (OTC) derivatives market); and

(ii) removing filing requirements for futures service agencies, emphasizing and strengthening the monitoring and control of the futures market, and strengthening regulation while fully "delegating power, streamlining administration and optimizing government services". Meanwhile, regulators enacted and promulgated applicable regulations for futures companies and their subsidiaries, including:

(i) the "Interim Measures for the Administration of Subsidiaries of Futures Companies (Consultation draft)", to further regulate the business operation, internal governance and risk management systems of futures firms, guide the industry to focus on its main business and improve its ability to serve the real economy;

(ii) in December 2021, the People's Bank of China (PBOC), the China Banking and Insurance Regulatory Commission (CBIRC), the CSRC and the State Administration of Foreign Exchange (SAFE) jointly issued *the Guiding Opinions on Promoting the Standardized Development of Derivatives Business (Consultation Draft)* for public consultation, which collected and integrated of the existing regulatory rules and aimed to promote the healthy development of derivatives business rules.

With the coming better legal framework, the conditions were right for a successful futures market. There have been more futures and options products introduced to the market (totaling more than 90 as of the end of November 2021). Qualified foreign institutional investors were allowed to trade commodity futures, commodity options and stock index options.

After a suspension of issuing futures license of 20 years, new futures companies were once again permitted to be established and open for business. The first of these was Shandong Gangxin Futures, which opened in July.

China Commodity Indices Co., Ltd, jointly established by major futures exchanges, opened in Xiong'an New District, Hebei to provide specialized data information technology services in relation to commodity indices. The Guangzhou Futures Exchange was opened in April, marking another plank in the development of China's futures market.

The steady development of the market was reinforced by regulatory enforcement, covering administrative enforcements, annual classification ratings of futures companies, promulgation of *Opinions on Strictly Cracking Down on Securities-related Illegal Activities in accordance with Laws*, and enforcement actions against securities and futures institutions found to have been in breach of regulations.



#### Registration-based system is further improved, with focus on information disclosure

The implementation of the new IPO process based on registration (differ from the previous approval mechanism) in the STAR Market and the ChiNext Market has made the system of reviewing IPOs much more efficient. This has reduced the period for reviewing and then registering IPOs to about 5 months (in approval mechanism, the timeline is unpredictable and varies from 1 to 3 years). The Central Economic Work Conference, held from 8 to 10 December 2021 in Beijing, proposed to fully implement the registration-based IPO system, signaling a new era of registration for all securities issuance in China.

In order to ensure that the registration system works properly in the interests of creating healthy and balanced capital markets, as well as the focus on IPOs, regulators have also looked at improving regular information disclosure, cracked down on illegal acts, and improved the methods for delisting. In other words, they have made sure that all aspects associated with listing shares work efficiently to support the process of registration.

A core regulatory concern has always been information disclosure. In March, the CSRC issued the amended *Administrative Measures on Information Disclosure by Listed Companies* to improve the basic principles and requirements for regular information disclosure by listed companies. In October, in order to address issues arising in connection with prospectuses (such as insufficient relevance and weak investment decision-making), the CSRC sought public opinion on the *Guiding Opinions on Improving the Quality of Information Disclosure in Prospectuses under the Registration-based System (Consultation Draft).* The aim is to improve the quality of information disclosure in prospectuses.

Another area of concern for regulators has been securities-related illegal activities by listed companies and intermediary agencies. The policy of "zero tolerance" involving transgressors has helped raise the quality of listed companies, while imposing greater responsibilities on issuers and intermediaries. Registration and delisting go hand in hand to promote efficient, reliable and balanced capital markets which consists of high quality listed companies.

A-share delisting is proceeding apace, and around 15 companies delisted in the first half of 2021, making such a process normal. In

November, the Shanghai Stock Exchange and the Shenzhen Stock Exchange issued new delisting regulations, including the *Shanghai Stock Exchange Self-Regulatory Guidelines for Listed Companies No. 2-Financial Delisting Indicators: Operating Revenue Deduction* and the *Information Disclosure Business Guidelines for Listed Companies on the Science and Technology Innovation Board No. 9-Financial Delisting Indicators: Operating Revenue Deduction* issued by the Shanghai Stock Exchange. The regulations were oriented towards cracking down on shell companies and achieving "delisting all that should be delisted". In terms of financial indicators, the rules made clear that "business income irrelevant to the main business and revenue without commercial substance" should be deducted from the calculation of operating revenue, which would effectively prevent listed companies from selling their assets or obtaining governmental subsidies at the end of the year or in other ways to maintain listed company status.



### Regulations on the business of securities companies continue to be refined, with particular focus on corporate governance

In 2021, with the development of registration based system reform, there were further measures introduced to raise the standards by which securities companies in the investment banking business field operate.

(i) In February, the CSRC issued the revised *Administrative Measures on Issuance and Trading of Corporate Bonds* to clarify lead underwriters' due diligence responsibilities for bond issuance and internal accountability;

(ii) The Guiding Opinions on Urging Securities Companies Carrying out Investment Banking Business to Fulfill Duties under the Registrationbased IPO System issued in July pointed out that the responsibilities of investment banks should be clearly assigned and the policy of "responsibilities upon filing" should be adopted;

(iii) To urge the investment banks to duly perform their duties, the *Provisions on Supervision of IPO and Pre-Listing Tutoring* and the *Opinions on Strengthening Regulation on Incorruptibility in Investment Banking Business of Intermediaries under the Registration-based System* (*Consultation draft*) issued in September detailed the *requirements* for pre-listing tutoring/counseling, and provided strict rules on tutoring/ counseling procedures;

(iv) In November, the CSRC issued the consultation draft amendments of the *Guidelines for Working Papers on Sponsor Business for Securities Issuance and Listing* and *Due Diligence Guidelines for Sponsors*, which were intended to further clarify the standards for the sponsors and to promote the high-quality development of the investment banking business of securities companies. In response to this, the stock exchanges and the Securities Association of China (SAC) also revised and issued rules related to securities issuance and underwriting in 2021. Other business rules of securities companies are also being gradually rolled out. For example, the SAC issued the *Guidelines on Return Swap Business of Securities Companies* in December to provide more detailed regulations for return swap business.

The corporate governance of securities companies has also been the subject of regulation. In August 2021, the CSRC launched a targeted enforcement program aimed at securities, futures and funds industries with the goal of developing the internal policies and procedures, improving administrative regulation, establishing effective corporate governance and gradually bringing about the market-driven mutual monitoring system. In the past, companies in these sectors have put their own market performance ahead of risk management, and regulators are determined to strengthen supervision by following the principle of "substance over form".

In addition, regulators have imposed more stringent and detailed requirements on securities companies when it comes to risk management. In October, the SAC issued the *Guidelines for Reputational Risk Management of Securities Companies*, a special regulation based on the 2016 *Regulations on the Comprehensive Risk Management of Securities Companies*. These guidelines were timely with the prevalence of Internet-related business and the need for securities businesses to be more mindful of the dangers of reputational risk. The *Guidelines on Return Swap Business of Securities Companies* issued in December required securities companies to include swap businesses into their risk control management and to manage all types of risks. At the same time, the CSRC carried out some special inspections on the risk management covering various businesses of some securities companies and announced that they would conduct on-site inspections on securities companies to ensure "full coverage" risk management.



### Representative litigations in securities disputes became more common, and alternative dispute resolution mechanisms for securities and futures disputes developed

Courts in all regions and at all levels adopted a number of new measures for the settlement of securities disputes, following the guidance as set out for investor mediation and litigation system provided in the *Securities Law*.

Representative litigation is now increasingly used. There is a distinction between "ordinary" representative litigation, which requires investors to actively express intention to participate, and "special" representative litigation, where all affected are joined into the litigation without having to give express intention but they must actively withdraw if they don't want to participate in the litigation. This latter category is considered more conducive to protect the interests of investors.

The concept of representative litigation is a useful method for adjudicating on securities disputes. Special representative litigation is similar to the "class action" in the United States and other jurisdictions. The CSRC has said that it will promote special representative litigation more widely, which may serve to deter those from breaching securities laws and regulations.

(i) Representative was used for the first time in March 2020 by the Hangzhou Intermediate Court in the Wuyang bond fraudulent issuance case;

(ii) In July 2020, the Supreme People's Court adopted the *Provisions on Several Issues regarding Representative Litigation in Securities Disputes*, formally implementing securities representative litigation, which came into operation fully in 2021;

(iii) On May 11, 2021, the Shanghai Financial Court awarded a total of RMB123 million to 315 investors in the Feilo Acoustics case (the first example of ordinary representative litigation since the practice was formally launched);

(iv) On November 12, 2021, the Guangzhou Intermediate Court issued a judgment against Kangmei Pharmaceuticals, awarding investors RMB2.5 billion for losses they had sustained because of the false statements made by Kangmei. Additionally, those held responsible for the liabilities were held jointly and severally liable. Other dispute resolution mechanisms are available to investors looking to protect their interests. On October 15, 2021, the CSRC issued the *Opinions on Launching a Pilot Program of Arbitration in the Securities and Futures Sectors in accordance with Laws* to add arbitration as another way of adjudicating on securities disputes. In November, China's first securities arbitration center was launched in Shenzhen.

The expansion of new dispute resolution mechanisms was supported by securities and futures enforcement activities.

(i) In November, the State Council issued the *Implementing Measures* for the System of Commitment by the Accused to Securities and Futuresrelated Administrative Enforcement, which established an "administrative reconciliation" system with commitment by the defendant at its core; and

(ii) The Ministry of Justice and the CSRC drafted the *Implementing Rules for the System of Commitments by the Accused to Securities and Futures-related Administrative Enforcement (Consultation draft)* drawing together the experience of the administrative reconciliation pilot.

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### Crackdown on securities-related violations

The authorities stepped up their enforcement against those in breach of China's securities laws and regulations in 2021. With the implementation of the amended *Securities Law*, the availability of administrative regulations and clearer criminal prosecution standards, there was greater scope to crack down on transgressors.

In July 2021, the Opinions on Strictly Cracking down on Securities-related *Illegal Activities in accordance with Laws* (Opinions) issued by the General Office of the CPC Central Committee and the General Office of the State Council integrated all the aforementioned regulations. This was the first time the General Office of the CPC Central Committee and the General Office of the State Council had issued a paper relating to securities violations, demonstrating the authorities' "zero tolerance" approach to those in breach of laws. The Opinions provided some 27 measures to improve the efficiency and intensity of cracking down on securities-related activities. Although the Opinions covered all aspects

of the securities and futures markets, the main focus of regulators has been on illegal activities of listed companies and investors. In particular, the Opinions proposed an arrangement in which the Securities Crimes Investigation Bureau of the Ministry of Public Security was based in the CSRC and "a working mechanism for stationing procurators in the CSRC" which will build up a smooth link between the administrative penalties imposed by the CSRC and criminal liability pursued by the procurators. By linking criminal enforcement agencies with securities regulators, the aim is to strengthen enforcement against securities-related violations and crimes.

In 2021, more than half the penalties imposed for breaching securities regulations were levied on investment banking and brokerage businesses. The penalties were severe. For example, Haitong Securities and Haitong Asset Management were required to suspend part of their businesses for up to 12 months for governance failures and lack of risk controls in their investment advisory business. Those individuals found to have been responsible were banned from holding professional positions for two years. In the Kangmei case, the former chairman of the board and general manager Ma Xingtian and five other directly responsible people, as well as certified public accountants, were held to be jointly and severally liable; and 13 others, including the independent directors, were also held to be partly responsible for the breaches. These were high-profile punishments, which received much public attention. The regulatory authorities have also been more proactive when it comes to law enforcement. For example, the CSRC preemptively reviewed the auditing practices of Shenzhen Tangtang Certified Public Accountants and the annual reports of several companies whose accounts had been audited by Shenzhen Tangtang. Many problems were discovered.

In the judicial branch, the court's reliance on the preceding administrative procedure was abolished to give the courts greater freedom to reach their own judgments and not to be bound by predecision of the CSRC. For example, in the Baoqianli case, although the Northeast Securities and BDO Shu Lun Pan Certified Public Accountants did not receive administrative penalties for breaches, the court still found them liable for failure "to diligently perform their duties" and shall undertake the responsibility of compensation.

## 07

### Markets further opened up to international investors, and closer international cooperation established with other countries' regulators

The securities market continued to open up through 2021, as regulators worked to establish a well-functioning market and market access was increased.

More foreign securities companies set up or expanded China-based businesses. JPM Securities became the first wholly foreign-owned securities company in the PRC, followed by Goldman Sachs (China) Securities. BNP Paribas, Warburg Pincus, Sumitomo Mitsui and Citigroup all submitted applications for the establishment of foreign-invested securities companies. CSRC accepted the application by Standard Chartered Securities to set up a securities business. Daiwa Securities and DBS Securities had commenced their business operation with approval from the CSRC.

Regarding cross-border investment and trading, in August, the Hong Kong Securities and Futures Commission announced the launch of A-share-related stock index futures to further attract overseas long-term funds to invest in A-shares. In September, the Southbound Bond Connect was officially launched, marking the two-way opening-up of the Bond Connect. In October, QFI was allowed to invest in commodity futures and other financial derivatives products. In November, international copper, as a futures products launched in China, became a benchmark for trade pricing under several cross-border trade transactions, and FTSE Russell officially included China government bonds in the FTSE World Government Bond Index (WGBI). All these changes helped to make China's securities and futures markets more competitive internationally.

