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Working Paper

China's Financial Holding Companies: Mixed Operation and Separate Supervision

JIN Sheng

Adjunct Researcher, Centre for Banking & Finance Law, Faculty of Law, National University of Singapore

jin.sheng@law.nyu.edu

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http://law.nus.edu.sg/cbfl/

Centre for Banking & Finance Law
Faculty of Law
National University of Singapore
Eu Tong Sen Building
469G Bukit Timah Road
Singapore 259776
Tel: (65) 66013878
Fax: (65) 6779 0979
Email: cbfl@nus.edu.sg

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ABSTRACT:

This working paper will discuss the trend of mixed operation and related path selection of China's financial regulatory system. The rapid development of mixed operation of financial holding companies or financial conglomerates, such as CITIC, Ping An, Everbright, big four state-owned banks and big SOEs' combination of industry and finance, has challenged this supervision segregation and exposed loopholes within the current legal framework since the late 2000s. Compared with the separate operation, mixed operation of financial industry has advantages in synergistic effects, optimizing business operations of commercial banks, combination of industrial and financial capitals, and providing one stop shopping services. However, absence of effective regulatory system on mixed operation may result in problems of capital adequacy ratio (CAR), affiliated transactions, insider trading, tax avoidance and financial risks. In addition, FHCs may substantially strengthen the market concentration of dominant state-owned capitals, benefit certain interest groups, and weaken nongovernmental capitals.

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[Key Words] Financial Holding Company (FHC); Mixed Operation; Supervisory Arbitrage; Financial Regulatory System; Financial Conglomerate

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Over the past two decades, China has made substantial progress in developing banking, insurance, securities and trust sectors of its financial market, which have been characterized by heavily bank-oriented financing, exchange rate controls and governments' deep involvement in equity and bond's issuance and investments. For the purpose of ending the chaos in financial services on an underdeveloped market at the early stage of the PRC's openness, the government established separate operation system in December 1993.[1] Under the *Law of PRC on the People's Bank of China* (1995), PBC, as the central bank, exercised supervision and control over the banking industry.[2] Meanwhile, the State Council shall establish a mechanism of administration coordination to regulate the financial industry.[3] Thereafter, the PRC Commercial Bank Act (1995), Insurance Law (1995) and Securities Law (1999) addressed the separate operation and separation supervision of insurance, banking, securities and trust sectors. For example, under the PRC Securities Law (1999), securities business shall be engaged in and administered as a business separate from the banking business, trust business and insurance business. Securities companies should be established separately from banks, insurance companies and trust companies.[4] Interestingly, although the separate operation and separate supervisory system was established in mid-1990s, there were no rules or policies prohibiting a large shareholder from holding stocks of banks, insurance, securities and trust companies. Theoretically, this leaves room for financial conglomerates[5] or pure financial holding companies.

The 11th Five Year Plan formulated in 2005 created a turning point of mixed operation. The amended *PRC Securities Law* in 2005 added the exception for the general rule of "separation operation" – "unless otherwise provided for by the state".[6] That is, "separate operation" is the general rule; while mixed operation is administrated by special rules. The amended Insurance Law (2009)[7] have similar stipulation on exceptions of separate operation. After the financial crisis in 2008, China's proactive fiscal policy and radical economic stimulus released the financial repression, as well as spurred cross-sector financial business and shadow banking. Accompanying the marketization of interest rate, financial disintermediation and mixed operation of financial services, the current separate regulatory system has to face challenges of financial innovation and financial deepening.

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[1] See the *Decision of the State Council on Reform of the Financial System* issued by the State Council on December 25, 1993.
[2] See Article 2 of the *Law of PRC on the People's Bank of China*, issued by the National People's Congress on March 18, 1995, amended on December 23, 2003.
[3] Ibid, Article 9
[4] Article 6 of the *PRC Securities Law* issued by the Standing Committee of the National People's Congress on December 29, 1999.
[5] "Financial conglomerate" refers to "conglomerate whose primary business is financial and whose regulated entities engage to a significant extent in at least two of the activities of banking, insurance and securities". See the Basle Committee on Banking Supervision, the International Organization of Securities Commissions and the International Association of Insurance Supervisors, "Supervision of Financial Conglomerates" (February 1999), p.69, available at: http://www.bis.org/publ/bcbs47.pdf.
[6] Article 6 of the *Securities Law* amended by the Standing Committee of the National People's Congress in 2005.
[7] See Article 8 of the PRC Insurance Law amended in 2009.

I Evolution of Regulatory System of Financial Industry

A. Establishing the Principle of Separate Regulation of Financial Markets

From 1980s to early 1990s, there was no strict separate operation in China's financial industry. The People's Bank of China (**PBC**) performed integrated supervision and administration functions for the banking and non-banking financial institutions at that time. Its main functions ranged from formulating financial rules and regulations, issuing and regulating Chinese Currency (Renminbi), scheduling and dispatching credit funds, examining the incorporation of financial institutions and administrating financial markets, to managing foreign exchanges and gold reserves.[8] Accompanying the reform of economic system and development of financial markets in mid-1990s, the PBC was identified as the specific central bank, which formulated and implemented monetary policies and exercised surveillance over the banking industry subject to the leadership of the State Council.[9]

In order to curb an overheated economy, China started to implement the separate operation policy. In late 1993, the State Council made the decision of reforming the financial system. Three policy banks, including National Development Bank, Agricultural Development Bank of China and China Import-Export Credit Bank (CIECB), were set up. After separating from the policy business, the big four state-run specialized banks, including China Industrial and Commercial Bank (ICBC), Agricultural Bank of China (ABC), Bank of China (BOC) and China Construction Bank (CCB) transformed into state owned commercial banks. The State Council employed the policy of classified management for the industries of insurance, securities, financial trust and banking.[10] Under the separate operation framework of the State Council, three supervisory authorities for securities sector, insurance sector and banking sector were founded.

CSRC

In October 1992, the State Council set up the securities regulatory authority. Two organs, the State Council Securities Committee (SCSC) as the national principal organization to exercise unified management and control of stock market, and the China Securities Supervisory and Management Committee (CSSMC) as the enforcement agency, were founded.[11] The SCSC and CSSMC exercised supervision and control of securities issuance and trading of a unified national stock market.[12] In 1998, the SCSC and CSSMC merged as an organ: the China Securities Regulatory Commission (CSRC). The *Circular of the General Office of the State Council on Issuing the Regulation on the Main*

[8] The State Council, "Reply of the State Council on the People's Bank of China Concerning the Relationship between the PBC's Function as a Central Bank and Specialized Banks" (14 July 1982).
[9] Article 2 of the Law of People's Bank of China issued by the National People's Congress on March 18, 1995 and amended in December 2003.
[10] Article 6 of the *Decision of the State Council on Reform of the Financial System* issued by the State Council on December 25, 1993.
[11] See Article 1 of *Further Strengthening Macro-management of Securities Market* issued by the State Council on December 17, 1992.
[12] Article 5 of *Interim Provisions on the Management of the Issuing and Trading of Stocks* issued by the State Council on April 22, 1993.

Functions, Interior Institutions and Staffing of the China Securities Regulatory Commission (1998) stipulates the main functions, interior institutions and staffing of CSRC. Under this regulation, the CSRC is a public institute of the ministry level directly under the State Council, who shall, according to the power authorized by the State, exercise the administration function, and supervise and manage the national securities and futures market.[13] The CSRC is given legislative power as an organ endowed with administrative functions directly under the State Council.[14] Like other competent ministries and commissions, CSRC is authorized to issue orders, instructions and regulations within their jurisdiction in accordance with the law and decisions of the State Council, under the *Organic Law of the State Council*[15] and the PRC Constitution.[16]

CIRC

After the enactment of the *PRC Insurance Law* in 1999, the PBC established the insurance department to supervise the insurance industry. The PBC also established corresponding sections in its branch offices at the province level.[17] The China Insurance Regulatory Commission (CIRC) was founded on November 18, 1998. The PBC responsible for the supervision and administration of the insurance sector was transferred to the CIRC and the latter became the watchdog of insurance sector. Like other supervisory authorities, it sets up dispatched offices around the country, which perform the duties of supervision and administration as authorized by the insurance regulatory body under the State Council.[18]

CBRC

The China Banking Regulatory Commission (CBRC) was founded in April 2003. In accordance with the *Regulation on the Main Functions, Interior Institutions and Staffing of the China Banking Regulatory Commission*, the CBRC supervises and manage the banks, financial assets management companies and trust investment companies and other financial institutions of savings according to its authorization from the State Council. The supervision and management functions assumed by the PBC for the banking financial institutions was integrated into CBRC's responsibility.[19]

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[13] *Circular of the General Office of the State Council on Issuing the Regulation on the Main Functions, Interior Institutions and Staffing of the China Securities Regulatory Commission* issued by the State Council on September 28, 1998.

[14] Article 71 of the *PRC Legislation Law* issued by the National People's Congress on March 15, 2000.

[15] Article 10 of *Organic Law of the State Council* issued by the National People's Congress Standing Committee on December 10, 1982.

[16] Article 90 of the *PRC Constitutional Law* issued by the National People's Congress on December 4, 1982 and amended in 1993, 1999 and 2004.

[17] Wikipedia, "China Insurance Regulatory Commission" https://zh.wikipedia.org/wiki/%E4%B8%AD%E5%9B%BD%E4%BF%9D%E9%99%A9%E7%9B%91%E7%9D%A3%E7%AE%A1%E7%90%86%E5%A7%94%E5%91%98%E4%BC%9A

[18] Article 9 of the *PRC Insurance Law* issued by the NPC Standing Committee on June 30, 1995. It was revised in 2002, 2009, 2012 and 2014.

[19] Article 1 Item 1 of *Regulation on the Main Functions, Interior Institutions and Staffing of the CBRC* issued by the General Office of the State Council on April 25, 2003.

B. The Coordinate Mechanism among the PBC, CBRC, CSRC and CIRC

In 1995, the State Council was supposed to establish a financial supervision and administration coordination mechanism.[20] Under the *Law of PRC on the People's Bank of China* (1995), the PBC shall, together with the banking regulatory organ of the State Council, and other financial supervision and administration organs of the State Council, establish the supervision and administration information sharing mechanism.[21] On June 22, 1998, the central committee of the Chinese Communist Party (CCP) approved the establishment of the Financial Working Committee of the CCP Central Committee, which was responsible for leading, coordinating and managing the operations of financial organs.[22] In November 2002, the Central Financial Security Leading Group was founded under the leadership and instructions of the Central Financial and Economic Leading Group.[23] The Central Financial Security Leading Group administrated the central bank, financial regulatory bodies, big four state owned banks, four state owned asset management companies, three state policy banks, CITIC and Everbright.[24] In April 2003, the relevant functions of the Financial Working Committee of the CCP Central Committee were authorized to the newly established CBRC by the State Council.[25]

In 2002, the State Council approve the pilot program of financial holding company in the China International Trust and Investment Corporation (CITIC), Ping An Insurance Company of China, Ltd. (Ping An) and China Everbright Limited (Everbright). The emergence of financial holding companies initiated the transition to mixed operation of financial sectors and brought forth challenges to the separate supervisory system.

<u>The 2004 Memorandum on Joint Meeting Mechanism</u>

In June 2004, the CBRC, CSRC and CIRC had a joint conference and reached the *Memorandum of Understanding on Division of Responsibilities and Cooperation in Financial Supervision and Regulation*. This Memo confirmed the separate supervision of difference sectors of financial industry again. It also required that the supervision of a financial holding company should follow the principle of separate supervision of financial industry. That is, "The supervision of the parent company of the financial holding company rests with relevant commission in accordance with the nature of the company's principal business. The different subsidiaries of the financial holding company

[20] Article 9 of the *Law of PRC on the People's Bank of China* issued by the National People's Congress on March 18, 1995 and amended in 2003.
[21] Ibid, Article 35.
[22] Wikipedia, "Financial Working Committee of the CCP Central Committee" was rescinded in March 2003.
[23] Wikipedia, "Central Financial and Economic Leading Group" has been the top and core organ in the PRC economic decision-making since 1980. Available at:
https://zh.wikipedia.org/wiki/%E4%B8%AD%E5%A4%AE%E8%B2%A1%E7%B6%93%E9%A0%98%E5%B0%8E%E5%B0%8F%E7%BB%84
[24] "Central Financial Security Leading Group",
http://blog.sina.com.cn/s/blog_4c44e3f40102e6wk.html.
[25] Article 1 Item (2) of the *Regulation on the Main Functions, Interior Institutions and Staffing of the China Banking Regulatory Commission* issued by the General Office of the State Council on April 25, 2003.

are under separate supervision in accordance with the nature of each subsidiary's business activities."[26]

In addition, it established a work mechanism for the three regulatory authorities – "the Joint Meeting Mechanism". In accordance with the Memo, the CBRC, CSRC and CIRC should hold regulation meetings on a quarterly basis to discuss major issues on financial regulatory policies and market responses. The Chairmen and authorized vice-Chairmen of three regulators attend the joint meeting. Members take turns to convene the meeting every six months. Each regulator sets up a liaison office and any member can ask the convener to summon an interim meeting under the emergency situation. This periodic meeting only discusses issues of cross-commission supervision, and should not affect responsibilities and routine work mechanisms of each regulator. The PBC, the Ministry of Finance or other government agencies may be invited to the joint meeting. The minutes of joint meetings shall be implemented following the approval of the State Council.[27] The three regulator agreed to establish a regular information exchange mechanism.[28] Thus the CBRC, the CSRC and the CIRC established an elementary coordination system under the 2004 Memo.

The 2008 Coordination Mechanism

The 2004 did not provide a coordinator to solve regulatory gaps or regulatory arbitrages. Besides, there were overlapped duties between the PBC and the CBRC after the CBRC became independent from the PBC in 2003. The emerging financial market needed an effective regulatory system. In July 2008, the General Office of the State Council issued the *Provisions on the Main Functions, Internal Structure and Staffing of the People's Bank of China*. This regulation provided a framework on the responsibilities of the PBC, CBRC, CSRC and CIRC. Under this coordinative framework, the PBC is responsible for "establishing, jointly with the financial regulatory departments, regulatory rules for financial holding companies, and standards and norms for the cross-sector financial business, and responsible for monitoring financial holding companies and cross-sector financial instruments."[29] The CBRC is responsible for "supervising and administering the inter-bank lending market, inter-bank bond market, inter-bank instrument market, inter-bank foreign exchange market and the gold market and the transactions of related derivatives of the aforesaid markets."[30] The PBC, together with the CBRC, CSRC and CIRC, should establish a coordination mechanism under the guidance of the State Council in order to coordinate the monetary policy and regulatory policy of financial sectors by means of inter-commission working conference. The four regulatory authorities should establish a system for sharing financial information and submit major issues to the State Council for a final decision.[31] This regulation authorized the function

[26] Article 8 of the *Memorandum of Understanding on Division of Responsibilities and Cooperation in Financial Supervision and Regulation* signed by the CBRC, CSRC and CIRC on June 28, 2004.
[27] Ibid, Articles 15, 16 and 17.
[28] Ibid, Article 12.
[29] Article 2 Item 7 of the *Provisions on the Main Functions, Internal Structure and Staffing of the People's Bank of China* issued by the General Office of the State Council on July 10, 2008.
[30] Ibid, Article 2 Item 6.
[31] Ibid, Article 5 Item 4.

of the PBC in the financial coordination mechanism and addressed the central bank's responsibility in safeguarding financial stability.

The Inter-ministerial Joint Meeting of Financing Guarantee Business Supervision

In 2009, the State Council decided to establish the Inter-ministerial Joint Meeting of Financing Guarantee Business Supervision. The joint meeting is led by the CBRC. A few government authorities, including the National Development and Reform Commission (NCRC), the Ministry of Industry and Information Technology, the Ministry of Finance, the PBC, the State Administration for Industry and Commerce and the Legislative Affairs Office of the State Council, attend to formulate policy measures for promoting the development of financing guarantee business, solve major problems and guide local governments to conduct supervision and risk disposal on financing guarantee business.[32] The joint meeting set up an office in the CBRC, which handles the daily work of the Joint Meeting.

The Inter-ministerial Joint Meeting System for Financial Regulation and Coordination

In August 2013, upon the approval of the State Council, the inter-ministerial joint meeting system for financial regulation and coordination among the PBC, the CBRC, the CSRC, the CIRC and the State Administration of Foreign Exchange (SAFE) was launched.[33] The Governor of the PBC acts as the convener of the joint meeting. The PBC sets up a liaison office for the joint meeting, which handles routine coordination.[34] The joint meeting is responsible for coordination: (i) between currency policies and financial regulation policies; (ii) between financial regulation policies and laws and regulations; (iii) between the maintenance of financial stability and the prevention and mitigation of regional and systematic financial risks; (iv) between cross-sector financial products and trans-market financial innovation; and (v) between the financial information sharing and the comprehensive statistical system of financial industry.[35] The inter-ministerial meeting may invite the Ministry of Finance and the National Development and Reform Commission (NDRC) to join the meeting if necessary. By May 2015, the five supervisory agencies jointly held 8 meetings and reviewed 35 topics under this Financial Regulation and Coordination Mechanism.[36] The inter-ministerial joint meeting system does not change the existing separate regulatory system or regulatory responsibility of each regulator. The 2013 coordination mechanism may lay foundation for the transition of umbrella regulatory system.

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[32] Article 1 of the *Notice of the General Office of the State Council on Further Specifying the Supervisory Functions for Financing Guarantee Business* issued on February 3, 2009.
[33] *Reply of the State Council on Approving the Establishment of the Inter-Ministerial Joint Meeting for Financial Regulation and Coordination* (Letter No. 91 [2013] of the State Council) issued by the State Council on August 15, 2013.
[34] Ibid, Article 2.
[35] Ibid, Article 1.
[36] Dandan Li, "The PBC Reveals the Joint Meeting Mechanism of Financial Supervision, Which Has Reviewed 35 Topics" (30 May 2013) *Shanghai Securities News*, available at: http://news.cnstock.com/news/sns_yw/201505/3446695.htm.

II Mixed Operation in Financial Sector

A. Strict Market Access - Licenses of Financial Institutions (FI)

Under the separate supervisory framework of financial services markets, there are more ten financial licenses, such as banking, insurance, securities, futures, trust, fund management, financial leasing, pawnbroker, money broker, microfinance and financing guarantee, issued by regulatory authorities in charge. The following table lists their approval government agencies and registered capital requirements.

	Approval Authority	**Applicable Laws & Regulations**	**Minimum Registered Capital Requirement**
Commercial Bank	CBRC	*PRC Law of Commercial Banks*; *Administrative Licensing Matters Concerning Chinese-funded Commercial Banks*	National Commercial Bank: CNY 1 billion; City commercial bank: CNY 100 million; Rural commercial bank: RMB 50 million
Insurance	CIRC	*PRC Insurance Law*	CNY 200 million
Securities Company	CSRC	*PRC Securities Law* (2014 Amendment) Article 127	Securities brokerage, securities investment consulting and financial advisory: CNY50 million; Underwriting, proprietary securities operation and securities asset management: CNY 100 million; Comprehensive operation: CNY 500 million
Futures Company	CSRC	*Regulation on the Administration of Futures Trading*; *Administrative Measures for Futures Companies*	CNY 30 million
Open-ended Fund Company	CSRC	*Law of Securities Investment Fund*; *Measures for the Administration of Securities Investment Fund Management Companies*; *Interim Provisions on the Management of Publicly Offered Securities Investment Funds by Asset Management Institutions*	CNY 100 million

Trust Company	CBRC	*Administrative Measures for Trust Companies*; *Administrative Licensing Matters Concerning Non-banking Financial Institutions*	CNY 300 million
Financial Lease	Ministry of Commerce	*Administrative Measures of Supervision on Financial Leasing Enterprises*; *Relevant Issues concerning Undertaking Financing Lease Business*; *Measures on the Administration of the Foreign-Funded Lease Industry*	Registered capital: CNY 170 million; Foreign company: USD 10 million
Pawnbroker	Ministry of Commerce	*Measures for the Administration of Pawning*	CNY 3 million; for real estate, CNY 3 million; for property, CNY 10 million
Payment Business Permit	PBC	*Administrative Measures for the Payment Services of Non-financial Institutions*	Internet payment; Prepaid card; bank card
Non-banking Financial Institutions	CBRC	*Administrative Licensing Matters Concerning Non-banking Financial Institutions*	CNY 20 million or equivalent currency (Money broker, Auto financing, Enterprise group financial company, Representative office of overseas non-banking FI)
Financing Guarantee Companies	Financial Office of Province Government	*Interim Measures for the Administration of Financing Guarantee Companies*	
Enterprise Group Financial Company	CBRC	*Operating Rules on Applying for the Establishment of Enterprise Group Financial Companies*	Registered capital: CNY 800 million; Total assets: CNY5billion; Net assets ratio: 30%
Financial AMC	CBRC	*Regulation on Financial Asset Management Companies*;	CNY 10 billion allocated by the MOF
Foreign-funded bank	CBRC	*Administration of Foreign-funded Banks*; *Administrative Licensing Items concerning Foreign-Funded Banks*	CNY 1 billion; or CNY 200 million for branches

Licenses of FI are rare resources on the financial market. Prior to 2014, there were sixteen years that CSRC did not issue any license of securities companies. They can be costly too. In the case of Everbright Group's taking over Gansu Trust Company Limited in July 2013, Everbright Group acquired 51% shares of Gansu Trust at the transferring price of CNY 1.832 billion.[37] From 1998 to 2013, the CSRC suspended issuing license of securities companies. There were 115 securities companies by 2014.[38] Regarding insurance license, there were 135 insurance companies operating on the market, including 71 life insurance companies and 64 property insurance companies by April 2014. In 2009, ICBC spent CNY 1.2 billion to purchase 60% shares of the Axa-Minmetals Life Insurance Co., Ltd. and obtained its insurance license.[39]

B. Mixed Operation of Banking and Insurance

In mid-1990s, the PRC established to develop separate operation in its financial industry. Under the *Law of the PRC on Commercial Banks* (1995), commercial banks were not allowed to undertake trust investment, securities trading or invest in fixed assets, which were not for self-use within the People's Republic of China.[40] The PBC was the sole banking watchdog of commercial banks prior to 2003.[41] The China Banking Regulatory Commission (CBRC) established in 2003 shares regulatory role of banking sector with the PBC.[42]

The *Commercial Bank Act* and the *Law of People's Bank of China* established the framework of separate operation and separate supervisory framework in mid-1990s. At the very beginning, the overlapped business between banking and insurance was settlement and custody business. Under the *PRC Insurance Law* (1995), an insurance company shall draw 20% of the registered capital as the guaranty funds and deposit them in the banks designated by the financial supervision and administration departments. The deposits shall not be used unless for liquidation purposes.[43]

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[37] "How Much Does It Cost to Obtain Full Financial Licenses After All?" (June 2014) 21th Century Business Herald, available at: http://tz.sinoins.com/2015-03/02/content_146995.htm.