In terms of international regulatory cooperation, in January 2021, the International Organization of Securities Commissions (IOSCO) approved the documents to be used to file complaints by public investors, proposed by the CSRC and commented on by regulatory agencies from 14 countries, including the United Kingdom, the United States and France. This was the first time that China had taken the lead in the formulation of international documents in the field of investor protection. In addition, in 2021, the CSRC strengthened its communication with the offshore regulatory agencies (such as the US Securities and Exchange Commission) on the issue of Chinese companies' listing in the US. Progress was made on issues such as information disclosure and audit supervision, which will help eliminate the regulatory barriers to Chinese companies' outward expansion.



### Regulators tighten controls over unlicensed securities business in the digital environment, and correct data compliance problems in cross-border securities business

As the world experiences digital transformation, the boundaries between activities of licensed and unlicensed institutions and between countries have become increasingly blurred. This is particularly the case in the securities sector, drawing the attention of regulators. In 2021, regulators have sought to encourage securities companies to take advantage of new technology while, at the same time, imposing controls to stamp out unlicensed businesses and ensure data compliance.

In 2021, a particular challenge for regulators was dealing with the new practice of securities companies to use third-party online platforms to carry out securities business, involving live webcasts and customer solicitation activities in cooperation with key opinion leaders in financial sector. Consumers were offered links to securities companies via the websites of unlicensed financial advisers to open accounts. Online comments and investor recommendations were also seen as being disguised and therefore unlicensed investment advisory services. The CSRC responded to stop such unauthorized activity. In early November, the Department of Securities and Funds Regulation of CSRC issued a notice which stated clearly that the social media influencers' receipt of account opening rewards were against the regulations and forbade the securities companies from setting up these online links. Securities companies were also told they must act to stop unlicensed persons from making market comments.

Another issue requiring regulators' attention was the ability of offshore securities companies engaging with domestic investors through the Internet. The regulators emphasized that the financial licenses could only operate within national boundaries. Any business conducted onshore by institutions only holding offshore licenses would be considered illegal financial activities.

Along with the issuance of *Data Security Law* and *Personal Information Protection Law*, regulators also addressed the issue of compliance of the data transmission in cross-border business operations, particularly concerning personal data protection.



### 2022 Regulatory Outlook



Since the announcement of the establishment, and the piloting of, the "registration-based" IPO system on the STAR Market of the Shanghai Stock Exchange in November 2018, the changes have been seen to work well.

(i) In June 2019, the STAR Market and the pilot registration-based IPO system were officially launched;

(ii) In August 2020, the first batch of companies were listed under the registration-based system on the ChiNext Market;

(iii) In September 2021, the Beijing Stock Exchange completed business registration and implemented the registration-based IPO system; and

(iv) In April 2021, the main board and the SME board of the Shenzhen Stock Exchange were merged, leaving only the main board of the Shanghai and Shenzhen Stock Exchanges not yet using the registration-based system for IPOs.

The registration-based system will be extended to all stock issuances. Such intention has been included in the 14th Five-Year Plan, and the 2021 Report on the Work of the Government specified that the reform of the registration-based system should be steadily promoted to create "multi-level" capital markets.

The Central Economic Work Conference, held in December 2021 to assign the main tasks for 2022, required full implementation of the registration-based system for stock issuance. The CSRC said that the next steps would be to adopt registration as the basis for all capital markets transactions, improving the quality of listed companies, improving the process of delisting, and putting more obligations on the part of intermediaries.

As the Central Economic Work Conference sounded the clarion call for the comprehensive registration-based system reform, and the CSRC also expressed its high emphasis on this reform, we expect that the registration-based system for stock issuance will be adopted by the main boards in 2022. The establishment of the so-called "traffic light" system (clear positive and negative authorizations) on the capital markets was repeatedly mentioned in 2021, and was finally affirmed at the Central Economic Work Conference in December and repeated by the CSRC. "Red light" means that regulators will not allow the relevant capital market activities or of certain players such as after detecting failings in anti-competitive behavior or insider trading, which might lead to the "disorderly expansion of capital". "Green light" means the regulators signal that certain activities will be allowed and encouraged so as to guide the development and flow of capital and stimulate the vitality of market players.

We expect in 2022 there will be closer coordination between the financial regulatory authorities and other relevant authorities and clearer rules on the establishment of "traffic lights" will be issued. For example, investment may be supported in fields such as science and technology innovation, manufacturing, and to small and medium-sized enterprises. Against that, monopolistic platforms and entities who conduct cutthroat competition may be prohibited from launching IPOs. The "traffic light" rules, together with the registration-based IPO system, will lay the foundation for future capital market regulation.

**N**2

### Violators will be more strictly punished as individuals' liability is reviewed

In 2021, the regulators had a number of ways at their disposal to impose sanctions on those acting illegally or criminally in the capital markets. The courts also played a part, as representative litigation (in which multiple claims could be heard at the same time) helped accelerate claims by those seeking redress against illegal activity and the courts increased the fines imposed on those breaching laws (as was seen in the Kangmei Pharmaceutical case). Based on these developments, we expect that there will continue to be tough administrative penalties imposed in 2022. With the development of fintech, the regulators will also adopt more novel and regular monitoring methods in daily work. Courts across the country will gradually implement representative litigation to tighten the criminal consequences of securities violations. In the coming year, we can expect to see enforcement by the regulators and the courts working closely together, to ensure a consistent approach to liability. There is likely to be more judicial interpretation of the criminal law as it applies to securities-related crimes in relation to *Amendment (XI) to the Criminal Law*. The cooperation between public security agencies and financial regulators will likely lead to more criminal offences being punished. Punishments for illegal activity will also be spelt out in new regulations for listed companies and related to the NEEQ.

The Kangmei Pharmaceuticals case exposed "failings" in China's independent director system. On the one hand, independent directors were not able to access internal information to enable them to make informed decisions and to participate properly in the company's daily operation and management; on the other hand, prior to the promulgation of the new *Securities Law*, it was not clear what their fiduciary duties were. These problems were not fully resolved in the Kangmei Pharmaceuticals case. We can expect to see further clarification about the extent of independent directors' duties and liabilities, and development of directors' liability insurance, in the coming year.

offers development opportunities for small and medium-sized securities companies.

(iii) Furthermore, the securities companies will continue to make efforts in the custody business in sub-fields, especially serving as custodian for passive index funds.

The amended *Securities Law* (which took effect in 2020) also indicated regulation of market making businesses would follow at some point. It may be that in 2022 those in that line of business will need to have an independent license of market making to operate. If this were to happen, there will certainly be securities companies which focus their efforts on developing market making business in the stock and bond markets, which will further increase market liquidity.

The *Company Law* may undergo further amendments in 2022, and the clauses on corporate governance and equity structure will be further developed. Securities companies and other financial institutions may seek further possibilities in corporate governance and equity structure design.



### Securities companies will divide up their businesses into different areas

In 2022, regulators will continue to encourage securities companies to compete on different tracks to increase specialization in different business areas, with supporting measures being rolled out.

(i) The Over-the-Counter Business Development Report published by the SAC showed a huge increase in OTC financial derivatives business in 2020, in which securities companies played a vital role. In 2021, a number of securities companies announced the contribution of OTC derivatives to their proprietary business and said they would transform their proprietary business. The general expectation is that securities companies will grow their derivatives business. Many of the top securities companies already have strong derivatives businesses in place, complementing investment and research capabilities, capital strength and risk pricing capabilities.

(ii) The establishment and opening of the Beijing Stock Exchange



### Green businesses and those helping to achieve carbon neutrality will be given greater access to finance

Developing a green economy and achieving carbon neutrality are key planks in China's 14th Five Year Plan. In 2021, a number of policies and measures were introduced to support the achievement of carbon peaking and carbon neutrality goals in both finance and taxation areas. For example, the General Office of the CPC Central Committee and the General Office of the State Council jointly proposed expanding the range of financing channels available to enterprises engaged in ecological protection and green development, establishing a green stock index, and encouraging qualified non-financial enterprises and institutions to issue green bonds.

The PBOC, the National Development and Reform Commission and the CSRC issued the *Catalogue of Projects Supported by Green Bonds* (2021), detailing rules related to green bonds. The vice chairman of
the CSRC, Fang Xinghai, disclosed that the CSRC had been studying and formulating policies and measures supporting the achievement of carbon peaking and carbon neutrality goals by: 1) increasing financing support for green and low-carbon enterprises; 2) requiring listed companies to disclose appropriate environmental information; 3) encouraging leading market participants to develop the concept of green investment; and 4) actively participating in the work related to sustainable finance of the International Organization of Securities Commissions (IOSCO).

We expect that in 2022, more enterprises will issue green bonds, and the green bond market will continue to expand; there will be more index investment products constructed based on listed companies in green industries, to guide the green investment concept of the whole market; the CSRC will step up information disclosure requirements related to carbon emissions and environmental protection of listed companies; and financing instruments based on environmental rights such as water-taking rights, emission rights and carbon emission rights will also be launched in due course.

Currently, the nation-wide carbon trading market is not active and participants are limited. In 2022, when conditions are right, institutional investors, including securities companies, may be allowed to participate in trading of the nation-wide carbon market.



### Regulations covering overseas listings may come into force, and cross-border regulation will be strengthened

In July 2021, the General Office of the CPC Central Committee and the General Office of the State Council clearly required in the Opinions to strengthen the regulate for China concepts stocks, to take practical measures to deal with the risks and emergencies of China concepts stocks, and to put appropriate regulations in place. In December, the CSRC sought public opinion on the Administrative Provisions of the State Council on the Overseas Issuance and Listing of Securities by Domestic Enterprises (Administrative Provisions) and the Administrative Measures for the Filing of Overseas Issuance and Listing of Domestic Enterprises (Filing Measures), which proposed the regulation of indirect overseas issuance and listing (in red chips and via VIE structures) by domestic enterprises. Domestic enterprises issuing securities and listing overseas

have to file with the CSRC and comply with laws and regulations on foreign investment, network security, and data security, and so on. Those forbidden from listing overseas include those expressly prohibited from financing by listing under laws and regulations, endangering State security, being involved in major ownership disputes, or being involved in illegal and criminal activities. If a securities company fails to strictly perform its duties or fails to urge the enterprise to comply with relevant regulations, it may be subject to warning or being fined by up to RMB5 million. The Filing Measures further clarified the requirements on the scope of application for filing, filing applicants and filing procedures, and provided that overseas securities company engaging in the sponsoring business of overseas issuance and listing of domestic enterprises or acting as the lead underwriter shall follow filing procedures with the CSRC, and submit annual reports on its engagement in such business to the CSRC.

We expect that the regulatory rules for overseas listing will be formally implemented in 2022. The direct overseas issuance and listing (H shares, and so on) of domestic enterprises and indirect overseas issuance and listing (red chips and via VIEs) of domestic enterprises will be subject to uniform regulatory requirements, and relevant "full floating" rules (i.e. all stocks of the listed companies will be publicly tradable) may be issued.

With the amendment of the *Company Law*, it will become possible to set up a weighted voting rights structure (WVR) in such overseas listed domestic enterprises. There will be more stringent requirements on data security, cross-border data flow, and state secrets management of overseas listed enterprises. In addition, regulation of overseas securities companies engaging in the sponsoring business of overseas issuance and listing of domestic enterprises will also be significantly strengthened.

There will be more cross-border law enforcement cooperation, as the CSRC works with regulatory departments in other jurisdictions to crack down on illegal acts such as corporate financial fraud and to protect the rights and interests of investors.

There may be more regulations covering cross-border securities activities in 2022. The CSRC may also formally issue the *Several Provisions on the Stock Connect Schemes between Mainland China and Hong Kong Stock Markets*, which prohibits mainland citizens from purchasing A-share shares through the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect.

We hope that the regulatory authorities of China and the United States agree on audit supervision as they continue to negotiate.

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### 2021 Key Dates

### **January 8**

The CSRC published the *Certain Provisions on Strengthening the Supervision of Private Investment Funds*, summarizing regulatory experience and refining regulatory requirements.

### May 11

The CBIRC published the Provisional Measures for Administration of Distribution of Bank Wealth Management Products by Bank Wealth Management Companies.

### May 27

The CBIRC published the Circular on Matters Related to the Regulation of the Management of Cash-management Bank Wealth Management Products.

### June 29

The NDRC published the *Circular on Further Improving the Pilot Scheme of the Infrastructure Sector REITs.* 

### September 10

The regulators on the mainland, Hong Kong and Macau respectively released the implementation details of the Cross-Border Wealth Management Connect in the Greater Bay Area ("**WM Connect**"). Thereafter, the Hong Kong Monetary Authority, the Macau Monetary Authority, the Guangzhou Branch of the PBOC, and the Shenzhen Central Sub-branch of the PBOC announced the first batch of banks permitted to conduct WM Connect business on October 18, and such business was launched on the following day.

### October 13

The CSRC announced to allow Qualified Foreign Investors ("**QFIs**") to invest in commodity futures, commodity options and stock index options.

### March 30

The Opinions on Financial Support for Hainan's Comprehensive Deepening of Reform and Opening-Up was promulgated, aiming to explore the introduction of the cross-border asset management business pilot scheme to issue RMB-denominated asset management products in offshore markets, and to launch Qualified Domestic Limited Partnership ("QDLP") and Qualified Foreign Limited Partnership ("QFLP") pilot schemes in Hainan Province.

### May 14

The Several Opinions on Accelerating Building Shanghai into a Global Asset Management Center was promulgated, raising the initiative of an international financial asset trading platform, and exploring the feasibility of using one platform to conduct QDLP and WFOE PFM businesses; on the same day, the first batch of public Real Estate Investment Trusts ("**REITs**") (9 in total) were approved by the Shanghai Stock Exchange ("**SSE**") or the Shenzhen Stock Exchange ("**SZSE**").