[38] Xinjiang Li, "Assessment of Financial Licenses: the Acquisition Account Book of Institutional Boss" (16 June 2014) *21 Century Net*, available at: http://3g.forbeschina.com/review/201406/0033694.shtml.

[39] Ibid

[40] Article 43 of the *PRC Law of Commercial Banks* issued by the National People's Congress on May 10, 1995 and amended on December 27, 2003.

[41] Ibid, Article 10

[42] See Article 62 of the *Law of the PRC on Commercial Banks* amended in 2003, "The banking regulatory organ of the State Council shall have the right to check on and supervise over the deposits, loans, settlement and bad debts, and other conditions of the commercial banks at any time in pursuance of the provisions of Chapter III, Chapter IV, and Chapter V of this Law… The People's Bank of China has the right to make examination on and supervision over the commercial banks in accordance with the provisions of Article 32 and Article 33 of the *Law of the People's Republic of China on the People's Bank of China*".

[43] See Article 78 of the PRC Insurance Law issued by the Standing Committee of National People's Congress on June 30, 1995. The capital guarantee funds are also required by the *Notice of China Insurance Regulatory Commission on Issues Concerning the Withdrawal and Deposit of Capital Guarantee Funds by Insurance Group (Holding) Companies and Mutual Insurance Companies* issued by the CIRC on August 12, 2008.

The insurance market was open gradually after China's entry into WTO in December 2001. In October 2004, the CIRC issued the *Interim Measures for the Administration of Stock Investments of Insurance Institutional Investors*. Insurance companies are allowed to invest in ordinary stocks, convertible company bonds and other investment varieties approved by the CIRC.[44] For example, the CIRC approved the "Beijing Shanghai high speed rail equity investment plan" in 2008 established by sponsorship of Ping Asset Management Co., Ltd., China Pacific Insurance (group) Co., Ltd., Taikang Asset Management Co., Ltd. and Taiping Asset Management Co., Ltd. This investment plan raised CNY 16 billion.[45]

Thereafter, insurance companies made progress in investing in banking. Ping An Insurance took over Shenzhen Commercial Bank in 2006. Ping An acquired Shenzhen Development Bank upon the approval of CIRC in 2010 and became the first insurance company that held nationwide banking license. In 2008, China Life Insurance controlled China Credit Trust Co., Ltd. In 2009, China Life Insurance became a shareholder of Hangzhou City Commercial Bank Co., Ltd.[46]

Meanwhile, the bank insurance model (BIM), also known as Bancassurance,[47] was introduced to China. Banks' insurance agency operation greatly developed after 2005. Insurance industry made the first step towards mixed operation of banking and insurance in 2006. In September 2006, the CIRC promulgated the *Investment in Shares of Commercial Banks by Insurance Institutions*. This allows insurance institutions to invest in shares of non-listed commercial banks, joint-stock commercial banks and urban commercial banks, upon the approval of the State Council.[48] Insurance companies may invest in bank shares via major investment or general investment, subject to basic requirements and approval procedure.[49] In December 2006, China Life Insurance invested CNY 5.67 billion in acquiring 20% shares of Guangdong Development Bank. In

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[44] Article 11 of the Interim Measures for the Administration of Stock Investments of Insurance Institutional Investors issued by CIRC on October 24, 2004.

[45] "The Beijing Shanghai High Speed Rail Equity Investment Plan Has Been Approved and Taikang Life Insurance Contributed CNY 3 Billion" (26 June 2008), available at: http://www.taikang.com/tkzc/tab2485/info249896.htm?COLLCC=3824813485&.

[46] Xiaomin Lai, "The Current Macro-economic Polity Is Too Strict – Transition Is of Great Significance" (4 November 2011), available at: http://gold.jrj.com.cn/2011/11/04151611493646-1.shtml.

[47] "Bancassurance business of commercial banks" means "that commercial banks as authorized by insurance companies sell insurance products and provide relevant services on behalf of insurance companies within the extent of authorization and collect agency fees from insurance companies in accordance with law." See Article 2 of the *Circular on Printing and Distributing the Guidelines for Regulating the Insurance Agency Business of Commercial Banks*, issued by CIRC on March 7, 2011.

[48] Article 1 of the *Investment in Shares of Commercial Banks by Insurance Institutions* issued by the CIRC on September 21, 2006.

[49] Articles 4 and 6 of the *Investment in Shares of Commercial Banks by Insurance Institutions* issued by the CIRC on September 21, 2006.

January 2007, Ping An Insurance Group invested CNY 4.9 billion in taking over 89.2% shares of Shenzhen Business Bank.[50]

In June 2005, the Bank of Communications started to establish a bancassurance company after it got listed on Hong Kong Stock Exchange. In Januray 2009, the BoComm Life Insurance Company Limited was incorporated in Shanghai. In September 2009, the CBRC and CIRC approved that Bank of Communications acquired 51% shares of China CMG Life Insurance Company Ltd. Bank of Communications becomes the first commercial bank that invests in insurance sector in the PRC.[51]

In January 2008, the *Memorandum of Understanding Concerning Enhancement of Cooperation between Banks and Insurers and Cross-Sector Regulatory Cooperation*, upon the approval of the State Council, was signed by the CBRC and CIRC. The Memo stipulated procedures of risk management, market withdrawal and information exchange. This opened the door of commercial banks investing in insurance companies. Later, four big state-owned banks controlled insurance companies respectively and became financial holding groups. In 2009, Bank of Communications invested in BoCommLife Insurance Company Limited and held 62.5% of its shares. In 2010, Bank of Beijing invested in ING-BOB Life Insurance Co., Ltd. and held 50% of its shares; Bank of China invested in Bank of China Insurance Co., Ltd. and held 100% of its shares. In 2011, China Construction Bank invested in CCB Life Insurance Co., Ltd. and held 51% of its shares. In 2012, Industrial and Commercial Bank of China invested in ICBC-AXA Life Insurance Co., Ltd. and held 60% of its shares; Agriculture Bank of China invested in ABC Life Insurance Co., Ltd. and held 51% of its shares.[52]

In summary, the cooperation between banks and insurance companies are mostly on the basis of distribution agreements/distribution arrangements. The bancassurance business between banks and insurance is conducted by agency agreement. That is, an insurance company signs an agency agreement when entrusting a commercial bank to conduct insurance business. If the agency agreement is between a first-level branch of the insurance company and a first-level branch of the commercial bank, they must obtain written authorization from their hear offices in advance and file the agreement with their head offices.[53] The distribution agreement business shows that China's bankassurance is not an in-depth integration of banking and insurance. Thus, they have established a loose contractual relationship rather than in-depth cooperation.

[50] Hui Zhang, "The Business Cooperation between Banks and Insurance Complements Each Other" (19 January 2015) *International Finance News*, available at: http://paper.people.com.cn/gjjrb/html/2015-01/19/content_1521802.htm.
[51] "Bank of Communications Becomes the First Commercial Bank that Purchases Insurance Euqity" (13 September 2009), available at: http://finance.people.com.cn/BIG5/10020155.html.
[52] Hui Zhang, "The Business Cooperation between Banks and Insurance Complements Each Other" (19 January 2015) *International Finance News*, available at: http://paper.people.com.cn/gjjrb/html/2015-01/19/content_1521802.htm.
[53] Article 13 of the *Circular on Printing and Distributing the Guidelines for Regulating the Insurance Agency Business of Commercial Banks*, issued by CIRC on March 7, 2011.

In addition, banks deal with custody business for insurers' investment projects. In October 2014, the CIRC and CBRC issued the *Regulating the Insurance Asset Custody Business*. It requires insurance group (holding) companies and insurance companies shall select qualified financial institutions and place all investment assets under the custody and supervision of the third party.[54]

C. Mixed Operation in Insurance Sector

In 1980, the People's Insurance Company of China (PICC) recovered its operation after the openness of the PRC. In 1995, an insurance company was prohibited from undertaking property insurance and life insurance concurrently. [55] Under the *PRC Insurance Law* (1995**)**, insurance companies shall be set up according to this law to engage in commercial insurance business. No other unit or individual is allowed to engage in such business.[56] In 2002, this restriction was loosen and a property insurance company was allowed to undertake short-term health insurance and accidental injury insurance businesses upon verification of the CIRC.[57] By the end of June 2015, there were over 160 insurance companies. The total asset value of industry sector was CNY 11.43 trillion (including bank deposit of CNY 2.68 trillion and investments of CNY 7.69 trillion) and net assets reached CNY 1.53 trillion.[58]

From May 1996 to June 1999, when insurance assets were deposited in banks, the PBC announced seven reductions of interest rate. The insurance sector had to face increase of operating costs and cutting rates. Thus, the State Council approved that insurance companies purchased securities investment funds in October 1999. [59] Insurance institutional investors (insurance companies, insurance asset management companies, insurance group companies and insurance holding companies), upon the approval of the CIRC, may engage in or entrust a qualified institution to engage in the trading of stocks, convertible company bonds, and other stock market products. [60] This bridged limited mixed operation between insurance and securities sector. In addition, an insurance institutional investor must set up an independent custody mechanism via a third party bank.[61] So this business concerns operations of insurance, securities and banks.