### June 1

The opening ceremony of Shanghai-Hong Kong ETF Connect was held and one ETF product from each of SSE and the Hong Kong Exchanges and Clearing Limited ("**HKEX**") was listed and traded on both markets.

### July 27

The first wholly foreign-owned insurance asset management company, Allianz Insurance Asset Management Company Limited, was approved to commence business.

### September 24

The Southbound Trading under Bond Connect was officially launched four years after Northbound Trading was implemented.

### December 10

The CBIRC published the consultation paper of the *Regulations on the Administration of Insurance Asset Management Companies*, which clarified the position of insurance asset management companies as "aiming to achieve long-term value maintenance and asset appreciation"; the *Measures for the Administration of the Liquidity Risk of the Bank Wealth Management Products of Bank Wealth Management Companies* was promulgated.

### **2021 Regulatory Observations**

Post-Asset Management New Rules Era: the regulatory systems of the CBIRC and the CSRC move towards consistency while characteristics of different institutions are taken into consideration, and financial institutions endeavor to take challenge to finish the "last mile" of the transitional period

The year 2021 is the last year of the transitional period of the Asset Management New Rules (issued by multiple financial regulators in 2018), and the regulatory systems of asset management gradually become well bedded in. Various supporting rules of the Asset Management New Rules have been gradually put in place (except for the Provisional Measures for Administration of Cash Trust of Trust Companies in the trust sector, which has not been officially promulgated following public consultation), and the regulatory systems of bank wealth management (i.e. asset management services offered by commercial banks or their dedicated subsidiaries. The industry tends to continue to use this terminology even though the "wealth management ( 理 财 in Chinese)" service in most contexts is asset management in nature), funds, securities asset management, insurance asset management, and other related industries and products are becoming unified.

Taking the bank wealth management business as an example, in 2021, the CBIRC published the *Provisional Measures for Administration of Distribution of Bank Wealth Management Products by Bank Wealth Management Companies*, the *Circular on Matters Related to the Regulation of the Management of Cash-management Bank Wealth Management Products*, and the *Measures for the Administration of the Liquidity Risk of the Bank Wealth Management Products of Bank Wealth Management Companies*. Additionally, according to the 2022 legislative plan released by the CBIRC, it intends to issue the *Measures on Consumer Appropriateness Management of Banking and Insurance Institutions* in 2022.

The system and rules for bank wealth management companies (including wealth management subsidiaries ("**WMSs**") and other non-bank financial institutions approved by the CBIRC which mainly conduct bank wealth management business, such as the bank wealth management companies controlled by foreign shareholders) are gradually converging with the CSRC system. At the same time, the regulatory authorities' approaches towards asset management products are still based on the types of product manufacturers. For example, the distribution channels of WMSs are still limited to banking institutions. And the consultation paper of the *Regulations on the Administration of Insurance Asset Management Companies* emphasizes that insurance asset management companies still need to be anchored in long-term and steady investment strategies to achieve the goal of long-term value maintenance and asset appreciation.

With the end of the transitional period approaching, financial institutions have been stepping up their efforts to make all changes to meet the requirements of regulators to upgrade their operations ("Rectification"), such as clearing out the principalprotected or non-compliant asset management/bank wealth management products. Although most institutions are said to be able to accomplish the Rectification on time, the work of some institutions is more of "form over substance", and some products are still being secured by the credit of financial institutions while the Asset Management New Rules requires the financial institutions shall not provide any direct or indirect, explicit or implicit guarantees, repurchases and other commitments to bear risk on behalf of the asset management products. After the expiration of the transitional period, the regulators will promptly deal with assets that are not "rectified" by financial institutions on a case-by-case basis. The regulator may take additional measures against any financial institutions still not in compliance with new regulations, including but not limited to suspension of new business and adjustment of regulatory ratings until such assets have been fully "rectified". In addition, new issues and challenges have emerged in the process of strictly implementing the requirements of the Asset Management New Rules. For example, the requirement of net worth management (which means that the actual value and the return on assets shall be reflected in the net worth of the asset management product) has caused financial institutions to rethink the importance of their investment and research capabilities in order to produce more competitive asset management products.

# 02

Regulatory approaches have been further refined to cover the full life cycle (i.e. fundraising, investment, management, and exit) of asset management products

In 2021, regulators continued to refine their regulatory approaches with regard to individual asset management products, with new regulatory requirements covering the entire life cycle of asset management products, including "fundraising, investment, management, and exit". Regulators also began to pay special attention to key fields and high-risk transaction scenarios.

(1) "Fundraising": The regulators have stressed that the online distribution by internet platforms has to be licensed and those that are not licensed need to rectify.

(2) "Investment": In recent years, the regulators have regulated investment behaviors from multiple perspectives, such as concentration restriction on investments (i.e. the regulators impose upper limits on underlying assets an asset management product can invest in from different perspectives), investment scope, and market misconduct prohibitions. However, the regulators rarely mention specific investment/trading activities from a micro perspective. It is worth pointing out that new trading models such as quantitative trading and high-frequency trading have recently developed rapidly in the Chinese market. Regulators have tentatively imposed information reporting requirements on these special trading models in 2021, laying the groundwork for future regulation.

(3) "Management": In September 2021, the General Office of the Ministry of Finance published the consultation paper of the *Regulations on Accounting Treatment Related to Asset Management Products.* The proposed unified accounting treatment will promote the implementation of the principle of net worth management and prevent financial risks. In addition, the official of the Market Department of the CSRC mentioned in 2021 that the CSRC will facilitate the issuance of the *Regulations on Supervision and Administration of Private Investment Funds* as soon as possible.

(4) "Exit": The importance of diversity of exit routes for private equity/venture capital ("**PE/VC**") products cannot be overstated. In 2021, the establishment of the Beijing Stock Exchange has provided a new way for domestic companies to go public. Added to that,

earlier this year, the Beijing Equity Trading Center took the lead in implementing applicable supporting rules of equity transfers relating to PE/VC investments. In November, the CSRC approved the pilot transfer of PE/VC investments in the Shanghai regional equity market. Other regions in China such as Sanya, Hainan Province have also proposed to actively explore the establishment of similar mechanisms.

# 03

Taking fund investment advisory service as an opportunity, both domestic and foreign institutions have made comprehensive arrangements in the wealth management sector, and the overall regulatory system over the wealth management sector has gradually taken shape

In the post-coronavirus era, the transformation of asset management institutions has begun, and wealth management is one of the market's key concerns (unlike the bank wealth management service, the wealth management service (财富管理 in Chinese) refers to the comprehensive buy-side advisory services and tailored investment and financing solutions to clients, which is close to the term as used in most offshore jurisdictions).

In the first half of the year 2021, several institutions obtained the public fund investment advisory pilot qualification, which may provide a catalyst for the transformation of the wealth management business. After assessing the actual situation in the wealth management sector and gathering regulatory experience, in the second half of the year 2021, the CSRC and the AMAC focused on further regulation of fund investment advisory businesses. For example, the CSRC publicly issued the draft of the Circular on the Regulations of Fund Portfolio Strategy Advisory Activities in November 2021, which aims to differentiate and regulate fund investment advisory services (which is regarded as buy-side service) from investment advisory services ancillary to fund distribution (which is more from the perspective of sellers). In addition, the AMAC issued guidelines on the content and format of legal documents for fund investment advisory services for public consultation, and the CSRC issued guidelines on service performance and client asset presentation for public consultation. As a result, the regulatory regime for fund investment advisory business is gradually taking shape, and the standardization of the investment advisory market is also expected.

Meanwhile, foreign institutions have started to become actively involved in wealth management businesses in China. In 2021, several foreign financial institutions, such as Credit Suisse, have been preparing for, or have submitted, applications for business qualifications covering important segments of wealth management services, such as product distribution, investment advisory service, and securities brokerage.

Trust companies have also been actively developing investment trusts (mainly securities-based investments) and family trust businesses, to fall in line with regulatory pressure. As for bank wealth management products provided by bank wealth management companies, the official release of the Provisional Measures for Administration of Distribution of Bank Wealth Management Products by Bank Wealth Management Companies added another piece of the puzzle to the supporting regulatory system for bank wealth management business. Currently, bank wealth management products are only allowed to be sold by bank wealth management companies themselves and banking institutions, which has an impact on the ability of acquiring consumers through internet platforms, brokers and other sophisticated distribution channels. However, for small and medium-sized banks that have not yet set up WMSs, such restrictions on distribution channels may offer them an opportunity to approach their existing customers directly to develop their wealth management business.

# 04

Mutual market access between the mainland and Hong Kong/Macau deepens with greater range of products

Based on the experience gained from Stock Connect and Bond Connect, the mutual market access concept is being consistently explored and deepened. Four years after the introduction of the Northbound Trading under the Bond Connect, Southbound Trading was launched in September 2021. As one of the channels by which onshore institutions are allowed to make offshore investment in the overseas bond market, Southbound Trading further accelerates the pace of internationalization of the PRC bond market.

After nearly two years of preparation since the announcement of the Greater Bay Area Construction Leading Group in November 2019 to explore the establishment of the WM Connect in the Greater Bay Area, the first batch of business of the WM Connect was officially launched in October 2021. The approach in the early stage of the WM Connect was to proceed cautiously with proper risk controls, involving low-risk products, closed-loop funds flow, careful regard for investor protection and methods introduced for resolving disputes, among other measures.

Unlike previous mutual market access programs, the WM Connect allows retail customers to open investment accounts and make investments directly across the border for the first time, providing investors in the Greater Bay Area with a wider degree of flexibility in choosing investment products. According to the Guangzhou Branch of the PBOC, a total of 20 banks provided services to individual investors in November, leading to 7,517 new investors. Of these, a total of 5,100 people from Hong Kong and Macau participated in the Northbound Connect, and a total of 2,417 people from the mainland participated in the Southbound Connect.

In addition to the Southbound Trading under Bond Connect and the WM Connect, the mainland and Hong Kong are also actively exploring the cooperation mechanism of ETF Connect. SSE, SZSE and HKEX have listed ETF products respectively under ETF Connect. Given the different regulatory regimes of the mainland and Hong Kong and other practical reasons, ETF Connect is still mainly achieved through the QDII/QFII channel by way of "mutual investment". HKEX, SSE, SZSE, and China Securities Depository and Clearing Corporation ("**CSDC**") reached a high-level agreement at the end of December 2021 on the availability of eligible ETFs under Stock Connect. As the next step, HKEX, SSE, SZSE, and CSDC will work closely on the details of inclusion, including business and technical preparations such as amendments to applicable rules.



### Steady progress in further opening-up and integration into the global financial system

Since the new QFI regulations came into effect in 2020, the hurdle for hedge funds to apply for QFI qualification was removed and several hedge fund managers already successfully obtained a QFI qualification in 2021. In addition, on October 13, 2021, the CSRC issued a regulation that allows QFIs to invest in commodity futures, commodity options and stock index options, which is a further implementation of the new QFI regulations (but specific transactions are subject to upcoming rules of exchanges). Besides, in 2021, quota approvals for QDIIs tend to be seen more often.

On March 30, 2021, the PBOC, the CBIRC, the CSRC, and the SAFE jointly issued the Opinions on Financial Support for Hainan's Comprehensive Deepening of Reform and Opening-up, proposing to explore the development of the pilot scheme of cross-border asset management and to support foreign investors to invest in various types of asset management products issued by financial institutions in the Hainan Free Trade Zone. This has become one of the financial pilot schemes that the market is viewing with great interest to see how it works in practice. In May 2021, the Shanghai Municipal Government released Several Opinions on Accelerating Building Shanghai into a Global Asset Management Center, an indication of the Shanghai government's determination to asset management sector to put in place a good system to support bank wealth management, trusts, securities, funds, insurance, private equity and futures in order to build a global asset management center. Shanghai Lingang District also intends to build an international financial asset trading platform with both issuance and trading functions. Furthermore, the SAFE has approved multiple regions to carry out cross-border business such as those conducted through QDLP and QFLP schemes. The Sino-French Financial Dialogue also mentions that China welcomes French asset management institutions to set up joint venture bank wealth management companies with WMSs of Chinese banks.

At the same time, foreign investors continue to be enthusiastic about the asset management market in China and are entering the market:

- Allianz became the first wholly foreign-owned insurance asset management company;
- The bank wealth management joint venture of BlackRock, CCB and Fullerton was approved to open for business and issued its first product;

- The bank wealth management joint ventures between Schroders and Bank of Communications and between Goldman Sachs and ICBC were approved for their respective establishments;
- The first wholly foreign-owned public fund company, BlackRock Fund Management Limited Company, was approved to open for business and promptly launched its first public product;
- Both Fidelity and Neuberger Berman were approved to establish their wholly foreign-owned public fund companies;
- JP Morgan announced it would acquire 10% equity interest of China Merchants Bank's WMS; and
- Bridgewater became the first WFOE PFM with assets under management ("**AuM**") reaching RMB10 billion.

These foreign institutions are likely to bring new developments to the asset management market in China.

### The asset management sector contributes to the reform of the pension system, while, in turn, the pension system introduces new long-term funds into the asset management sector

China's reform of pensions continued. Compared with the first pillar (public pensions) and second pillar (annuities and other pensions serving similar purposes and functions), the development of the third pillar (individuals contributing to their own pensions through, for example, personal savings and commercial pension insurance) has lagged behind. Faced with the pressure of an aging society, the reform of the pension system is essential. Regulators are also actively exploring other ways to develop the third pillar (apart from commercial insurance).