[54] See Article 1 of the *Notice of the China Insurance Regulatory Commission and the China Banking Regulatory Commission on Regulating the Insurance Asset Custody Business* issued by CIRC on October 24, 2014.
[55] Article 91 of the *PRC Insurance Law* issued by the Standing Committee of the National People's Congress on June 30, 1995
[56] Article 5 of the *PRC **Insurance Law*** issued by the Standing Committee of the National People's Congress on June 30, 1995.
[57] Article 92 of the Amended PRC Insurance Law issued on October 28, 2002.
[58] Refer to statistical data of China Insurance Association, available at: http://www.iachina.cn/content_2beeedfc-1e91-11e5-83ae-84955f1b6dd0.html.
[59] Nannan Zhao, "Exploring the Mixed operation Tendency between Securities and Other Financial Sectors", available at: http://www.126doc.com/p-46132379.html.
[60] *Interim Measures for the Administration of Stock Investments of Insurance Institutional Investors* issued by the CIRC on October 24, 2004.
[61] Ibid, Article 3

The State Council's decision on reforming the financial system encouraged to develop a number of nation-wide, regional and specialized insurance companies in property insurance companies, life insurance companies, asset management companies and health insurance companies.[62] By June 2011, the CIRC approved eight nationwide insurance companies, including PICC Property and Casualty Company Limited, China Life Insurance Company Limited, China Property & Casualty Reinsurance Company Limited, China Taiping Insurance Holdings Company Limited, Ping An Insurance (Group) Company of China, Ltd., China Pacific Insurance (Group) Co., Ltd. and Sunshine Insurance Group Corporation Limited.[63]

In February 2005, the CIRC issued further rules on the proportion of stock investment by insurance funds: "Article 2 (2) The cost balance of the investment that is invested in a listed company which circulation equity capital is less than 100 million shares by the insurance institutional investor shall not exceed 20% of the assets of the company that can be invested in the stock (including investment in unit-linked insurance product and the universal life insurance product, the same as follows); (3) The cost balance of the investment that is invested in the circulation equity of a same listed company shall not exceed 5% of the assets of the company that can be invested in the stock."[64]

In September 2006, insurance funds were allowed to invest in bank shares, subject to the proportion limit stipulated by the CIRC. "When investing in Bank Shares, Insurance Institutions must observe the following rules: the total balance of general investment and major investment in shares shall not exceed 3% of the institution's total assets by the end of the previous year; balance of general investment in a single bank shall not exceed 1% of the institution's total assets by the end of the previous year. Balance of other kinds of major investment shall be reported to the CRIC for approval; balance of major investment made by the company's capital shall not exceed 40% of the institution's paid-in capital minus accumulated losses by the end of the previous year."[65]

In 2009, the CBRC conducted the pilot program for commercial banks' equity investment in insurance companies. It requires each commercial bank can only invest in one insurance company.[66] Commercial banks approached to obtain control rights of insurance companies through acquisitions. By the end of May 2015, there were 75 life insurance companies and 69 property insurance companies in China; and the total assets of insurance industry was CNY 10.12 trillion. However, the average insurance density was only CNY 1,300, and the insurance depth/penetration was only 3%. There is still much

[62] Article 6 Item (1) of the *Decision of the State Council on Reform of the Financial System* issued by the State Council on December 25, 1993.
[63] "Anbang Insurance Has Obtained Approval and Reply from the CIRC; The Insurance Sector Has Eight Insurance Group Companies" (), available at: http://www.anbang-life.com/anbang/anbangzixun/meitibaodao/2676.jsp.
[64] Article 2 of the *Issues Related to Stock Investment by Insurance Funds* issued by the CIRC on February 17, 2005.
[65] Article 3 of the *Investment in Shares of Commercial Banks by Insurance Institutions* issued by CIRC on September 21, 2006.
[66] Article 3 of the *Administrative Measures for the Commercial Banks' Pilot Equity Investment in Insurance Companies* issued by the CBRC on November 5, 2009.

development space for the insurance industry and the cooperation of banking and insurance.

Developing insurance group company is another path for mixed operation. By the end of 2005, there were six insurance group corporations, which occupied over 75% market share of China's insurance sector.[67] Some insurance groups such as Ping An Insurance developed into FHCs. On December 29, 2003, Ping An Trust Co., Ltd., together with Hong kong and Shanghai Banking Corporation Limited, jointly acquired the Fujian Asian Bank, which changed its name as "Ping An Bank" later. The *Notice of the China Insurance Regulatory Commission on Issuing the Interim Administrative Measures for the Entrusted Investment of Insurance Funds*, issued by CIRC on July 16, 2012, allowed insurance companies to entrust funds to an insurance asset management company, a securities company or a securities asset management company for investment due to certain requirements. The business of asset management runs through banking, securities, insurance and trust. In 2013, the assets value of entrusted management in the four financial sectors was nearly CNY 40 trillion.[68]

Many insurance companies have developed into insurance groups since 2000, such as China Life, the People's Insurance Company (Group) of China (PICC), Anbang Insurance Group, China Pacific Insurance (Group) Co., Ltd., Huatai Insurance Group, Ping An Insurance (Group) Company of China Ltd. and Sunshine Insurance Group. They have involved many areas of mixed operation: (i) the insurance agency business of commercial banks; (ii) entrust insurance funds to an insurance asset management company for investment; (iii) stock investment by insurance funds; and (iv) investment in the unit-linked insurance product. They all adopt the mixed operation model.

D. Mixed Operation between Trust and other Sectors

The PRC trust industry started from 1979. In that year the China International Trust and Investment Corporation (CITIC) was founded upon the approval of the PBC. At present, trust sector is the second largest in China's financial industry. By June 2015, there were 68 trust companies and their total assets value was CNY 15.87 trillion.[69] At present, it is the third largest financial sector next to banking. The following table shows the rapid growth of trust sector from 2007 to 2015 after introducing mixed operation.[70]

[67] Hao Zhan, "Reform of Mixed Operation between Insurance and Other Financial Services" (November 2008) *China Legal Review*, available at: http://hk.lexiscnweb.com/china_legal_review/view_article.php?clr_id=24&clr_article_id=36.

[68] Zhi Zheng and Shengnan Zhang ed., *Annual Report of the Development of China's Assets Management Industry (2014)*, Beijing, China: Social Sciences Academic Press (China), 2014, p. 4.

[69] Refer to statistical data of the China Trustee Association, http://www.xtxh.net/xtxh/industrydata/index.htm.

[70] Data of 2013-2015 are from the statistical data of the China Trustee Association, http://www.xtxh.net/xtxh/industrydata/index.htm. Data of 2007 -2012 are from United Research Group of China Trustee Association and Financial Research Institute of Chinese Academy of Social Sciences, Road of Development of China Trust Industry: General Report of Research Project on Development Strategies of China Trust Industry" (May 2013), available at: http://www.xtxh.net/attachments/download/zgxtcyfz.pdf.

Year	2007	2008	2009	2010	2011	2012	2013	2014	June 2015
Total Assets (CNY trillion)	0.95	1.22	2.02	3.04	4.81	7.47	10.91	13.98	15.87

In April 2001, the *PRC Trust Law* was promulgated by the Standing Committee of the National People's Congress. From 2002 to 2005, there were limited cooperation between banks and trust companies. From 2002 to 2006, a trust companies was not allowed to exceed 200 trust contracts in collective management, operation and disposal of trust capital, and the value of each contract shall not be less than CNY 50,000.[71] CNOOC Trust Company was the first to introduce cooperation of banking and trust.[72] In May 2006, Minsheng Banking Corporation issued one-year Extraordinary RMB Financial Plan (T1), which is the earliest product of trust loan lent directly from the bank. The expected maximum annualized rate of return was 2.76% and the minimum trusted amount was CNY 50,000.[73] From 2006 to 2009, banks and trust companies cooperated to issue 6,132 financial management products including trust loans and credit assets.[74] In particular, their cooperation reached a plateau since the Four Trillion Yuan Economic Stimulus Package in 2008 and the loose monetary policy led to expansion of credit loans.
However, trust companies became banks' channels of shadow credit loans.

One of the bank-trust cooperation was purchase of new shares, since banks were not allowed to participate in stock market trading directly. In 2007, banks and trust companies jointly invested CNY 906.83 billion in purchase of new issued shares and made great profits from the bull market at that time.[75] However, there was turning point of mixed operation of banking and trust companies in 2009 and 2010. For the purpose of avoiding risks, the CBRC in 2009 required the bank-trust wealth management products must not be invested in the credit assets or instrumental assets of the bank that issued the financial management product.[76] In order to constrain the off-balance-sheet loans arising from bank-trust cooperation, the CBRC suspended the bank-trust financial management cooperation through "window guidance".

[71] Article 6 of the *Interim Measures for the Administration of Capital Trust of the Trust and Investment Companies* issued by the PBC on June 13, 2002 and expired on January 23, 2007.
[72] KPMG, "The 2012 Investigation Report of China's Trust Industry" (July 2012), available at: ttps://www.kpmg.com/CN/zh/IssuesAndInsights/ArticlesPublications/Documents/China-Trust-Survey-2012-201207-c-v3.pdf.
[73] "Extraordinary RMB Financial Plan T1", http://db.money.sohu.com/bank/view/114/00001114.html.
[74] Xinyu Xia, "The Cooperation between Banking and Insurance Has Not Ended after Seven Years: Game Analysis on Regulatory Makes 'Innovation' Again" (6 March 2013) *China Business News*, available at: http://www.yicai.com/news/2013/03/2531925.html.
[75] Zhenlong Tang, "Banks and Trust Companies Jointly Participate in Purchasing New Shares with over CNY 900 Billion" (3 January 2008) *Shanghai Securities News*, available at: http://finance.people.com.cn/GB/1040/6727464.html.
[76] Article 5 of the *Notice of China Banking Regulatory Commission on the Relevant Matters concerning the Cooperation between Banks and Trust Companies* issued by CBRC on December 14, 2009.

In 2011, the CBRC issued the *Further Regulating Wealth Management Cooperation between Banks and Trust Companies* in order to impose supervisory constraints on the bank-trust cooperation. In May 2011, the CBRC required commercial banks should convert the off-balance-sheet assets in wealth management cooperation between banks and trust companies into on-balance-sheet assets by the end of 2011. It required banks and trust companies must reduce the balance of loans in their weather management cooperation by no more than 25% each quarter.[77] In June 2011, the CBRC issued the *Notice of the Non-Bank Financial Institutions Supervision Department of the China Banking Regulatory Commission on Effective Regulation of Net Capital of Trust Companies, Conversion of Off-Balance-Sheet Assets into On-Balance-Sheet Assets in Cooperation between Banks and Trust Companies, Marketing of Trust Products, and Other Matters*. The "off-balance-sheet business" refers to the business of commercial banks which is not accounted into the balance sheet in accordance with the existing accounting standards, and does not compose real asset liability or liabilities, but may change the profit and loss. It includes such two types of business: guaranty and partial commitment.[78] "Guaranty business" refers to the business where commercial banks accept the entrust of clients and bear responsibility in favor of the third party, such as guaranty (letter of guarantee), stand-by L/C, documentary L/C, honoring L/C, etc.[79] "Commitment business" refers to the business where commercial banks supply contracted L/C operation including loan commitment to clients on a future date in accordance with the previously contracted terms and conditions.[80] Prior to 2011, the scope of off-balance-sheet was broad and it included three types of business: guaranty, commitment and financial derivative transaction business.[81] This change indicates that the supervisory authority made efforts to restrain the scale of shadow banking and enhance risk control.

By the end of 2014, the total asset of trust industry reached CNY 13.98 trillion.[82] Institutions such as commercial banks, policy banks, trust & investment companies, financial companies, urban credit cooperatives and rural credit cooperatives conducted trust business, of which insurance companies mainly engaged in enterprise annuity and asset management business and banks mainly engaged in custody of enterprise annuity and financial management business. It is noting that the trust business is different from trust business in common law jurisdictions. Aside from its mixed operation with banking and insurance, trust companies involved in securities and private equity investments, too.

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[77] See Article 1 of the *Notice of the General Office of the China Banking Regulatory Commission on Regulating the Scope and Methods of Conversion from Off-Balance-Sheet Assets to On-Balance-Sheet Assets in Wealth Management Cooperation between Banks and Trust Companies*

[78] Article 2 of the *Guidance on the Risk Management of Off-balance-sheet Business by Commercial Banks* issued by the CBRC on March 22, 2011.

[79] Ibid, Article 3.

[80] Ibid, Article 4.

[81] "Financial derivative transaction business" refers to derivative transaction business such as forward, swap and option of currencies and interest rates thereof carried out by commercial banks in order to meet the requirements of maintaining values for customers or self-management of derive transactions. See Article 5 of the *Guidance on the Management of Off-balance-sheet Business Risks by Commercial Banks* issued by the PBC on November 9, 2000.

[82] See statistic data of China Trustee Association, www.xtxh.net.

In the securities investment trust business, which includes "assembled funds trust plan" or a "separately managed trust product in securities", a trust company charges management and performance fees and shall report to the CBRC or CBRC's local office.[83] A trust company may invest in funds of a non-listed company under its trust plan or other equity upon the approval of the CBRC.[84] Since the business scope of trust sector covers both finance and industry, it can cooperate with banks, securities companies, insurance companies and fund management companies provided financial products on currency market, capital market and industrial investments.

E. Mixed Operation Concerning Securities Sector

In accordance with the PRC Securities Law (1999), securities business shall be engaged in and administered as a business separate from the banking business, trust business and insurance business. Securities companies shall be established separately from banks, trust companies and insurance companies.[85]

By the end of 2004, there were 120 securities companies in Mainland China and their total assets were CNY 4.09 trillion. Securities companies engage in purchase and sale of stocks, securities underwriting and sponsorship, securities investment consulting, asset management, and margin trading.[86] The market value of Shanghai Stock Exchange and Shenzhen Stock Exchange reached CNY 60 trillion, which was approximately equal to China's GDP at the same time, at its peak in mid-2015. By the end of June 2015, there were 125 securities companies, their total assets valued at CNY 8.27 trillion and their net assets valued at CNY1.30 trillion.[87]

In accordance with the PRC Securities Law (1999), securities business shall be engaged in and administered as a business separate from the banking business, trust business and insurance business. Securities companies shall be established separately from banks, trust companies and insurance companies.[88]

From May 1996 to June 1999, when insurance assets were deposited in banks, the PBC announced seven reductions of interest rate.[89] The insurance sector had to face increase of operating costs and cutting rates. Thus, the State Council approved that insurance companies purchased securities investment funds. Two regulations, the *Interim Measures for the Administration of Insurance Companies' Investing in Enterprise Bonds* in May

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[83] Articles 11 and 12 of the *Operating Guidelines for the Securities Investment Trust Business of Trust Companies* issued by the CBRC on January 23, 2009.
[84] Article 1 of the *Guidelines for Trust Companies to Operate the Trust Private Equity Investment Business* issued by the CBRC on June 25, 2008.
[85] Article 6 of the *PRC Securities Law* issued by the Standing Committee of National People's Congress on December 29, 1999.
[86] Securities Association of China (SAC), http://www.sac.net.cn/hysj/zqgsjysj/.
[87] Ibid
[88] Article 6 of the *PRC Securities Law* issued by the Standing Committee of National People's Congress on December 29, 1999.
[89] "Research on the Tendency of Regulating Mixed Operation between Securities Sector and Other Financial Sectors", available at: http://www.chinabaike.com/work/lunwen/jj/stock/1140267_2.html.

2003 and the *Interim Measures for the Administration of Stock Investments of Insurance Institutional Investors* in October 2004, provided guidance for this operation.

In 2005, the PBC, CBRC and CSRC launched a pilot program, which permitted commercial banks set up fund management companies upon the approval of CSRC. This is regarded as an important step of cross-market and mixed operation of banking and securities sector.[90] Fund management companies established by commercial banks are supervised by the PBC, CBRC and CSRC, which shall establish a supervision information sharing system for information exchange. The three regulators supervise different aspects. The PBC shall put on file and supervise these fund management companies' access to the nationwide inter-bank bond markets.[91] The CBRC supervises relevant risk control indicators and consolidated balance sheet.[92] The CSRC ensures the legitimation operation of fund assets and safeguard fund holders' rights.[93]

In June 2006, insurance companies were allowed to invest in shares of non-listed banks such as domestic commercial banks, joint-stock commercial banks and urban commercial banks, subject to certain proportion of investment and accounting base, filing or approval by the CIRC.[94] Then some insurance companies started to establish insurance holding companies or acquire stocks of other financial institutions. In December 2006, China Life invested CNY 5.67 billion in acquiring 20% shares of Guangdong Development Bank. In January 2007, Ping An Insurance Group invested CNY 4.9 billion in taking over 89.2% shares of Shenzhen Commercial Bank.[95]

In January 2008, upon the approval of the State Council, the CBRC and the CIRC signed the *Understanding Memorandum on Strengthening In-depth Cooperation and Inter-trade Supervisory Cooperation between Banking and Insurance*. In November 2009, CBRC issued the *Notice on Issuing the Pilot Administrative Measures for Commercial Banks to Make Equity Investment in Insurance Companies*. According to the pilot plans, each commercial bank can only invest in one insurance company, subject to the approval of the CBRC.[96] These steps show that the tendency of mixed operation has emerged.

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[90] The Financial Market Department of the PBC, "Press Conference by Officials in Charge on the *Measures on the Pilot Management of the Establishment of Fund Management Companies by Commercial Banks* issued by the PBC, CBRC and CSRC" (20 February 2005), available at: http://www.pbc.gov.cn/publish/jinrongshichangsi/1024/1606/16064/16064_.html.

[91] See Article 23 of the *Measures on the Pilot Management of the Establishment of Fund Management Companies by Commercial Banks* issued by the PBC, CBRC and CSRC on February 20, 2005.

[92] Ibid, Article 21.

[93] Ibid, Article 22.

[94] Articles 3 and 6 of the Investment in Shares of Commercial Banks by Insurance Institutions issued by the CIRC on September 21, 2006. This regulation expired on December 5, 2012.

[95] "Mutual Investment between Banks and Insurance Companies Are in Trial", available at: http://www.sinosure.com.cn/sinosure/xwzx/rdzt/tzyhz/gntzhj/37377.html.

[96] Article 3 of the Circular of the China Banking Regulatory Commission on Promulgating the Administrative Measures for the Commercial Banks' Pilot Equity Investment in Insurance Companies issued by the CBRC on November 5, 2009.

In 2012, many accommodative policies came out, and the era of major asset management descended. In late 2012, securities companies and fund management companies developed their asset management business. On October 18, 2012, the CSRC promulgated the *Measures for the Administration of the Customer Asset Management Business of Securities Companies*, the *Detailed Rules for the Collective Asset Management Business of Securities Companies*, and the *Detailed Rules for the Targeted Asset Management Business of Securities Companies*. On November 1, 2012, the CSRC promulgated the amended *Provisions on Issues about Implementing the Measures for Fund Management Companies to Provide Asset Management Services to Specific Clients on a Pilot Basis*, and the *Interim Provisions on the Administration of Subsidiaries of Securities Investment Fund Management Companies*. Accordingly, securities sector joined the bank-trust channel business.

Another area of mixed operation is the credit asset backed securitization,[97] which was launched in 2005. In 2005, the CBRC issued the *Measures for the Administration over Pilot Securitization of Credit Assets* and the *Measures for Supervising and Administrating the Pilot Securitization of Credit Assets by Financial Institutions*. The China Development Bank issued the first securitization product of credit assets in 2005. Credit asset securitization was suspended for a few years after the global financial crisis due to its potential risks. In June 2012, it was relaunched and a pilot program of CNY 50 billion was proceeded and the underlying assets were encourage to apply to national major infrastructure projects, agriculture-related loans, loans for small and medium-sized enterprises, loans for financing platform companies of local governments, loans for energy conservation and emission reduction, loans for strategic emerging industries, loans for cultural and creative industries, loans for social security housing projects, auto loans, and other diversified credit assets.[98] In March 2013, the CSRC promulgate the *Administrative Provisions on the Asset Securitization Business of Securities Companies* and the CLO business expanded rapidly. By the end of 2014, 53 financial institutions issued 95 CLO products and the total scale reached CNY 387.2 billion, of which the China Development Bank 34.2% market share.[99]

[97] "Credit asset backed securitization" means "a banking financial institution, as the promoter institution, entrusts the credit assets to a trustee institution, and the trustee institution issues beneficial securities to investment institutions in the form of asset-backed securities and pays the yields from asset-backed securities by the cash generated from the aforesaid assets". See Article 4 of the *Measures for Supervising and Administrating the Pilot Securitization of Credit Assets by Financial Institutions* issued by the CBRC on November 7, 2005.

[98] See Article 1 of the *Relevant Matters Concerning Further Expanding the Pilot Securitization of Credit Assets* issued by the PBC, CBRC and Ministry of Finance on May 17, 2012.

[99] Li Yuan, "The Practice of Securitization of Credit Assets" (2015) *China Finance*, Vol. 4, available at: http://finance.sina.com.cn/money/bank/bank_hydt/20150302/102121621860.shtml.

III Categories of Financial Holding Companies

At present there are six categories of financial holding companies (FHC): (a) Financial groups in the pilot FHC program including the China International Trust and Investment Corporation (CITIC), Ping An Insurance Company of China and China Everbright Limited; (b) The "Big Four" Bank Holding Companies; (c) FHCs combining industry and finance established by central state owned enterprises (SOEs) such as PetroChina, COFCO and China Resources; (d) FHCs established by local governments; (e) FHCs established by four state owned financial asset management companies; and (g) Foreign FHCs; (f) Quasi-FHCs operated by civilian battalion capital. Of these FHCs, the first three categories have developed quickly in the last decade. In contrast with split operation, mixed operation of financial sector/industry has advantages in synergistic effects, optimizing business operations of commercial banks, combination of industrial and financial capitals, and providing one stop shopping services.

A. The Pilot Program of FHCs - CITIC, Everbright and Ping An as Pure FHCs

In 2002, the State Council approved that the CITIC Group Corporation, Ping An Insurance and China Everbright Limited undertook the trial of financial holding companies. This pilot program is regarded as a transition from separation operation to mixed operation of China's financial services industry.