Pilot pension bank wealth management products made their debut in 2021. Unlike the pension-target funds under the CSRC system, the pension bank wealth management products issued by the WMSs are equipped with more "pension" features, such as: (1) the products come under closed-ended operation, but supports early redemption when certain conditions are met (e.g., major diseases); (2) the products adopt the "income-smoothing funds" mechanism to ensure regular investment return (a certain percentage of excess income over the benchmark is distributed to the income-smoothing fund to cope with the situation where the return of the product is uneven).

Bank wealth management companies have certain advantages in carrying out pension asset management: (1) commercial banks have an extensive base of savings clients; (2) bank wealth management has extensive experience in asset allocation and the offering of low- and medium-risk products; (3) regulators intend to guide the development of professional products with real pension-saving functions. In a speech in October 2020, CBIRC Chairman Guo Shuqing said that the regulators should explore uniform standards for pension financial products and should abolish products that do not live up to their names.

The pension system is also closely linked to the asset management sector. For a long time, institutional investors, represented by social security funds, pension funds and enterprise annuities, have argued for the sound development of the asset management sector. The reason is, compared with retail investors who pursue short-term interests, they are more concerned to achieve longterm investments. Pension bank wealth management products are conducive to the transferring of individual investors' "deposits" into investments with the aim of achieving a balance of risks. mandatory repayment-related provisions shall be deemed invalid has also been signaled by judges. For instance, in the Zenith Steel Group vs. Sandu Xinghe case, the court of second instance upheld the first instance judgment, holding that, despite the general principle that violation of regulations would not affect the validity of a contract, a contract should be considered invalid if the content of such regulations involves financial security, market order, national macroeconomic policy, and other public policies. Accordingly, the court held in this case that the contract on mandatory repayment should be invalid. The court of the first instance also mentioned that if Zenith Steel Group considered that the manager was at fault for the investor's loss, the investor could claim damages separately once the amount of loss had been determined. This also confirmed the principle that the manager with management responsibility should be liable for losses caused by their fault (at least to some extent).

Furthermore, in recent trials, it was held that a distributor (or a nonlicensed institution that substantially performs the distribution and related functions), as the agent of the manager, may be held jointly and severally liable, in accordance with the *Minutes of the National Courts' Ninth Conference on Civil and Commercial Trial Work.* For example, in the Ju Pai case, the controlling shareholder of the manager was substantially involved in the promotion, distribution, investment, and management of the private fund, and therefore in essence constituted the agent of the manager, and thus the shareholder should be jointly and severally liable with the manager.

While emphasizing the elimination of mandatory repayment, the principle of caveat venditor ("seller beware") and caveat emptor ("buyer beware"), clearly stated in the Minutes of the National Courts' Ninth Conference on Civil and Commercial Trial Work, has been carried through in judicial practice

The core purpose of the *Asset Management New Rules* is to put an end to mandatory repayment to investors and to let the investors bear the investment risks. Regulators have enforced this strongly. For example, Sichuan Trust was fined RMB34.9 million for, amongst others, promising zero principal loss or minimum investment return. At the same time, in recent trials, the regulatory directive that the

# 08

### Carbon trading system gradually improved to promote the development of the green asset management business

The year 2021 is the first year of the 14th Five-Year Plan, out of which emerged a number of key goals so far as the promotion of the environmental industry is concerned.

 In March, the State Council issued the 14th Five-year Plan for China's National Economic and Social Development (2021-2025) and the Outline of Perspective Goals for 2035, proposing to promote green development and the harmonious coexistence of human beings and nature, build a green development policy system, strengthen the legal and policy guarantees for green development, and

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vigorously develop green finance.

- In February, the *Management Rules of Carbon Emissions Trading* (*for Trial Implementation*) came into effect; and in July, the national carbon emissions trading was officially launched in the Shanghai Environment and Energy Trade Exchange.
- In November, the Guiding Opinions on Strengthening the Integration of Industry to Promote the Green Development of Industry were promulgated, proposing to innovate green financial products and services and to support the orderly transfer of production capacity, relocate hazardous chemical production enterprises, and build advanced manufacturing clusters with a comprehensive package of financial tools such as M&A loans and asset management.

The green policies and market practice represented by peaking carbon dioxide emissions and achieving carbon neutrality (the so-called "30-60" objective) progressed steadily in 2021.

Along with the high-level policy support from the regulators, green asset management products with the theme of peaking carbon dioxide emissions and achieving carbon neutrality have emerged in various forms in the market this year. For example, the first domestic "carbon neutrality" asset securitization product issued by Yingda Trust, the first carbon-neutral service trust established by Zhonghai Trust with Chinese Certified Emission Reduction (CCER) as the underlying asset, and several ESG ETFs have been approved. It is not difficult to find that green asset management products with the theme of peaking carbon dioxide emissions and achieving carbon neutrality play a role in value discovery and value investment in the field of energy conservation and environmental protection.



### **2022 Regulatory Outlook**



The Asset Management New Rules and its supporting provisions will continue to promote the sound development of the asset management sector. With the asset management business gradually returning to its original purpose (i.e. active management), the importance of professional operation and compliance has become more and more pronounced. We expect that regulators will continue to build a regulatory system for asset management to guide the healthy, long-term development of the sector.

In addition to the banks' splitting bank wealth management business from their banking businesses, securities companies have also set up specialized asset management subsidiaries, which is an important measure to implement the *Asset Management New Rules* on risk segregation of legal persons and represents a further specialization of the asset management business. However, since 2021, the pace of license approvals for WMSs has slowed significantly, which we believe is related to the CBIRC's mindset of urging the transformation of the bank asset management business and emphasizing compliance.

We also expect that regulators will be more cautious in approving the splitting of asset management business or the new qualification of asset management business, and the approval of new licenses for WMSs or other bank wealth management companies might be tightened. For commercial banks that cannot achieve a "clean start", regulators might suspend or even not approve the establishment of WMSs. Under such circumstances, these commercial banks will not be able to continue their bank wealth management business after the terms of their existing self-manufactured products expire. With this trend, the less sophisticated players will cease to exist, and the phenomena of asset management institutions being "large in quantity but undesirable in quality", or "large in AuM but undesirable in return" will be improved.

In addition to the above, as part of growing professionalism that is being encouraged, we expect that the regulation of the third-party service sector will be strengthened. The regulator's attention will be extended to cover other aspects of the business, such as custody, FATA, distribution, valuation and IT, as it will be the responsibilities of managers to ensure that the asset management institutions focus on their core business and risk management.

# 02

### From commission fee-first to client interest-first, the wealth management sector will undergo profound changes

We expect that the consultation paper of the investment advisory business qualification issued by the CSRC will probably be formally promulgated and implemented in 2022, and the approval of fund investment advisory qualification (currently only on a pilot basis) will become more common in the future. The importance of buy-side advisory business will be further highlighted, particularly when it comes to fund investment advisory services. The wealth management market will gradually move from a sellerled one to a more mature model, i.e. being closer to the needs of investors and relying on the professional capabilities of financial institutions to provide multi-category and multi-dimensional advisory services.

The regulatory approaches of the regulators will put more emphasis on the different fiduciary responsibilities of service providers to the product issuers and to the investors, and discussions over the boundaries of the responsibilities of service providers from different perspectives, as well as the prevention and handling of conflicts of interest.

On this basis, the provision of integrated and customized services will further lead to growth opportunities in a series of businesses such as brokerage, private products and structured products. No single financial institution can yet provide comprehensive and full process wealth management services under PRC law. The advantages of a group company will be shown at this stage and the intra-group cooperation model will be further explored. We expect that the leading experience in this regard may shed new light on the regulation of intra-group collaboration.

# 03

### Cross-border regulation and enforcement issues may be highlighted as asset management and wealth management markets go global

Along with the deepening of the mutual market access regime and the steady progress of financial opening-up, the wealth management sector and the asset management sector will continue to promote global operation, and bringing new opportunities for global asset allocation for global and Chinese investors. On this basis, the wealth management sector and asset management sector may usher in a new development boom. We expect that regulators will continue to promote the development and improvement of policies and systems related to crossborder asset management, such as further expanding the scope of QFI investment and issuing supporting implementation rules, expanding the QDLP/QFLP pilot schemes, and promoting pilot cross-border investment by private equity funds. In addition, regulators will also focus more on practical issues, such as how to regulate the cross-border transmission of financial services related data.

As the global financial system becomes more closely integrated, the importance of cross-border regulatory supervision and enforcement cooperation becomes all the more important. How to strengthen the collaboration and information sharing between regulators, prevent the risks arising from cross-border capital flows, and cope with the different financial supervision requirements of different jurisdictions will become new challenges for regulators. We believe that the implementation of the "place of business segment" principle established by the WM Connect will bring fresh ideas to solve these challenges. We expect that, while the possibility of introducing specific implementation rules on cross-border regulations and enforcement in the near term is low, the regulators will continue to gain experience and lay the groundwork for future rules.



### More efforts to be devoted to investor education

In the era following the introduction of the Asset Management New Rules, there is likely to be a reversion to the position where investors have greater influence. For example, how individual investors can further release the funds in their savings accounts to diversify asset allocation, how institutional investors should invest to maximize returns by balancing the risks, and how government investors can balance maximizing returns with the benchmarking role of the government will all come to the fore. In this process, sound investor education will help investors gain a deeper understanding of how the asset management sector works and how they can best work out what investments are best for them.

The "net worth transformation" of bank wealth management business and the elimination of "mandatory repayment" will overturn the traditional perceptions of investors of bank wealth management products. It will become an important issue for bank wealth management to gain investors' understanding and continue to win their investment. We expect that the CBIRC will continue the regulatory focus on protecting consumer rights, with more emphasis on making sure that investors of asset management products are suitable and investor education in the overall process of issuance and distribution of asset management/ wealth management products. So far as keeping investors well informed is concerned, bank wealth management businesses could learn from mutual funds.

Domestic and foreign institutions need to put themselves in their clients' shoes and assist "non-professional" investors (represented by individuals, or "retail" investors) to select suitable products which are best suited to their own needs and conform to their risk appetite. In addition to general educational content such as risk disclosure and elimination of "guaranteed repayment", we expect that regulators may place more emphasis on the introduction of offshore products (especially those that are more innovative and complex in structure compared to asset management products available in the onshore market).



### The theme of "green" may become an important direction for the transformation of the asset management sector

In recent years, the green finance business in the PRC has laid a good foundation, with green credit and green bonds performing very well. Financial regulators have made clear their encouraging and supportive attitude towards green finance businesses and products in the *Guiding Opinions on Strengthening the Cooperation of Industry and Financing to Promote the Green Development of Industries*. Currently, the asset management sector has started to actively issue green products. We believe that the green theme will be an important direction for the transformation of the asset management sector in the coming year.

We expect that supporting policies will clarify the meaning of "green theme", provide clearer identification criteria, improve the framework and standards for information disclosure of applicable entities and define the legal responsibilities of managers. Accordingly, regulators might also issue relevant preferential or supportive policies to provide the impetus for the development of green asset management.

# PRC Financial Regulation: Annual Report (2022) FinTech

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### 2021 Key Dates

### January 13 / February 19

The China Banking and Insurance Regulatory Commission (CBIRC) and the People's Bank of China (PBOC) issued the Notice on Matters Concerning the Regulation of Internetbased Personal Deposits of Commercial Banks, and the CBIRC issued the Notice on Further Regulating the Internet Lending Business of Commercial Banks.

### February 7

The Anti-monopoly Commission of the State Council issued the *Anti-monopoly Guidelines on Platform Economy*.

### June 10 / August 20

The Standing Committee of the National People's Congress passed the *Data Security Law* and the *Personal Information Protection Law* (PIPL).

### July 30

The State Council issued the *Regulations for Security Protection of Critical Information Infrastructure.* 

### September 28

The Beijing Financial Technology Innovation Supervision Working Group and the Shenzhen Financial Technology Innovation Supervision Working Group both announced the completion of the tests on "the innovative applications of financial technology innovation supervision tools". The first batch of applications "exiting the sandbox" came out.

### **December 2**

Pudao Credit Co. completed the filing of corporate credit investigation business, becoming the second credit investment institution after Baihang Credit Co. Both have licenses to provide individual and corporate credit business.

### January 20

The PBOC issued the *Regulations on Non-bank Payment Institutions (Consultation draft).* 

### April 29

The financial regulatory authorities summoned 13 internet platform enterprises and imposed seven requirements to change their practices.

### July 6 / November 25

The Shenzhen Municipal People's Congress issued the *Data Regulations of Shenzhen Special Economic Zone*; the Shanghai Data Exchange was officially launched in Shanghai, 8 types of data products relating to financial industries and other industries were listed, and the Shanghai Municipal People's Congress passed the *Shanghai Data Regulations*.

### September 27

The PBOC issued the *Administrative Measures on Credit Investigation Business*.

### October 29 / November 14

The CAC issued the *Measures for the Security Assessment* of *Data Outbound Transfer (Consultation draft)* and the *Network Data Security Management Regulations* (Consultation draft).

### **December 28**

The CAC and 12 other authorities issued the amendment to the *Cybersecurity Review Measures*.

### **2021 Regulatory Observations**

### Fintech regulatory framework developed, strengthening the requirement that financial businesses must operate under license

On March 5, 2021, Premier Li Keqiang stated in the government work report that the supervisions of financial holding companies and fintech companies should be reinforced to ensure that financial innovation is carried out under prudential regulation. In 2021, financial regulators further emphasized that all types of institutions that are substantially involved in financial business in the form of platform cooperation and technological innovation should be licensed and subject to unified regulation. Following the momentum of 2020, regulators continued to issue a series of rules to strengthen fintech regulation. By the end of 2021, fintech-related regulations or consultation papers were released in all major areas covering banking, securities, insurance, funds, microcredit, and credit investigation, bringing both financial and nonfinancial institutions under the purview of regulation, and applying equivalent standards to the similar financial activities.

With respect to financial institutions, the regulators issued new regulations addressing financial institutions' violations or circumventions of regulations in deposit and loan businesses that were conducted via the internet, collaborating with third parties, and so on. In January 2021, the CBIRC and the PBOC issued the Notice on Matters Concerning the Regulation of Internet-based Personal Deposits of Commercial Banks, emphasizing that commercial banks conducting deposit business through the internet should strictly comply with laws and regulations, and they must not violate or circumvent any regulatory requirements by means such as online operations. The Notice also clarifies that commercial banks should not operate time deposit or time-demand deposit businesses through non-self-operated online platforms. In February 2021, the CBIRC issued the Notice on Further Regulating the Internet Lending Business of Commercial Banks, setting out the regulatory requirements on the funding proportion between commercial banks and their cooperating agencies when granting internet loans.

With respect to <u>non-financial institutions</u>, the financial regulators have continued the strong regulatory position they have taken about the operation of online platforms businesses. The *Administrative Measures on Credit Investigation Business* issued by the PBOC on September 27, 2021 stated the licensing requirement to carry out credit investigations, which also includes the provision of *de facto* credit investigation

services operating under the name of "credit information services", "credit services", "credit scoring", "credit rating" and "credit repair", is necessary. The PBOC made it clear that those engaging in personal credit investigation business without the PBOC approval under the façade of big data companies, fintech companies, and so on, will be acted against the law. The measures further clarified that financial institutions shall not be permitted to cooperate with market entities that have not yet obtained a proper credit investigation license.

On April 29, the PBOC, the CBIRC, the China Securities Regulatory Commission (CSRC), the State Administration of Foreign Exchange (SAFE), and other financial regulators held talks with 13 leading online platforms to raise "rectification" requirements they needed to fulfil with regard to the issues such as licensed operation of financial services, shareholder qualifications, shareholding structure, capital, risk segregation, related transactions, improving corporate governance, and implementing "two participation/one control" shareholding limitations in banking and insurance institutions. In October, Guo Shuqing, the chairman of the CBIRC, further stated that similar businesses and entities should be treated alike and regulatory arbitrage should be eliminated.

# **D2**

### Evaluation and assessment of consumers' financial rights gained further attention, prioritizing the prohibition of inducing consumers to take on too much debt

Financial consumer protection has been repeatedly strengthened by the financial regulators in recent years. Regulators effectively urged fintech-related institutions, including commercial banks, to establish and improve financial consumer protection mechanisms by incorporating consumer protection into their assessment criteria for financial institutions, and by sanctioning and investigating their behavior regarding consumer right infringements. For example, the Measures for the Regulatory Evaluation of Banking or Insurance Institutions' Protection of Consumer Rights and Interests, promulgated by the CBIRC on July 5, 2021, established annual supervisory evaluations for consumer protection, prompting affected financial institutions to include consumer protection as a key aspect of their internal compliance; and the CBIRC Beijing Branch set out standard requirements for auto finance companies and consumer finance companies within its jurisdiction with regard to the protection of financial consumer rights in a number of ways, such as corporate

governance, price management and contract management.

Prohibiting the inducement of consumer over-indebtedness has been the focal points of the regulators' consumer protection endeavors. The 2021 PBOC Working Meeting required that excessive marketing of financial products and inducing over-indebtedness should be strictly prohibited. On February 24, 2021, the CBIRC, the CAC, the Ministry of Education, the Ministry of Public Security, and the PBOC jointly issued the Notice on Further Regulating the Supervision and Administration of Online Consumer Loans for College Students, prohibiting the inducement for college students to take on too much debt, which might lead them to becoming over-burdened with debt.

Since 2021, the financial regulators have launched several "rectification movements" for financial consumer protection in the fintech sector, criticizing some financial institutions for infringing consumer rights. The CBIRC and the Financial Consumer Protection Bureau of the PBOC have circulated critical, in some cases imposing administrative penalties, on a number of financial institutions and internet companies and/or their related personnel for illegally deceiving consumers or seriously infringing consumers' basic rights, such as the right to information, the right to independent choice, and the right to being dealt with fairly in transactions. The problems of inadequate consumer rights protection systems are particularly significant when it comes to those cooperating with online platforms. The regulators have adopted a strong regulatory stance and strict enforcement towards the violations of consumer rights and interests.



### Personal data protection reinforced, including collection and use of data

The promulgation of the PIPL on August 20, 2021 marked the establishment of the basic legal framework for personal information (which is more commonly referred to as "personal data" outside China) protection. As the first special law on personal information protection in the PRC, the PIPL has defined the scope of personal information and has covered all manner of possessing personal information, including collection, storage, use, processing, transfer (including cross-border transfer), provision, disclosure, erasure, and so on. Based on the applicable laws, the PIPL refined principles and rules

for personal information protection such as "the principle of consent", improved the system of rights and obligations related to personal information protection, and restricted certain conduct such as "big data discriminatory pricing" and illegal processing of personal information. In short, the PIPL has laid the legal foundation for governing the digital society.

For all financial institutions and fintech companies, who invariably process people's personal information, protecting personal information will become a critical part of the legal obligations in their operations. Violating such obligations under certain circumstances will constitute a criminal offence, as well incurring administrative penalties and giving rise to potential civil liabilities.

So far as law enforcement is concerned, national and local regulators have identified the major applications (apps) and online platforms that were being used to collect people's personal information. For example, on May 10, the CAC issued a circular on the illegal and "abnormal" collecting and using of personal information by 84 apps; on November 18, the CAC Hainan Branch issued a circular on the illegal usage of personal information by 13 apps.

On top of this, in recent years, banks have been restricted from certain lending collaboration businesses (what are called "channeling services"). In July 2021, regulators required online platforms, when collaborating with financial institutions in forms of lending channeling, lending facilitation, joint lending, and so on, must not directly provide information (including information voluntarily submitted by individuals, information generated within the platform, and information externally obtained) to financial institutions in the name of application information, identity information, basic information, and personal profile scoring information. Instead, any such collaboration had to be conducted through a new form of agency, called "online platform-credit investigation agency-financial institution", which has stricter controls on the collection and use of personal information.

The courts have also delineated the legal boundaries for personal information processing activities of e-commerce platforms. For example, on October 29, 2021, the Hangzhou Internet Court published a judgment in which an e-commerce platform's unauthorized provision of user information to the platform's built-in payment software has been identified as constituting a tort (a "wrong" in legal terminology) and ruled that the platform was liable to compensate individual users.



### Financial data regulation strengthened, and data trading on the horizon

On June 10, 2021, the Data Security Law (DSL) was formally promulgated as a fundamental law in the field of data security, establishing a multilayer classification of data protection to enforce a stricter administration of the national core data related to national security, the core economic sectors of the national economy, people's wellbeing, and major public interests. Regulators formulated a series of supporting rules for the implementation of data security-related laws. In the second half of the year, the CAC issued the Measures for the Security Assessment of Data Outbound Transfer (Consultation draft) and the Network Data Security Management Regulations (Consultation draft), which are the key supporting regulations for the implementation of the three major data laws, namely the Cybersecurity Law, the DSL and the PIPL. Those draft regulations set out the strict criteria of cross-border data transfer requiring security assessment, refined rules implementing provisions of the major data laws and upgraded obligations for data processors. Specific to the Network Data Security Management Regulations (Consultation draft), it expanded the scope of network security review to include foreign listings (for those data processors processing personal information of more than 1 million people), Hong Kong listings, and mergers and acquisitions under specific circumstances for online platforms.

The *Cybersecurity Review Measures* issued at the end of 2021 and to be implemented in February 2022 also prescribed that any foreign listing of an internet platform operator, which had a database of information with more than 1 million people, shall be submitted to the Office of Cybersecurity Review for its prior review.

Regulators also addressed the data protection requirements and obligations that the financial sector need to abide by. For example, on December 3, 2021, the China Financial Standardization Technical Committee issued the *Financial Data Security - Data Security Assessment Specification (Consultation draft)*, which provided guidelines on the circumstances and assessment requirements under which financial institutions should conduct data security assessments. In addition, regulators also clarified the responsibilities of regulatory departments and regulatory coordination for data security regulation. On January 15, the CBIRC publicly issued the *Administrative Measures on Regulatory Data Security (for Trial Implementation)*, which established how regulatory data security should be managed. On July 6, the *Opinions* 

on Strictly Cracking Down on Illegal Securities Activities in Accordance with the Law, jointly issued by the General Office of the Communist Party of China Central Committee and the General Office of the State Council, specified the responsibilities of domestic industry supervisors and regulatory authorities, while strengthening collaboration between regulatory authorities.

In the first half of 2021, the CBIRC imposed administrative penalties of as much as several millions in RMB on a bank for issues including failing to report important information system emergencies and leaking sensitive information on its internet portal website. The DSL, effective since September 2021, increased the penalties for violations such as data leakage, with the maximum fine raised to RMB10 million. Financial institutions will face stricter data security regulation and penalties from the authorities in the future, and it is imperative for those institutions to improve their internal data security governance procedures. At present, based on the experience of data security projects in the financial sector, China Financial Certification Authority (CFCA) has summarized the "IPDR" model of data security governance, which might provide a good reference for financial institutions to improve their level of detail on data governance and application of data security technology.

Property rights associated data first came to be considered at a special meeting of the Financial Stability Committee in October 2020, at which it proposed "to establish basic systems and standards for the property rights of data resources and the circulation of transactions". In December 2020, Guo Shuqing, the chairman of the CBIRC, also stated that, with large technology companies in control of data, the ownership of data rights and interests needed to be clarified. Since 2021, the leading large technology companies have launched projects related to privacy computing and data property rights, promoting novel concepts such as "data property rights" and "data property rights trading". Local governments such as Shanghai and Shenzhen had already laid out the framework of regulations in this area. For example, on November 25, Shanghai promulgated the Shanghai Data Regulations, protecting "the legal or contractual property rights and interests of natural or legal persons formed in the use, processing and other data processing activities, as well as the legitimate property rights and interests obtained in relation to data innovative activities in the development of the digital economy".

In addition, these Regulations provide that data trading activities can be carried out in accordance with the law, and that those market players engaged in data trading activities can independently set prices subject to the law. On the same day, the Shanghai Data Exchange was established, it received and completed applications for listing of about 100 data products, covering finance, transportation and communication sectors, among others, and some of the first order data trading was also concluded. Among these were an "enterprise electricity smart-graphing" product and a civil chart service product, between the Industrial and Commercial Bank of China and Shanghai Electric Power Co., which was the first transaction in the banking sector and reflected that the traditional financial institutions have already successfully entered the market. However, the central regulators have not yet clarified rules and arrangements for data property rights and their protection.



### Scope of credit information defined and limits on license credit investigation businesses set

Regulators have long been concerned by the existence of thousands of "quasi-credit investigation institutions" that engaged in semilegal or illegal businesses such as online lending and misused data. On September 27, 2021, the PBOC promulgated the Administrative Measures on Credit Investigation Business, a major new regulation covering credit investigation businesses (which mean credit checks), following the 2013 Administrative Regulations on Credit Investigation Industry and the Administrative Measures for Credit Investigation Institutions. The Administrative Measures on Credit Investigation Business defined "credit information" and has expanded its scope from the traditional lending information to include information (such as the basic information, the lending information, and other relevant information, as well as the analytical and evaluation information based on such information) collected in accordance with law for providing financial services to identify and determine the credit status of enterprises and individuals. All of these collectively helped to set the boundaries of credit investigation businesses.

Since December 2020, regulators have repeatedly signaled their intention to tighten supervision of credit investigation businesses. Specifically, the PBOC has constantly stated that there is a requirement when carrying out credit investigations that "alternative credit data" outside of the scope of lending data must be used, and any personal credit investigation business must be licensed. On December 22, 2020, the PBOC issued the first penalty in the personal credit investigation

sector against a credit investigation company for "engaging in personal credit investigation business activities without approval" and "delaying in filing for the appointment of senior management personnel by the enterprise credit investigation institution". The fine and the confiscation of illegal gains amounted to just under RMB20 million, which, so far, is the largest fine imposed for breaches of regulations relating to credit investigation. In July 2021, the PBOC issued a directive saying that online platforms could only conduct investigation institutions. It also demanded that financial institutions could only collaborate with licensed personal credit investigation institutions to deliver personal credit investigation services.

At the same time, there are opportunities in the credit investigation business. In February 2021, China's second licensed national personal credit investigation institution, Pudao Credit Co., opened. Following that, a number of market participants, such as Shanghai Lujiazui International Financial Asset Exchange Co. and 360 DigiTech, have also disclosed their plans to obtain credit investigation licenses.

06

### Stronger anti-monopoly supervision measures on the online platform economy and payment sector adopted

At the beginning of 2021, both the PBOC and the CBIRC made it clear that they would strengthen the supervision of the financial activities of online platform companies and steadfastly implement the policies of the CPC Central Committee and the State Council to strengthen antimonopoly regulation and prevent the disorderly expansion of capital.