<u>CITIC Group Corporation</u>

The China International Trust and Investment Corporation (CITIC) was founded as a state owned investment company in July 1979. China CITIC Bank was incorporated in 1987. CITIC Securities Company Limited and Changsheng Fund Management Co., Ltd. were incorporated in 1995 and 1999 respectively. In 2000, CITIC and Prudential plc set up the joint ventured CITIC-Prudential life insurance company. In October 2001, the parent company of CITIC changed its name as CITIC Group Corporation. CITIC Holdings, as the first financial holding company in the PRC, was incorporated on December 5, 2002.[100] CITIC Group engages in both financial services and non-financial business. Its non-financial businesses include Real estate, civil infrastructure, project contracting, energy and resources, manufacturing and IT business. In 2010, CITIC successfully obtained all seven main financial licenses of banking, securities, insurance, futures, fund management, trust and financial lease. CITIC Group owns subsidiaries of CITIC Holdings, China CITIC Bank Corporation Limited, CITIC Securities Co., Ltd., CITIC Trust Co., Ltd., CITIC Prudential Life Insurance Co., Ltd., CITIC International Financial Holdings Limited, China CITIC Bank International and CITIC Assets Management Corporation Ltd. The parent company manages its subsidiaries but does not engage in substantial financial business. At present, CITIC Group is the largest financial conglomerate in China.[101] The case of CITIC Group Corporation provides an example of

[100] Wikipedia, "CITIC Group Corporation" (31 July 2015), https://zh.wikipedia.org/wiki/%E4%B8%AD%E5%9B%BD%E4%B8%AD%E4%BF%A1%E9%9B%86%E5%9B%A2.
[101] Refer to the website of the website of CITIC, www.citic.com.

transition from "separate operation and separation supervision" to "FHC's synergic operation plus subsidiaries' separate operation".

Ping An

It was founded in 1988 in Shenzhen initially as a casualty insurance company. In June 1994, Ping An became the first financial institution in the PRC that introduced foreign strategic investors - Morgan Stanley and Goldman Sachs, whose jointly held nearly 10.1% of Ping An issued shares.[102] Ever since then, Ping An started to make efforts to diversify its financial services, aside from develop its core business of property insurance, life insurance and casualty insurance. Morgan Stanley, Goldman Sachs and HSBC played an important role in improving Ping An's corporate governance toward international standards and developing investment strategies. In 2002, HSBC became Ping An's shareholder. In June 2004, Ping An was listed on the Hong Kong Stock Exchange. In May 2005, HSBC acquired a combined stake of 9.91% held by Morgan Stanley and Goldman Sachs and increased its stake to 19.9% of Ping An stocks.[103] In 2009, Ping An took over Shenzhen Development Bank by merger. In 2010, Ping An obtained all seven financial licenses and developed into a financial holding company on the basis of an insurance company. At the end of 2014, Ping An was composed of Ping An Life, Ping An Property & Casualty, Ping An Annuity, Ping An Health, Ping An Bank, Ping An Securities, Ping An Trust and Ping An-UOB Fund. Its subsidiaries provide financial services of insurance, banking and investment. As of 2014, life insurance, property & casualty, banking, trust, securities, asset management and others occupied 39.8%, 22.3%, 28.8%, 5.6%, 2.0% and 1.5% of Ping An's net profits.[104] Compared with the other two financial conglomerates, Ping An takes full use of its sales network of insurance and has successfully integrated various financial businesses and developed synergy effects of mixed operation through cross-selling.

Everbright Group

The China Everbright Limited (Everbright) was founded in 1983. Like CITIC, Everbright engages in both financial and industrial business. Everbright developed a loose mixed operation among China Everbright Bank, Everbright Securities, Everbright Holdings, Everbright Futures, Shenyin & Wanguo Securities Co., Ltd., Manulife-Sinochen Life Insurance Co., Ltd., Everbright Holdings Asset Management Co., Ltd., Everbright Pramerica Fund Management Co., Ltd. and Everbright Financial Lease Co., Ltd. Thus, it develops the "Macro Asset Management" strategy for its FHC. In December 2014, China Everbright Group was incorporated as a state owned joint-stock company, after restructuring from a solely state-owned enterprise and upon the approval of the State Council. The Ministry of Finance holds 44.33% and Central Huijin Investment Ltd. holds 55.67% equity of China Everbright Group.[105]

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[102] Refer to the website of Ping An, https://www.pingan.com/about/en/news_70052.jsp.
[103] Refer to the website of Ping An Insurance, www.pingan.com.
[104] Refer to the website of Ping An, http://ir.pingan.com/en/gongsigaiyao/index.shtml.
[105] Refer to the website of China Everbright Group, www.ebchina.com.

	Bank	***Insurance***	***Fund***	***Securities /Futures***	***Trust***	***Financial Lease***
An Bang[106]	Y	Y	Y	Y	Y	Y
Fosun[107]	N	Y	Y	Y	N	Y
Wanxiang Group[108]	N	Y	Y	Y	Y	Y
Founder Group[109]	Y	Y	Y	Y	Y	Y

B. Bank Holdings - Big Four

In mid-1980s, four wholly state owned banks, ICBC, BOC, CCB and ABC, changed into commercial banks. In 1984, ICBC was founded.as the first commercial bank of PRC in the PRC history.[110] The four largest Chinese commercial banks (CIBC, ABC, BOC and CCB) are state-owned because the Central Huijin Investment Ltd. (Huijin) and the Ministry of Finance (MOF) hold absolute control rights. In 2005, Huijing and MOF together held 100% shares of “big four”. In 2012, Huijin and MOF together held 70.6% shares of CIBC; Huijin and MOF together held 79.42% shares of ABC; Huijing held 67.72% shares of BOC; Huijin held 57.21% shares of CCB.[111]

So far banking sector has played a dominant role in China’s financial services and nationwide economic system. By the end of June 2015, the total assets of banking sector were CNY 183.68 trillion and the total liabilities were CNY 170.38 trillion.[112] On the latest largest global bank list, Chinese banks take thirteen seats. The Big Four ranks top four largest banks on the 2015 Forbes Global 2000, of which ICBC ranks #1 with total assets at USD 3,322 billion and market values at USD 278.3 billion.[113]

Unlike the other categories of Chinese FHCs, Big Four take different path in establishing their financial holding companies. Of the Big Four, CIBC, BOC and CCB first established overseas subsidiary companies, then their overseas subsidiaries turned to run business in the mainland. Thus they indirectly realized mixed operation through both domestic and overseas companies.[114]

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[106] Refer to the website of Anbang Insurance Group: www.anbanggroup.com.
[107] Refer to the website of Fosun Group: http://www.fosun.com.
[108] Refer to the website of Wanxiang Group: http://www.wanxiang.com.cn.
[109] Refer to the website of Founder Group: http://www.founder.com.
[110] MBAlib, “ICBC”, http://wiki.mbalib.com/zh-tw/%E4%B8%AD%E5%9B%BD%E5%B7%A5%E5%95%86%E9%93%B6%E8%A1%8C.
[111] CCB Research Institution Working Group, *China Commercial Bank Development Report (2013)* (Beijing, China: China Finance Publishing House, 2013), p. 21.
[112] Refer to statistical data of China Banking Regulatory Commission, www.cbrc.gov.cn.
[113] Liyan Chen, “The World’s Biggest Public Companies-2015 Ranking” (6 May 2015) *Forbes*, available at: http://www.forbes.com/global2000/list/#tab:overall.
[114] Minggao Zheng, *The Path Exploration of Comprehensive Operation in Financial Industry of China*, (Beijing, China: China Economic Publishing House, 2012), pp. 93-96.

Bank	***Insurance***	***Fund***	***Securities***	***Trust***	***Financial Leasing***
CIBC	ICBC-AXA Life	ICBC Credit Suisse Asset Management (International) Company Limited	ICBC International Holdings Limited		ICBC Leasing Financial Services
ABC	ABC Life Insurance Co., Ltd	ABC-CA Fund Management Co., Ltd.	ABC International Securities Co., Ltd.		ABC Financial Leasing Co., Ltd.
BOC	BOC Group Insurance Co., Ltd.; BOC Group Life Assurance Company Limited	BOC Investment Management Co., Ltd. (BOCIM)	BOC International Holdings Limited; BOC International Securities Limited		BOC Aviation
CCB	CCB Life	CCB Principal Asset Management Co., Ltd.	CCB International (Holdings) Limited	CCB Trust Co., Ltd.	CCB Financial Leasing Corporation Limited

Bank of China (BOC)

Bank of China (Hong Kong) Limited (BOCHK) was founded in 1917. In 1980, 14 banks together established Bank of China Group. Bank of China registered Bank of China International in U.K. in 1998. In 1999, Bank of China established a joint-venture asset management company and a trust company. In 1999, Bank of China Group started its reorganization and the restructure was approved by the PBC in 2001. In July 2002, the BOCHK Holdings (2388; OTCBB: BHKLY) got listed on the Hong Kong Stock Exchange and became the first overseas listed state owned commercial bank. The BOCHK Holdings is a wholly owned subsidiary of the BOC.[115] BOC was the first to develop FOC in Big Four. In July 1992, BOC established Bank of China Group Insurance Co., Ltd. and engaged in various insurance business. In February 1998, BOC established Bank of China Group Life Insurance Co., Ltd. In 2001, Bank of China Group Insurance Co., Ltd. set up its branch in Shenzhen and extended its business to the mainland. In March 2002, BOC International established BOC International (China) Limited to engage in securities underwriting and brokerage of A-shares, as well as investment banking.[116]

[115] Wikipedia, "Bank of China Hong Kong", available at: https://zh.wikipedia.org/wiki/%E4%B8%AD%E5%9C%8B%E9%8A%80%E8%A1%8C%EF%BC%88%E9%A6%99%E6%B8%AF%EF%BC%89.

[116] Minggao Zheng, *The Path Exploration of Comprehensive Operation in Financial Industry of China*, (Beijing, China: China Economic Publishing House, 2012), p. 94.

Industrial and Commercial Bank of China (ICBC)

In 1998, ICBC took over the British business of Bank of East Asia Limited and established Industrial and Commercial East Asia Finance Holdings Ltd. to engage in M&A, financial advisory, equity financing and securities underwriting. In 2003, ICBC (Asia) acquired 24.9% shares of Taiping Life Insurance, a Hong Kong listed company. ICBC turned to mixed operation after obtaining overseas licenses of banking, insurance and securities.[117] In 2005, ICBC's bancassurance business reached CNY 85.3 billion.[118] In October 2006, ICBC got listed on both the Hong Kong Stock Exchange and the Shanghai Stock Exchange. In 2005, Goldman Sachs, together with American Express, purchased 10% of ICBC shares as strategic investors.[119] In October 2010, ICBC purchased 60% shares of AXA Minmetals Assurance Co., Ltd., a Sino French life insurance company.[120] Through its overseas subsidiaries, ICBC engages in mixed operation.

China Construction Bank (CCB)

In 1995, together with Morgan Stanley, CCB established joint venture investment bank – China International Capital Corporation Limited (CICC). CCB held 43.45% shares of CICC as the largest shareholder.[121] In 2005, American Bank invested USD 2.5 billion in purchasing CCB's shares as strategic investor. Like ICBC and BOC, CCB completed joint-stock system restructuring and introduced strategic investors in 2005.[122] In 2010, CCB acquired 51% shares of the Pacific-Aetna Life Insurance Co. Ltd.[123] CCB and its overseas subsidiaries have hold licenses of banking, insurance, trust, securities and financial lease.