Regulators have introduced a series of anti-monopoly regulations, and have improved the existing rules:

(i) On January 20, 2021, the PBOC issued the *Regulations on Non-bank Payment Institutions (Consultation draft)*, which defined the scope of "a relevant market", the criteria for determining market dominance and alter measures , so as to strengthen anti-monopoly regulatory measures in relation to the payment sector;

(ii) On February 7, the Anti-monopoly Commission of the State Council issued the Anti-monopoly Guidelines on Platform Economy, emphasizing

their commitment to prevent and stop monopolies in online platforms so as to promote the healthy and orderly development of the platform economy;

(iii) On September 27, the Administrative Measures on Credit Investigation Business was promulgated, setting out a number of principles by which credit investigation businesses should operate, including "fairness" in providing credit investigation products and services to the public, not imposing unreasonable commercial conditions to restrict the use of information by different users, and not leveraging any dominance to sell discriminatory or exclusionary products and services; and

(iv) On October 23, the Draft Amendment to the *PRC Anti-Monopoly Law* was published for *public* consultation. The draft amendment also added anti-monopoly rules for digital platforms based on the experience of the above-mentioned Guidelines, providing that "operators shall not abuse advantage in data, algorithms, technology, and capital and platform rules to exclude or restrict competition".

In terms of enforcement, in 2021, the regulatory penalties for market players' unfair competition practices became stricter. For example, the SAMR imposed penalties on several online platforms for the monopolistic conduct of forcing merchants into "exclusive dealing agreements". On Aril 29, 2021, the PBOC, the CBIRC, the CSRC, the SAFE, and other financial regulators held regulatory talks involving 13 online platforms operating financial business, requiring, among others, the platforms to break the information monopoly and carry out personal credit investigation business strictly through licensed credit investigation institutions. And in July 2021, the PBOC Credit Information System Bureau issued a notice to online platforms, requiring them to fully "stop direct connection" in providing personal information for financial institutions. On November 18, the State Anti-Monopoly Bureau was officially inaugurated at the SAMR headquarters, which means that China's anti-monopoly enforcement agencies will be more independent and authoritative.

# 07

Regulators confirmed the legal status of e-CNY, continued to promote research and development pilot programs, and gradually expanded application scenarios

With the issuance of the *Law on People's Bank of China (Consultation draft)* in the second half of 2020, the legal status of e-CNY (the digital currency) has become increasingly clear: e-CNY will exist as a specific form of the Chinese yuan (CNY) and co-exist with physical CNY in the long term. Currently, the e-CNY system had undergone design, development, function research and development, and joint testing. There have been pilot tests and checks undertaken and application scenarios expanded on the security and controllability. The big state-owned commercial banks have participated in the development and promotion of e-CNY, and have launched various types of application, such as e-CNY exchange business and offline payments.

As of October 22, 2021, 140 million personal e-CNY wallets and 10 million e-CNY corporate wallets had been "opened" in China, with 150 million cumulative transactions registering a total of nearly RMB62 billion transacted. In addition, 1.5 million merchants have supported e-CNY wallets, used for food and beverages, transportation, shopping, and government services. e-CNY is therefore well on its way to becoming mainstream legal tender.

However it is worth noting that as e-CNY has not yet been fully implemented, it lacks a "record tracing" mechanism and the general public is still not well informed about how the digital currency works. There have been cases of fraud and money laundering using e-CNY in Fujian, Guizhou, Jiangsu, Henan, and Hubei. The legislation and enforcement with respect to the prevention of risks relating to e-CNY is expected to be gradually established and developed in 2022.



Regulators strengthened the application of regulatory technology practice, continuing to expand the "regulatory sandbox" process, and closing the loop for "entering and exiting the sandbox"

In the *Fintech Development Plan (2019-2021)*, the PBOC aimed to establish a sound process for innovation, have flexible regulation, and set out boundaries of compliant fintech innovation. The "14th Five-Year Plan" stated the goal was to "strengthen the use of regulatory technology and financial innovation risk assessment, and to explore the establishment of innovative products correction and suspension mechanism". The Financial Stability Committee also stressed at its meeting on April 8 that it should make full use of modern information technology to improve the regulation technology and enhance the efficiency and coverage of regulation.

To implement the *Fintech Development Plan (2019-2021)*, the PBOC first launched a regulatory pilot program for fintech innovation

in Beijing. As of the third quarter of 2021, more than a dozen provinces and cities had launched pilot programs, and more than 100 applications had been publicized. Currently, the main applicant institutions for such programs are financial institutions (with banks as the most important participants) or technology companies. Payment institutions and credit investigation institutions are also involved in the pilot programs.

In terms of application areas, sectors such as credit, operation management, and payments are the main focal points of the fintech innovation regulation. On September 28, 2021, the Beijing Financial Technology Innovation Supervision Working Group and the Shenzhen Financial Technology Innovation Supervision Working Group announced that the testing of several innovative applications of fintech innovation regulatory tools had been completed within their respective jurisdictions. What this means is that the first batch of innovative applications have "exited the sandbox" thereby closing for the first time the loop for fintech innovation exploration. This was an important milestone to strengthen fintech regulation and explore how fintech innovation should and be regulated in practice.



### **2022 Regulatory Outlook**



The 14th Five-year Development Plan will coordinate the stable development of fintech and strengthen prudential regulation

By the end of 2021, the fintech-related regulatory rules neared completion and the implementation of the Fintech Development Plan (2019-2021) issued by the PBOC was all but complete. On January 29, 2021, the FinTech Committee of the PBOC confirmed that it will issue a plan for the new stage of fintech development to accelerate the digital transformation of finance. The supervision over fintech will be oriented towards supporting the real economy, encouraging digital transformation, and improving the level of regulatory technology and transparency, so as to witness an era of prudence with full-risk covered. The supervision over the risks of existing licensed financial institutions will be strengthened. This will include the supervision over financial institutions in respect of the risk incurred by business cooperation arrangements between financial institutions and third parties (such as internet deposits, internet loans, and credit investigations). Meanwhile, the financial business of fintech companies will be regulated in accordance with the principle of "incorporating all financial activities into the regulation framework".

We expect that in 2022 the Interim Measures for the Protection of Personal Financial Information (Data), the Anti-Monopoly Law (Draft Amendment), the Regulations on Non-bank Payment Institutions (Consultation draft) and other relevant laws and regulations will be promulgated.

The regulators will continue to look at the best ways of regulating the sector, as between "function-based" regulation and "conductbased" regulation. They will aim to discourage illegal acts by imposing administrative penalties. They will also improve their supervision and law enforcement capabilities and strengthen the protection of financial consumers' rights and interests.

# 02

Data compliance and protection of consumer rights and interests continue to be the regulatory focus, and further promotion of cross-border data transfer is to be expected

In 2021, there was increasingly stringent supervision over data compliance. Tighter controls have an impact on the management of data by financial institutions, especially those with cross-border business or operation. We expect that in 2022 the *Measures for the Security Assessment of Data Outbound Transfer*, the *Network Data Security Management Regulations* and supporting rules, and special regulations and related supporting rules for personal information protection in the financial sector, such as the *Financial Data Security - Data Security Assessment Specification (Consultation draft)*, and the *Interim Measures for the Protection of Personal Financial Information (Data)* included in the 2021 regulation-making plan of the PBOC, will be promulgated.

We also hope that in 2022, financial regulatory authorities and data security management authorities (such as the CAC) will work together to effectively supervise the IT system and data protection of financial institutions or that in financial activities and provide more nuanced guidance for the routine activities of financial institutions.

While supervision is strengthened, there are also in place a number of pilot projects to see the best ways of promoting the cross-border flow of data. In April 2021, the Hainan Free Trade Port's exclusive international internet data channel was officially opened. In July, Shanghai formally included the construction of an international data port in Shanghai Pilot Free Trade Zone Lingang Special Area in its 14th Five-Year Plan, in order to explore the cross-border circulation of global data under the conditions of ensured data security and data control. We believe that in 2022, there will be developments in the establishments of the supporting infrastructure and industrial systems for the security of national cross-border data transfer.

In 2021, there was better supervision (both from legislation and enforcement perspectives) of consumer protection in the fintech area. For example, the *Network Data Security Management Regulations* (*Consultation draft*) and the *Guidelines for the Implementation of Main Responsibilities by Internet Platforms* (*Consultation draft*) require internet platform operators to disclose platform rules, privacy policies, and their algorithmic strategy disclosure systems, to protect consumers' right of consent for personal information processing activities, and to prevent potential data security risks in algorithm services such as "precision marketing". The Internet Information Service Algorithm Recommendation Management Regulations specifies user rights protection obligations for the algorithm recommendation service provider. The MIIT regularly circulated notices of criticism on the illegal collection of personal information by financial apps in 2021.

In order to comply with the regulatory requirements, the internet platforms are expected to establish and improve their business rules, privacy policies and algorithm disclosure systems to be more readerfriendly and intelligible for better protection of consumer rights and interests in 2022.



### The framework of internet business of financial institutions continues to be adjusted, and innovation of online credit card business proceeds

In 2021, the regulatory authorities issued a series of new rules to strengthen the supervision over internet products such as internet deposits, loans and insurance, with the aim of prohibiting commercial banks from conducting time deposits business and "time-demand optional deposit business" on non-self-operated platforms. They also looked to regulate the cooperation between banks and third-party agencies when jointly issuing internet loans, and restricting the qualifications of insurance institutions to conduct online insurance. After these regulations were introduced, several platforms removed their non-compliant internet deposit products, and insurance institutions stopped selling personal insurance through the internet. All of this means there will be big changes in the sale of internet financial products in 2022. Financial institutions will follow the online business regulations to actively develop new business models.

The Notice on Further Promoting the Standardized and Healthy Development of Credit Card Business (Consultation draft) issued by the CBIRC on December 16, 2021 introduced more regulations covering cobranded entities and cooperation between banks and their cooperating agencies regarding the issuance of co-branded credit cards. It also proposed "to explore and develop innovation models such as online credit card business via pilot projects". Though several banks have already launched online credit card businesses, some of them failed to meet compliance requirements for the management and control of such businesses with the rights and interests of their customers being infringed. In this Notice, the CBIRC puts forward regulatory requirements for credit card business operation and management, card issuance, credit management, credit card installment, interest and fees collection, and information disclosure. It also encourages qualified commercial banks to adopt innovative models such as online credit card business and new technologies to optimize functions of credit card service and relevant products, to participate in online credit card innovation activities and to provide consumers with more convenient, safe and diversified financial services.

We expect that in 2022, the regulatory authorities are likely to formulate special rules for controlling the online credit card business by taking into account of the experience in supervising over financial institutions' internet business and the characteristics of online business.

04

### Steady and sustainable development of the e-CNY with supporting laws and regulations to be promulgated

The Law on People's Bank of China (Consultation draft) issued by the PBOC on October 23, 2020 stipulated that the RMB will have both physical and digital forms, and the legal status of e-CNY will be confirmed. In 2021, several public talks by the regulatory authorities, especially the issuance of the *White Paper of the Progress of Research & Development of E-CNY* in China by the PBOC on July 16, have indicated that the regulatory framework for e-CNY is already under consideration.

We expect that in 2022 the revised *Law on People's Bank of China* will be promulgated and implemented, and separate regulations on and supervisory measures for e-CNY will also be introduced in due course, accompanying with the continuous optimization of the underlying technology of e-CNY.

In 2021, the e-CNY became a reality. Based on the disclosed local 14th Five-Year Plans and fintech construction plans, we expect that in 2022 the regulator will continue to accelerate the promotion of the pilots for e-CNY, to expand domestic retail application scenarios, and to improve the technical design of e-CNY. It is also expected that the underlying technology will be developed to ensure privacy and anti-counterfeiting functions.

In April 2021, Everbright Wealth Management Co. issued an e-CNY wealth management product and it is expected there will be more e-CNY-based financial products launched in due course. However, correspondingly, new types of illegal and criminal activities such as fraudulent use of e-CNY have sprung up, which need to be tackled. We expect that the regulators will gradually establish and improve the e-CNY record tracing mechanism and pay close attention to the illegal and criminal activities through e-CNY, such as money laundering, tax evasion, gambling and fraud. We can also expect the promotion and propaganda of laws and regulations in terms of e-CNY so as to achieve the effectiveness of e-CNY in its security, convenience and inclusiveness.

Supporting rules for financial holding companies will be implemented, and the internet platforms conducting financial businesses may be transformed into financial holding companies

Following the release of the *Decision of the State Council on Implementation of Administration of Admission of Financial Holding Companies* and the *Tentative Measures for Supervision and Administration of Financial Holding Companies* in 2020, supporting rules for financial holding companies have been gradually introduced. In March 2021, the PBOC issued the *Interim Provisions on the Administration of Recordation for the Office-Holding of Directors, Supervisors, and Senior Executives of Financial Holding Companies* as one of the supporting regulations. With these improvements, in 2021, the PBOC has accepted applications for establishing financial holding companies from CITIC Corporation Limited, China Everbright Group and Beijing Financial Holding Group, though further approval information has yet to be disclosed. We expect that in 2022, the supporting regulatory systems for financial holding companies, such as rules on consolidated management, capital management and related transaction management, may be released.

The internet platforms, which are expanding their business into the financial sector, are also required by the regulators to apply to become financial holding companies if they meet the threshold. In April 2021, the regulators talked with 13 internet platforms, proposing requirements including "to strengthen the supervision over key areas such as shareholder qualifications, equity structure, capital, risk isolation, and related transactions". The regulators also required companies meeting the requirements for establishing financial holding companies to submit the application. Furthermore, the *Guiding Opinions on Promoting the New Development Pattern of Financial Services* jointly issued by the CBIRC Shenzhen Branch and other two authorities on November 5 emphasized "strengthening the supervision over the financial activities of internet platforms, prudently supporting the development of fintech companies, and strictly preventing disguised financial activities in the name of technology services". Following the principle of prudential regulation that requires financial businesses to be conducted with licenses, existing internet companies, who are engaged in financial businesses and in the process of adjusting their operations to comply with new regulations, may apply to become financial holding companies in 2022.