The Agriculture Bank of China (ABC)

At the end of 2003, the State Council initiated the reform of wholly state-funded commercial bank and ABC started its transformation to a financial holding company, based upon FHC experiences of ICBC, BOC and CCB.[124] Unlike ICBC, BOC and CCB, it took more time for ABC to carry out the joint-stock system restructuring. In 2006, its non-performing loan (NPL) ratio was 24.75%, which needed injected fund of USD 140

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[117] Ibid, p. 95

[118] MBAlib, "Industrial & Commercial Bank of China", available at: http://wiki.mbalib.com/zh-tw/%E4%B8%AD%E5%9B%BD%E5%B7%A5%E5%95%86%E9%93%B6%E8%A1%8C.

[119] Xuefeng Shao and Zheng Li ed., *Research on ICBC's Deepening Reform and Management Innovation*, Beijing, China: Economic Science Press, 2008, p. 41.

[120] Jing Ye, "ICBC Take over AXA Minmetals Assurance Co., Ltd. and Becomes the Largest Shareholder" (7 June 2012) *Information Times*, available at: http://finance.ce.cn/rolling/201206/07/t20120607_16888446.shtml.

[121] Minggao Zheng, *The Path Exploration of Comprehensive Operation in Financial Industry of China*, (Beijing, China: China Economic Publishing House, 2012), pp. 95-96.

[122] Xuefeng Shao and Zheng Li ed., *Research on ICBC's Deepening Reform and Management Innovation*, Beijing, China: Economic Science Press, 2008, p. 41.

[123] CCB, "CCB Has Completed Acquiring 51% Shares of the Pacific-Aetna Life Insurance Co. Ltd." (29 June 2011), available at: http://fjt.ccb.com/gate/big5/www.ccb.com/cn/ccbtoday/news/20110629_1309316401.html.

[124] Bin Xiao, "The Research on the Model of the Agriculture Bank of China's Financial Holding Company" (2009), Ph.D. thesis for Southwestern University of Finance and Economics.

billion in order to decrease its NPL ratio below 5%.[125] After stripping off the bad assets, ABC transformed into a joint stock limited liability company and got listed in Hong Kong and Shanghai in July 2010. Its business currently covers investment banking, fund management, financial leasing and life insurance.[126]

In addition, banking sector's participating in trust and securities business lead to mixed operation in these areas. After 2005, Bank of Communications, State Development Bank, BOC and CCB realized participating in or controlling fund management companies respectively. In 2007, they developed their trust companies through restructuring and established their own financial leasing companies. In 2009, Bank of Communications established the BoCommLife Insurance Company Limited and became the first domestic bancassurance.[127]

C. Industry and Finance Combination of Central State Owned Enterprises

In mid-2000s, China implemented the strategy of "*Guo Jin Min Tui*", which literally means "State-owned enterprises approach and privately operated enterprises retreat". In May 2003, The State Council issued the *Interim Measures for the Supervision and Administration of State-owned Assets of the Enterprises* and the State-owned Assets Supervision and Administration Commission (SASAC) was authorized to manage major matters of state owned enterprises (SOEs).[128] In 2004, the SASAC made the Management Measures on Central Enterprises' Development Strategy and Plan as the blueprint of developing super large size central enterprises, such as three to five year mid-term development plan and ten year long-term development plan.[129] By 2014, there are 113 central enterprises which play a dominant role in the national economy.[130] Most of these central SOEs have established their own financial companies to deal with internal financing and investments. For example, the CNOOC Finance Co., Ltd. is responsible for providing financial services of accounting, foreign exchange and credit services for CNOOC members. The enterprise group financial company may undertake collecting and payment of money, guarantee, entrusted loans, entrusted investments and financial lease

[125] Xuefeng Shao and Zheng Li ed., *Research on ICBC's Deepening Reform and Management Innovation*, Beijing, China: Economic Science Press, 2008, p. 39.
[126] Refer the website of ABC, http://www.abchina.com/en/about-us/about-abc/Overview/.
[127] Xiaomin Lai, "Asset Management Companies Need Innovative Development Model and Enhance Business Transformation" (26 November 2010), available at: http://business.sohu.com/20101126/n277931807.shtml.
[128] The SASAC examines and approves the restructuring and stock system reform schemes of the solely state-owned enterprises and solely state-owned companies among the contributed enterprises. Splitting, merger, bankruptcy, dissolution, increase or reduction of capital, issuance of company bonds, and transfer of state-owned assets must be approved by the SASAC. See Articles 20-23 of the *Interim Measures for the Supervision and Administration of State-owned Assets of the Enterprises*, which was issued by the State Council on May 27, 2003 and amended on January 8, 2003.
[129] See Article 8 of the *Management Measures on Central Enterprises' Development Strategy and Plan*, which was promulgated by the SASAC on November 26, 2004.
[130] Refer to the name list of central enterprises of the SASAC, www.sasac.gov.cn.

for entity members, as well as issuing and underwriting financial company bonds upon the approval of CBRC.[131]

In particular, the central SOEs and local SOEs rapidly expanded in the economic stimulus scheme of Four trillion yuan[132] in 2008 and the *Ten Industrial Promotion Plan*[133] in 2010, which was to address problems of economic crisis and structural adjustment of internal needs, particularly strengthened the government-guiding model of economic development. In the 2008 massive economic stimulus package and a series revitalization measures, SOEs got full resources and policy priorities; while non-state-owned enterprises encountered various difficulties in raising capital, bank loans and daily operations. Following the four trillion yuan stimulus plan in November 2008, the Chinese government launched the plan for ten revitalization industries in early 2009. These ten industries include: shipbuilding, automobile, electronics, textile, iron and steel, nonferrous metal, petrochemical, mechanical equipment manufacturing, logistics and light industries.

The SASAC also encourages central SOEs to develop their own strategy of industry and finance combination. In April 2009, the China National Petroleum Corporation (CNPC) took over Karamay City Commercial Bank and renamed it as Bank of Kunlun Co., Ltd. In July 2009, CNPC acquired Ningbo Golden Harbor Trust Investment Co., Ltd. and renamed it as Kunlun Trust Co., Ltd.[134] CNPC Asset Management Co., Ltd. and China Petroleum Finance Co., Ltd. operate its financial business such as asset management, financing and insurance, asset restructuring, mergers and acquisitions, and investment. CNPC has established two joint ventures with ASSICURAZIONI GENERALI - Generali China Life Insurance Co., Ltd. and Generali China Insurance Co., Ltd.[135] The State Grid Corporation of China (State Grid) has established its "Yingda Affiliated" finnancial holdings group, which include Yingda Media Investment Group Co., Ltd., Yingda Taihe Life Insurance Co., Ltd., Yingda Chang'an Insurance Brokers Co., Ltd., Yingda International Trust Co., Ltd., Yingda Securities Corporation Ltd. and State Grip Yingda International Holdings Group Ltd.[136] Another example of industry and finance combination is the Baosteel Group Corporation (Baosteel). Baosteel has established Hwabao Investment Co., Ltd., Hwabao Trust Co., Ltd., Fortune SG Fund Management

[131] Articles 28-29 of the Administrative Measures for Enterprise Group Finance Companies issued by the CBRC on July 27, 2004 and amended on December 28, 2006.
[132] The PRC State Council announced the 2008-2009 economic stimulus plans on November 9, 2008. The biggest share of 4 trillion yuan was invested in "trillion invested in "infrastructure construction including railways, roads, airports, urban power grids and irrigation projects". See Ministry of Commerce, "China's pro-active fiscal policy and moderately loose monetary policy" (May 21, 2012) <http://english.mofcom.gov.cn/aarticle/zm/201205/20120508135891.html>.
[133] Baike, "Ten Industrial Promotion Plan in 2010", http://www.baike.com/wiki/%E5%8D%81%E5%A4%A7%E4%BA%A7%E4%B8%9A%E6%8C%AF%E5%85%B4%E8%A7%84%E5%88%92.
[134] "Will the 'Industry and Finance Combination' of State Owned Enterprises Make Sense?" (8 July 2009) *Caixin*, available at: http://opinion.caixin.com/2009-07-08/100189981.html.
[135] Refer to the website of China National Petroleum Corporation: www.cnpc.com.cn.
[136] Refer to the website of State Grid Corporation of China: www.sgcc.com.cn.

Co., Ltd., Hwabao Securities Co., Ltd. and Baosteel Finance Co., Ltd. [137] Aside from these holding subsidiaries, Baosteel has also invested in financial institutions such as CCB, Pudong Development Bank, Shenzhen Development Bank, Bank of Communications, Industrial Bank, China Pacific Insurance (Group) Co., Ltd., Union Securities, Huatai Insurance and Xinhua Life Insurance.[138] The following table shows that the CNPC, China National Offshore Oil Corporation (CNOOC), China Huaneng Group (Huaneng), State Grid, China Minmetals Corporation (Minmetals), China National Cereals, Oils and Foodstuffs Corporation (COFCO), China Resources (Holding) Co., Ltd. (CRC), China Merchants Group (CMB), Baosteel and Aviation Industry Corporation of China (AVIC) have established financial holding companies.

SOEs	***Bank***	***Insurance***	***Fund***	***Securities or Futures***	***Trust***	***Financial Leasing***
CNPC[139]	Y	Y	?	?	Y	Y
CNOOC[140]	N	Y	Y	Y	Y	Y
Huaneng[141]	N	Y	Y	Y	Y	Y
State Grid[142]	N	Y	Y	Y	Y	Y
Minmetals[143]	N	Y	Y	Y	Y	Y
COFCO[144]	Y	Y	Y	Y	Y	N
CRC[145]	Y	Y	Y	Y	Y	N
CMB[146]	Y	Y	Y	Y	N	N
BaoSteel[147]	N	Y	Y	Y	Y	N
AVIC Capital[148]	N	Y	Y	Y	Y	Y

D. Four Asset Management Companies -Xinda, Huarong, Great Wall and Orient AMC

After the Asian Financial Crisis, the State Council decided to set up four state-owned asset management companies (Huarong, Great Wall, Orient and Cinda) to dispose of bad loans of big four state-owned banks (ICBC, ABC, BOC and CCB) respectively. From 1999 to 2006, four big AMCs were focused on debt to equity swaps. In 2007, the four state owned AMCs turned to comprehensive operations of financial services and gradually transformed into financial holding companies.

[137] Refer to the website of BaoSteel: www.baosteel.com.
[138] "Analysis on the Industry and Finance Combination" (22 July 2015), available at: http://www.pinyi001.com/p1/news/vocation/2015/0722/55.html.
[139] Refer to the website of China National Petrolem Corporation: www.cnpc.com.cn.
[140] Refer to the website of China National Offshore Oil Corporation: www.cnooc.com.cn.
[141] Refer to the website of China Huaneng Group: www.chng.com.cn.
[142] Refer to the website of State Grid Corporation of China: www.sgcc.com.cn.
[143] Refer to the website of China MinMetals Corporation: http://www.minmetals.com.
[144] Refer to the website of COFCO: www.cofco.com.
[145] Refer to the website of China Resources (Holding) Co., Ltd.: www.crc.com.hk.
[146] Refer to the website of China Merchants Group, www.cmhk.com.
[147] Refer to the website of BaoSteel: www.baosteel.com.
[148] Refer to the website of the AIC Capital, http://www.aviccapital.com/.