### >>>>>

# PRC Financial Regulation: Annual Report (2022) Insurance

### 2021 Key Dates

### **January 15**

The Provisions on the Administration of the Solvency of Insurance Companies was issued, improving the regulatory framework of China Risk-Oriented Solvency System (C-ROSS)

### March 10

The CBIRC amended the Detailed Rules for the Implementation of the Regulation on the Administration of Foreign-Funded Insurance Companies

### May 20

The CBIRC issued the Measures for the Evaluation of Performance of Duties by Directors and Supervisors of Banking or Insurance Institutions (for Trial Implementation)

### June 2

The CBIRC issued the *Corporate Governance Standards for Banking or Insurance Institutions*, reshaping the superstructure of corporate governance of insurance institutions

### July 27

Allianz Insurance Asset Management Co., Ltd was approved to open for business, becoming the first wholly foreign-owned insurance asset management company

### August 16

The Guiding Opinions on Promoting the Development of Shanghai into an International Reinsurance Center was issued, developing Shanghai into an international reinsurance center and launching the digital reinsurance registration and settlement platform

### September 30

The CBIRC issued the Measures for the Supervision of the Conduct of Principal Shareholders of Banking or Insurance Institutions (for Trial Implementation)

### **November 12**

The transfer of 49% equity in Allianz China Life Insurance Co., Ltd has received approval, making it the first wholly foreign-owned life insurance company developed from a joint venture

### **December 3**

The CBIRC issued the Notice of Relevant Measures for Clarifying the Opening up of the Insurance Intermediary Market, loosening investment requirements for insurance intermediary institutions

### **February 1**

The Measures for the Regulation of the Internet Insurance Business took effect, as internet insurance business regulation enters a new era

### April 7

The CBIRC issued the Notice of Profoundly Conducting the Special Work to Address Irregularities in the Personal Insurance Market, addressing typical issues and key risks in the market

### June 1

The Pilot Program of Exclusive Commercial Pension Insurance was launched

### July 21

The Provisions on the Administration of the Reinsurance Business was issued

### July 27

The CBIRC reviewed regulation of insurance in its mid-year forum, including reviewing inspection and supervision

### September 2

National Pension Insurance Company received approval to set up, boosting the "third pillar" of pension insurance

### October 12

The CBIRC issued the Notice of Issues Concerning Further Regulating the Internet Personal Insurance Business of Insurance Institutions, to strengthen the regulation of internet personal insurance business

### **November 24**

The CBIRC issued the Measures for the Supervision and Administration of Insurance Group Companies

### **December 10**

The CBIRC held the (enlarged) meeting of the Party Committee to convey and study the guiding principles of the Central Economic Work Conference, and arrange implementation measures in light of the regulatory work of the banking and insurance industries actually carried out

### **2021 Regulatory Observations**



### Gradual unification of banking and insurance regulatory frameworks

Since the merger of the former China Banking Regulatory Commission and China Insurance Regulatory Commission in 2018, the CBIRC has successively launched a centralized cleanup of regulations and regulatory documents for the banking and insurance sectors and gradually unified the two sectors' regulatory frameworks. In 2021, multiple regulatory documents applicable to both the banking and insurance sectors were issued, covering corporate governance, supervision of the conduct of principal shareholders, undertakings of major shareholder undertaking, license management, recovery and resolution plans, reputation risk administration, related party transactions (as a consultation paper), evaluation of performance of duties by directors and supervisors, recourse and deduction of performance-based compensation, protection of consumer rights and interests and other key aspects.

In the new regulations, many of the banking industry standards have been transplanted to the insurance industry. The *Corporate Governance Standards for Banking or Insurance Institutions* ("Governance Standards") issued in June incorporates many corporate governance requirements of commercial banks and reshapes the rules for nomination of directors and supervisors, as well as the composition of boards of directors and boards of supervisors of insurance institutions. The Governance Standards aims to strengthen the set-up of boards of directors, strengthen the role of boards of supervisors, give greater powers to independent directors, and ensure that executives carry out their duties more rigorously.

The Measures for the Supervision of the Conduct of Principal Shareholders of Banking or Insurance Institutions (for Trial Implementation) ("Principal Shareholders Measures") issued in September also draws on the regulations of commercial banks to control the pledging of equity interests by shareholders of insurance institutions for the first time, and to prevent principal shareholders from borrowing excessively or limiting their voting rights. In addition, the Measures for the Evaluation of Performance of Duties by Directors and Supervisors of Banking or Insurance Institutions (for Trial Implementation) issued in July transplanted the comparable requirements of the banking sector, filling the regulatory gap for insurance institutions in terms of directors' and supervisors' duties. Work on the unification of the regulations continues, with the *Measures for the Regulation of IT Outsourcing Risks of Banking and Insurance Institutions* released at the beginning of 2022 and the new regulation on related party transactions still under public consultation. There still remain a number of areas where the regulations covering the banking and insurance sectors are not yet unified, including compliance management, information disclosure, rules for independent directors, and compensation practices.



### Reshaping corporate governance

Guo Shuqing, Secretary of CPC Committee of the PBOC and Chairman of the CBIRC, in his article *Improving Corporate Governance is the Top Priority of Financial Enterprise Reform*, confirmed that there had been significant improvements in corporate governance in the banking and insurance sectors since the 18th CPC National Congress, highlighting the streamlining of the responsibilities of financial enterprises, the leadership of the CPC, and cleaning up and regulating the shareholding relationship of financial enterprises. The issuance of the Governance Standards and the Principal Shareholders Measures in 2021 consolidated these reforms.

One of the significant features of the new regulations is the strengthening of supervision of shareholders imposing constraints on what shareholders are permitted to do. The Governance Standards and the Principal Shareholders Measures have added "Major Shareholder" and "Principal Shareholder" to the classification of shareholders of insurance institutions. Major shareholders are required to provide long-term commitments to replenish the capital of insurance institutions and to make three types of written undertakings to the regulator: covering "declaration", "compliance", and "due diligence". Principal Shareholders are required to comply with a series of additional restrictions on their conduct as set out in the *Measures for the Administration of Equities of Insurance Companies*.

Another notable feature of the new regulations is reflected in the governance of insurance institutions. The Governance Standards limits the powers of sole shareholders, such that the same shareholder and its related parties is not able to nominate more than one-third of the

board of directors, may not nominate both independent and nonindependent directors, and may not nominate both directors and supervisors. Under the changed governance rules, the controlling party of an insurance institution (whether Chinese-funded or foreign-funded) can no longer achieve absolute control over the board of directors through its nominated directors.

The Governance Standards also stipulates, for the first time, the need for special resolutions of the board of directors of insurance institutions when effecting some changes of business (some resolutions must be adopted by directors representing more than two-thirds of the voting rights) to ensure that decisions on such matters do not become the "monopoly" of the controlling party and to protect the rights of minority shareholders to be informed, to make decisions and to supervise important matters of the company. The new regulation allows for some flexibility by wholly-owned insurance institutions (such as wholly-owned subsidiaries of insurance groups or wholly foreignowned insurance companies), but the changes in regulations are likely to have a direct impact on most foreign-owned insurance companies and Chinese insurance companies which have just a small number of shareholders.

In practice, we have already noted that many institutions are planning or have already amended their articles of association to adjust to the new requirements. Considering the extensive impact of the new regulations, reallocating shareholder rights and improving corporate governance will continue to be high priorities for investors and insurance companies.

To date, regulators have been relatively lenient when it comes to the corporate governance of insurance companies, with governance failings being reflected mostly in downgradings of ratings. There have been improvements with fewer institutions in 2021 being given poor ratings from the year before (although there are no A-rated institutions). With the unification of the regulations and the drawing of red lines, the regulators may become stricter in enforcing the regulations, including restricting shareholders' rights and against principal shareholders' violations). So far as high-risk institutions affected by shareholder violations are concerned, regulators may favor market-based solutions (i.e. acquisition) or even bankruptcy as ways of addressing illegal behavior.

# 03

### New round of insurance sector regulators, mirrored by a string of new investment projects

When China joined the World Trade Organization in 2001, insurance premiums in China were about 3% of those in the world's largest market, the US. Today, China is the second largest insurance market in the world. The sector has been gradually opening up since 2018, and 2021 saw a centralization of regulations confirming that opening-up.

In March, the CBIRC revised the Detailed Rules for the Implementation of the Regulation of Foreign-Funded Insurance Companies (the "Detailed Rules") by removing the "tail" of the existing restriction on the percentage limit of foreign investment in life insurance companies. The newly revised Regulation on the Administration of Foreign-Funded Insurance Companies in 2019 allowed "foreign insurance group companies" and "overseas financial institutions" to acquire shares in foreign-funded insurance companies. On this basis, the Detailed Rules provided the definition of these two types of institutions, but still allowed regulators discretion in practice. Considering that the standards for classifying the institutions under different financial regulatory systems are different, and few cases existed where overseas non-insurance financial institutions acquired shares in Chinese-funded insurance companies, it remains to be explored in practice whether the non-traditional financial licenses can satisfy the licensing criteria, and whether the insurance investment platform within an integrated group can reach the requirement as a group. In addition, the Detailed Rules unified the applicable laws and regulations for Chinese-funded and foreign-funded insurance group companies (which are also mentioned in the Measures for the Supervision and Administration of Insurance Group Companies issued in November). The Detailed Rules also clarify that investment by overseas non-insurance financial institutions or by Chinese investors in Chinese-funded and foreign-funded insurance companies applies the same set of rules in relation to the shareholder qualification, which further reflects the important feature of "internal and external consistency" in this round of opening-up.

There was more good news for those companies in the insurance sector looking to develop their business. First, regulators started the process of revising the rules applying to insurance asset management companies (after a lapse of 17 years) in order to remove the 25% shareholding limit for foreign investors. Second, the regulator issued a notice to lower the threshold when applying for an insurance brokerage license by overseas insurance brokerage companies, removing the requirements for the number of operating years and total assets of the shareholders, as well as getting rid of the requirement for the establishment of representative offices. Changes to regulations also allowed the establishment of insurance intermediary institutions by foreign insurance group companies and domestic foreign-invested insurance group companies, providing new guidance on foreign funds entering the businesses of insurance agency, brokerage and assessment. On removal of the above-mentioned restrictions on foreign shareholding in insurance asset management companies, the "11 Measures" issued by the State Council in 2019 and a series of measures for opening up the insurance sector proposed by the CBIRC from 2018 to 2019 will all be implemented at the level of laws and regulations.

Even as the regulatory changes came thick and fast, the new investment projects developed in a more orderly fashion.

(i) After obtaining the first foreign-controlled life insurance license, AIA actively prepared to create regional branches;

(ii) An investment of RMB12 billion by AIA into China Post Life Insurance was approved in January 2022;

(iii) Allianz set up an insurance asset management company through its domestic insurance group company in 2021, marking a change from the previous practice whereby foreign investors could only obtain insurance asset management licenses through subsidiaries of joint ventures;

(iv) In November, Allianz gained approval to become the sole owner of Sino-German Allianz Life, making Sino-German Allianz Life the second approved foreign-controlled life insurance company after AIA China, and the first wholly foreign-owned company developed from a joint venture;

(v) Following Allianz, in December HSBC gained approval from regulators increase its shareholding in HSBC Life China to 100%;

(vi) In terms of group companies and property insurance, the Chubb Group announced that it planned once more to increase its investment in Huatai Insurance Group, just short of becoming the absolute controller;

(vii) Starr Group also said it intended to increase its investment in the property insurance company.

(viii) Ergo Group, which has long been operating in the domestic life insurance market, said it planned to become the second largest shareholder of Taishan Property & Casualty Insurance.

Added to these market developments, there were examples of investment by domestic companies filling gaps left by foreign investors withdrawing from the China market. Contrasted with the rush of foreign investment into China's insurance sector after China joined the WTO, this time around foreign investors are more cautious in their approach to the China market, which is more competitive and more highly regulated. However, we still believe that the scale of foreign investment in the domestic insurance market will grow steadily in the next few years.



### C-ROSS Phase II Project completed, and insurance companies may have additional methods to raise capital

In March, the newly revised *Provisions on the Administration of the Solvency of Insurance Companies* came into effect, and the China Risk-Oriented Solvency System (C-ROSS) was officially written into departmental rules. Under C-ROSS, insurance companies have to adjust their balance sheets, to make sure their assets are in step with their liabilities, rather than simply benchmarking assets against their business volume as was the case before. There are three requirements that an insurance company needs to meet in order to become an "eligible" company for solvency purposes: meeting the core solvency adequacy ratio; meeting the comprehensive solvency adequacy ratio; and satisfying the comprehensive risk rating. Those companies that are classified as "ineligible" for solvency purposes may have restrictions on the business they can do, on setting up branches, and on how much they can pay directors, among other restrictions.

After going through the initial stage from scratch, regulators launched the C-ROSS Phase II Project in 2017. The *Solvency Regulatory Rules II for Insurance Companies* (the "Rules II") issued in December 2021 marked the successful completion of the second phase of this project, and the new rules will apply to the whole insurance sector starting with the quarterly solvency report in the first quarter of 2022. With experience from practice, the regulator has designed the Rules II to be more suitable for local conditions but based on international standards.

In respect of how capital is measured, the Rules II incorporate "exogenous" factors, allocating any future surplus of the policy to different levels of capital according to the remaining policy term and adjusting the recognition method of, and accrual requirement for, the value of assets such as investment real estate and long-term equity investment in order to filter out "fake" capital. Meanwhile, the Rules II have imposed new methods for calculating the minimum capital that insurance companies need to maintain and preventing them from inflating the value of assets held.

In terms of risk identification, the Rules II include a new risk measurement, calculating the minimum capital based on the underlying assets. Regarding the use of funds and product development, the Rules II encourage insurance companies to focus on their main business and to be more rigorous when developing new insurance products.

The Rules II will play a positive role in promoting the insurance sector, by preventing risk, encouraging insurance companies to concentrate on their core business and aiding international integration. However, the rules will also present some challenges for insurance companies. Because it may be difficult for some companies to meet the new solvency ratios, the regulators have given a grace period, with the Rules II being fully implemented by 2025 at the latest. In addition, the regulator also plans to allow insurance companies to inject more capital to boost their balance sheets. Currently, insurance companies can only raise capital through capital replenishment bonds and subordinated bonds. In November, the PBOC and the CBIRC sought public consultation on the rules that needed to be in place for insurance companies to issue unfixed term capital bonds. Tools such as perpetual bonds (that have been used in the banking sector) are also expected to be introduced as a capital-raising option for insurance companies in future.

# Insurers encouraged to develop new products, especially in healthcare, but under strict conditions

Auto insurance has undergone significant improvements in recent years, leading to lower premiums, greater coverage and higher quality. However, there was a decline in the auto insurance sector in 2021, as there was in the property insurance market. Some insurance companies are diversifying, for example looking at new energy auto insurance for new energy vehicles (NEVs). In December, the Insurance Association of China issued the *New Energy Vehicle Commercial Insurance Exclusive Clauses (for Trial Implementation)*, and, following that, a new energy vehicle insurance trading platform was launched on the Shanghai Insurance Exchange with the first batch of listed products from 12 property insurance companies.

Added to this, some insurance companies turned to the non-auto insurance market, particularly to health insurance and accident insurance, both of which grew rapidly in 2021. The CBIRC issued the *Notice on Issues Concerning Regulating the Short-Term Health Insurance Business* and the *Notice on Effectively Providing Customs Services regarding the Short-term Health Insurance Business* in January and May, to regulate the renewal, pricing and loss ratio of short-term health insurance products, as well as addressing problems such as combined sales, and prohibiting automatic renewable clauses in the contract.

The Measures for Regulating the Accident Insurance Business issued in October unifies the regulation for property and life insurance companies operating accident insurance and establishes a product pricing adjustment mechanism linked to the insurance claim. In addition, the CBIRC revised the Measures for the Administration of the Insurance Clauses and Premium Rates of Property Insurance Companies in August, clarifying the principle of jurisdictional supervision for property insurance products and improving the application of regulations to product development and the internal rules needed by insurance companies.

Another area that received attention from regulators in 2021 was that of life insurance, as well as from the insurance sector itself. Customized commercial medical insurance products were launched in many cities, providing opportunities for patients with pre-existing conditions to gain access to insurance, as well as the elderly who would not otherwise meet the criteria to be eligible to buy commercial medical insurance. In June, the CBIRC issued the *Notice on Regulating Urban Customized Commercial Medical Insurance Business of Insurance Companies* to regulate the market for these new types of products. In addition, new regulations were issued for the pilot program covering long-term care insurance as well as critical illness insurance.

The CBIRC also issued a notice in October to encourage insurance companies to bring onto the market more life insurance products, to actively develop products with lower thresholds for purchasing, simpler underwriting, affordable prices, and with clear protections for such groups as the elderly, farmers, low-income groups, and the disabled.

One other significant development was the end of the mutual aid

platforms, which had been popular. The regulatory authorities do not recognize the insurance nature of online mutual aid products. However, looking back at the development path of mutual insurance in China, it is worth reviewing and considering how this business model can really play a role in meeting the needs of the masses for insurance protection.

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### The "third pillar" of pension insurance continues to develop, although problems still need to be tackled

In March 2021, Premier of the State Council Li Keqiang proposed in the report on the work of the government to "work toward unified national management of basic pension insurance funds, and develop the private pensions, as the third pillar, in a well-regulated way". As China's population has got older, the demand for elderly care services has increased, in turn requiring refinements to pension schemes. A previous attempt to launch tax-deferred pension insurance failed to achieve the desired result of increasing take-up of pension policies. In 2021, the CBIRC started a pilot program of commercial pension insurance in Zhejiang province (including the city of Ningbo) and Chongqing. Different from the commercial pension insurance products currently provided on the market, the pilot products are more flexible in the payment methods and the fee structures. The products are particularly suitable for those working in new industries or those working flexibly, and these products have filled a gap in the market.

PBOC released the *China Financial Stability Report* in September and proposed establishing a system which bases on accounts. PBOC further proposed to expand the range of products in which the "third pillar" could invest, which would include financial products such as bank wealth management products, deposit savings products, commercial pension insurance products, and publicly offered fund products. In mid-2021, many leading financial institutions, including bank wealth management subsidiaries, securities companies, insurance companies, and state-owned capital holding platforms jointly invested in the establishment of the National Pension Insurance Co., Ltd. This new company should play an important part in the next round of reforms.

Regulators have also insisted that commercial pension companies address some key failings. The CBIRC issued the *Notice on Regulating and Promoting the Development of Pension Insurance Institutions* in December, requiring pension insurance institutions to focus on their main business. The Notice stipulates that pension insurance institutions shall not engage in asset management and shall reduce and clean up existing pension security management products.

Internet insurance regulation refined

On February 1, the *Measures for the Regulation of the Internet Insurance Business* took effect. On the basis of clarifying the nature of Internet insurance business, the Measures not only intended to prevent risks but also supported innovation. A rule system adapting to the development of Internet insurance has been established for various market players. From "zero supervision" to "third-party network platform" and to "selfoperated network platform", China's internet insurance regulatory system has entered into a new era. The regulations mainly include clarifying the nature of internet insurance business, strictly stipulating the requirements on the Internet insurance business operation, classifying the regulations according to the business entities, regulating Internet insurance marketing and publicity activities, and optimizing internet insurance after-sales service, among others.

The CBIRC started to focus on the Internet personal insurance business in 2021. The Notice of Issues Concerning Further Regulating the Internet Personal Insurance Business of Insurance Institutions was issued in October, and the supporting regulation on product price backtracking was issued in November. The Notice clarified the conditions on the access and operation of the Internet personal insurance business. At the same time, it specifies the limit to the scope of products, refines the exclusive regulatory rules for products, strengthens consumer protection, and requires the relevant institutions to complete "rectification" (i.e. make sure their operations comply with the regulations) before the end of 2021. Price tracing should start to be done from 2022. However, various institutions failed to complete the rectification within the specified time limit. In December, many products were removed from the market, and many life insurance companies announced that they would suspend their Internet insurance business from January 2022.

Meanwhile, regulators have also sought to clamp down on mis-selling, forced tie-in sales, inflated fees and failure to protect user information, including fining some of those found to have been in breach.



### Insurance funds benefit from loosening of restrictions on their investments, coupled with more regulation based on a rating system

Insurance funds continued to come under the spotlight of regulators through 2021, with the goal of improving the quality and efficiency of insurance funds serving the real economy.

First, the scope of financial products that the insurance funds can invest in was enlarged. In the middle of the year, the CBIRC issued the pilot rules for the investment of insurance funds in publicly offered real estate infrastructure funds (REITs), and allowed insurance funds to participate in the securities lending business.

Second, regulators scrutinized more closely fund application. In September, the "registration system" was changed to the "*enrollment* system" (i.e., initial approval and subsequent enrollment) for the asset-backed plans and insurance private funds promoted by insurance asset management companies. While implementing the policy of "delegation and decentralization", insurance companies had to demonstrate their responsibilities.

Third, investment restrictions were loosened in many ways. The regulator first cancelled the requirements for the "whitelist" (i.e approved) of financial enterprise bonds that can be invested in by insurance funds and the requirements for external credit ratings. At the end of the year, the regulator provided a series of preferential policies relating to insurance funds. Major adjustments include allowing insurance funds to invest in equity investment funds that are controlled by non-insurance financial institutions, and cancelling the limit on the scale of insurance funds investing in a single venture capital fund. There are no longer limits on the level of funds contributed by insurance private fund sponsors and their affiliated insurance institutions.

Regulatory standards will no longer be "one-size-fits-all" for equity investment, investment in financial products or establishment of asset management products. In early 2021, insurance asset management companies implemented the regulatory rating management, in which institutions are divided into four categories: A, B, C, and D. The indicators such as the regulatory rating results of asset management companies, the solvency level of insurance companies, comprehensive risk rating, and asset and liability management capability determine the corresponding regulatory requirements for the use of funds. The higher the evaluation result is, the more investment space and flexibility the institution enjoys. This idea of differentiated supervision is expected to be used in the follow-up marketoriented reforms of insurance funds.

### 2022 Regulatory Outlook



# Equal attention will be paid to the development and standardization of insurance products

China's insurance sector is witnessing adjustment to make sure that insurance products are more closely aligned with the many needs of the public. Regulation in 2022 may encourage insurance companies to invest more in digital transformation and technology empowerment, and develop more life insurance products. The regulatory authorities are formulating supporting policies and measures for individual pension accounts. The effective supply of commercial endowment insurance products is an important step in the reform. After several years of building systems, establishing institutions, issuing licenses and giving policy instructions, endowment insurance products may usher in a period of development and innovation. With the proposed goals of "carbon emissions peaking" and "carbon neutrality" (the 30:60 policy), green insurance may also take off.

In early 2021, CBIRC supplemented the negative list for life insurance and released a new version. Unreasonable and non-standard circumstances listed in the "negative list" and previous issue circulars will be the focus of future inspection and supervision.



### The issuing of intermediary licenses is expected to be resumed

The CBIRC issued the *Measures for the Implementation of Administrative License and Recordation for Insurance Intermediaries*, ending the longstanding position where intermediary licenses were separately regulated, and refining and unifying the administrative approval and filing requirements of insurance agents, insurance brokers, insurance assessors and insurance intermediary groups. The new rules have raised the entry requirements for companies applying for intermediary licenses, and have set up very strict qualification requirements on the senior managers of insurance agencies and brokers. We can expect the market to be enthusiastic about taking up intermediary licenses.

Local branch offices of the CBIRC deregistered thousands of insurance intermediaries' licenses to conduct insurance agency business in

2021, and the clean-up work is expected to continue. As the practices associated with intermediary services mature and the regulators issue favorable signals, we expect there to be more uptake in the coming year of those entering this market given the accumulated market demand.



### **Tougher penalties likely**

The CBIRC is increasingly taking a hard line on enforcing regulations, which includes imposing administrative penalties. The *Administrative Penalties Measures of the CBIRC* took effect on August 1, 2020, which not only marks the official implementation of the Measures, but also speeds up the implementation of unified standards for administrative penalties procedures in the banking and insurance sectors. According to the principle of "imposing punishment on the higher instead of the lower", more stringent penalties standards previously applied to banking institutions will also be applied to the insurance sector. It can be expected that in the coming year, the supervision and penalties meted out in the insurance sector will be stepped up, and the number and amount of penalties will be in line with those imposed in the banking sector.

According to incomplete data, the number of punishments issued by the CBIRC and its local branch offices in 2021 increased significantly compared with that in 2020, and top-level penalties such as suspension or restriction of business, removal of, or prohibition from, the industry to persons liable for violations were issued frequently, and the proportion of penalties imposed on liable persons also increased compared with that imposed last year. Local branches of the CBIRC have also actively issued regulatory documents to point out the focus and requirements of compliance management in their respective jurisdictions. It is believed that the intensity of inspection and supervision in the future practice will be correspondingly increased.



### Consumer protection rules are expected to be released

In June, the Consumer Protection Bureau of the CBIRC issued a notification relating one insurance company's infringement of the legitimate rights and interests of consumers. In July, the CBIRC issued the *Measures for the Regulatory Evaluation of Banking or Insurance Institutions' Protection of Consumer Rights and Interests*, summing up and establishing the best-practice consumer protection and supervision.

In the next phase, we expect the regulatory authorities may introduce corresponding administrative measures for banking and insurance companies in relation to consumer protection. For the moment, the regulatory authorities have released the *Guidelines for the Sale of Insurance* for public consultation. The administrative measures related to the sale of insurance may be released soon, in which the protection of consumers' rights and interests will be an important part.

With the initial establishment of the Internet insurance regulations in 2021, consumer protection in the Internet insurance business is sure to be a high priority in 2022. By reference to the efforts made to crack down on unqualified internet life insurance products, the issues regarding mis-selling and inadequate after-sales service raised by consumers are likely to receive more attention and be solved centrally. In addition, the protection of personal data of insurance consumers may also be put on the agenda under the general environment of building and improving the legal system of personal information protection.



## An important year coming for the reinsurance sector, with focus on Shanghai

The year 2021 is an important year for the development of China's reinsurance sector. The CBIRC has revised the *Provisions on the Administration of the Reinsurance Business* after an interval of six years, adjusted many provisions that are no longer applicable with the development of the market, and emphasized the strategic management of reinsurance. In the C-ROSS Phase II rules, the counterparty default risk factors of overseas reinsurance have been lowered.

In August, the CBIRC and the Shanghai Municipal People's Government jointly issued the *Guiding Opinions on Promoting the Development of Shanghai into an International Reinsurance Center*, specifying that Shanghai will develop into an international reinsurance center, with pilot cross-border reinsurance transactions carried out in the Shanghai Pudong Free Trade Zone. The digital reinsurance registration and settlement platform, together with groundwork laid to build the International Reinsurance Center, put in place the platform to create a sound reinsurance sector. During the year, several foreign-funded reinsurance branches were given approval to increase their registered capital, which signalled the strong demand for business expansion of the institutions.

It is expected that there will be more policies encouraging cross-border reinsurance transactions and investment by cross-border reinsurance institutions.

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