Huarong AMC

China Huarong Asset Management Corporation (Huarong AMC) was founded in November 1999 in order to dispose of bad debts of the Industrial and Commercial Bank of China. In August 2014, it introduced seven strategic investors, including Warburg Pincus, CITIC Securities International, Khazanah Nasional Bhd., China International Capital Corporation Limited (CICC), China National Cereals, Oils and Foodstuffs Corporation (COFCO), Fosun Capital Group and Goldman Sachs Group. Huarong AMC has been the largest asset management company in China.[149]

Cinda AMC

In April 1999, China Cinda Asset Management Co., Ltd. (Cinda AMC) was founded in order to dispose of bad debts of the China Construction Bank. In April 2012, Cinda AMC introduced four strategic investors, including National Council for Social Security Fund, UBS AG, CITIC Capital Holdings Limited and Standard Chartered Bank. In December 2013, Cinda AMC was listed on the main board of Hong Kong Stock Exchange.[150]

China Great Wall Asset Management Corporation (Great Wall AMC) was founded in October 1999 for the purpose of resolving bad debts of the Agriculture Bank of China. It has disposed of bad debts of more than 800 billion of non-performing loans. [151]

Orient AMC

In October 1999, China Orient Asset Management Corporation (Orient AMC) was founded in order to resolve bad debts of the Bank of China. Its total assets reaches CNY 230 billion. As a state-owned non-banking institution, its subsidiaries include China United Insurance Holding Company, Dong Xing Securities Co., Ltd., Daye Trust Co., Ltd., China National Foreign Trade Financial & Leasing Co., Ltd., Bangxin Asset Management Co., Ltd., Golden Credit Rating International Co., Ltd., Bangxin Huirong Investment Holding Co., Ltd., Orient Bangxin Capital Co., Ltd. on the mainland, and China Orient Asset Management (International) Holding Limited and Dong Yin Development (Holdings) Limited in Hong Kong.[152]

AMC	***Bank***	***Insurance***	***Fund***	***Securities***	***Trust***	***Financial Leasing***
Huarong	Y	Y	Y	Y	Y	Y
Cinda	N	Y	Y	Y	Y	Y
Great Wall	Y	Y	Y	Y	Y	Y
Orient	Y	Y	Y	Y	Y	Y

Great Wall AMC

Take the example of China Great Wall Asset Management Company. In 2014, it took over Deyang Bank as a strategic investor and acquired Great Wall Glory Securities Co., Ltd. by reorganization of Xiamen Securities Co., Ltd. By the end of June 2015, it

[149] Refer to the website of China Huarong Asset Management Corporation: www.chamc.com.cn.
[150] Refer to the website of China Cinda Asset Management Corporation: www.cinda.com.cn.
[151] Refer to the website of China Great Wall Asset Management Corporation: http://www.gwamcc.com/.
[152] Refer to the website of China Orient Asset Management Corporation: http://www.coamc.com/.

had obtained financial licenses of banking, insurance, fund management, financial leasing, trust and securities except the license of futures. Its total assets (including balance sheet and off balance sheet assets) reached CNY 400 billion.[153] The four state owned asset management companies are accelerating to obtain all seven financial licenses. [154]

Under the *Measures for the Supervision and Administration of Financial Asset Management Companies*, a financial asset management company is regulated as a financial group at three levels – the parent company, the subordinate banking financial institutions and the subordinate non-financial institutions. Both the parent company and its subsidiary banking financial institutions must meet the capital regulatory requirements of their supervisory authorities. The capital adequacy ratio of the parent company of a group shall be no lower than 12.5%.[155] The CBRC, as the supervisory authority of the parent companies of four AMCs, shall coordinate with other regulatory authorities and competent departments, such as the Ministry of Finance, PBC, CSRC and CIRC, so as to establish and improve the group regulation information sharing platform, eliminate the regulation gaps and reduce the regulatory arbitrages.[156]

E. Non-State-Owned FHCs

Many enterprise groups in China's private sector have pursed to establish their own financial institutions, although no policy encourages non-state-owned companies to become large shareholders of financial institutions or involve in financial services. Some private group companies, such as China Oceanwide Holdings Group (Oceanwide), Shanghai Aijian Co., Ltd. (Aijian), Oriental Group Inc. (SH, 600811) (Oriental), D'Long Affiliates (D'Long), Wanxiang Group (Wanxiang), Shanghai Nongkai affiliates, New Hope Group and Kinghing Affiliates made progress in establishing FHCs. Since financial sectors are strictly controlled by state owned capitals, non-state-owned FHCs not only develop slowly but also have to rely on regulatory gaps and regulatory arbitrages. These companies can be called quasi-FHCs.

[153] Chunmao Ma, "The Great Wall Asset Management Company Reaches the Threshold of CNY 400 Billion; only the License of Futures Trading Is Left" (22 July 2015), available at: http://www.scstock.com/main/a/20150722/22600.shtml.
[154] Dong Lu, "Four AMCs Are Struggling for Full Financial Licenses; Oriental AMC Intends to Take over Dalian Bank" (23 June 2015) *Securities Daily*, available at: http://caijing.chinadaily.com.cn/2015-06/23/content_21075507.htm.
[155] Article 91 of the Measures for the Supervision and Administration of Financial Asset Management Companies issued by the CBRC, Ministry of Finance, PBC, CSRC and CIRC on August 14, 2014. This regulation became effective on January 1, 2015.
[156] Ibid, Article 156

AMC	*Bank*	*Insurance*	*Fund*	*Securities*	*Trust*	*Futures or Financial Lease*
Oceanwide[157]	N	Y	Y	Y	Y	Futures
Aijian[158]	N	N	Y	Y	Y	Financial Lease
Oriental[159]	Y	Y	Y	Y	Y	Y
D'Long[160]	Y	Y	Y	Y	Y	Y
Wanxiang[161]	Y	Y	Y	Y	Y	Y
New Hope[162]	Y	Y	Y	N	Y	N
Kinghing[163]	N	N	Y	Y	Y	Futures
Nongkai[164]	Y	Y	Y	Y	Y	Y

Anbang Insurance Group: A Black horse
Anbang was founded in 2004 as an insurance company ("Anbang Property Insurance Inc.") in Beijing. Six years later, Anbang Life Insurance Inc. was incorporated. At present, Anbang's total assets surpass CNY 800 billion. It has over 3,000 outlets and over 20 million customers. Subsidiaries of An Bang Group include Anbang Property Insurance Inc., Anbang Life Insurance Inc., Anbang Hexie Health Insurance Co., Anbang Asset Management Co., Ltd., Ruihe Insurance Brokers, Chengdu Rural Commercial Bank, Anbang Asset (Hong Kong) and Boundyin Finance Lease.[165]

The Case of *D'Long*[166]
The D'Long case is the biggest finance case in PRC history. At its peak, D'Long expands up to 177 affiliated companies and hired employed more than 58,000 people. Tang Wanxin, the actual owner of D'Long Group and once China's biggest owner of publicly traded shares, was sentenced to eight-year in prison for illegally accepting deposits, manipulating stock prices and embezzlement. The judicial investigation, which includes more than 800 files, shows that more than 45 billion yuan, 2,500 institutions and 32,000 people in about 20 provinces involved.

[157] Refer to the website of China Oceanwide Holdings Group, http://en.chinaoceanwide.com/about/index.html.
[158] Refer to the website of Aijian Group, http://www.aj.com.cn/ajc/kgqy/zongshu/2013-09-22/378.html.
[159] "Interpreting the Oriental Affiliates in Details" (23 August 2007), available at: http://finance.sina.com.cn/stock/t/20070823/09033909416.shtml.
[160] Baidupedia, "The D'Long Event", http://baike.baidu.com/subview/11792079/12161432.htm.
[161] Refer to the website of Wanxiang Group, www.wanxiang.com.cn.
[162] Refer to the website of New Hope Group, http://www.newhopegroup.com/.
[163] SINA Finance, "The Kinghing Affiliates of Making Affiliated Group Movement", http://finance.sina.com.cn/guest236.shtml.
[164] SOHU Finance, "The Bungee Jumping of Nongkai Affiliates", http://business.sohu.com/12/79/column209787912.shtml.
[165] www.anbanggroup.com
[166] The Case of D'Long is an excerpt from Jin Sheng, *China's Listed Companies: Conflicts, Governance and Regulation*, Kluwer Law International, March 2015, at pp. 75-76.

The collapse of *D'Long* resulted in tremendous economic losses to its institutional and individual investors. It is worth noting that the financial approaches and its internal capital market played a particularly important role in *D'Long*'s takeover activities. *D'Long* utilized more than twenty financing tools to facilitate its takeover activities.[167] In October 2004, the debts of *D'Long* were up to ￥57,000,000,000. This case involved in more than 2,500 financial institutions and 32,000 individual investors.[168] The market-price manipulation in the *D'Long* case concerned more than ￥100,000,000,000, including approximately ￥43,700,000,000 for illegal pooling of public deposit and more than ￥60,000,000,000 for illegal market manipulation of securities prices. As the largest securities fraud case, the trial court handled more than 1,000 witness' testimonies and 900 files.[169]

The Wuhan Intermediate People's Court opened a court session in January 2006 and made the sentence on April 29, 2006. Wanxin Tang, who became the first individual to be charged with the crime of illegal pooling of public deposit, got a term of imprisonment of eight years. The defendants, Shanghai Youlian (900935), Xinjiang D'Long (600737) and D'Long International Industries committed the crime of illegal pooling of public deposit, market-price manipulation of securities and misappropriation of company capital. The court held that the D'Long Affiliate illegally acquired profits of ￥9,861,000,000. These three companies were fined ￥10,300,000,000. Shanghai Youlian (900935) was sentenced a fine of ￥300,000,000 for illegal pooling of public deposits. Xinjiang D'Long (600737) and D'Long International Industries were sentenced to be fined of ￥5,000,000,000 respectively mainly for the crime of manipulating trading prices of securities. From June 5, 2001 to August 31, 2004, Deheng Securities illegally attracted public deposits for ￥20,800,000,000.[170] On October 19, 2006, Yeguang Zhang, the representative legal person of *Deheng* Securities, was prosecuted by the Hubei Province Wuhan Municipal People's Procurate of illegally pooling public deposits.

According to the *21 Century Economic Report*, the Wuhan Intermediate People's Court reported the initial trial opinions on the case of *D'Long* to the Supreme Court in March

[167] Refer to Lijiu Tang & Xu Zhang, *Dissecting Delong (Jie Gou D'Long)* (Zhejiang People's Publishing House, Hangzhou 2005). D'Long used a series of controversial financial approaches: Credit Loans, Mortgage Loans, Share Pledge, Mutual Assured Loans, Internal Capital Market, Trust Management, Bond Repurchasing and Mortgage, Financing through Tradable, Financing through Notes Receivable, Collateral Loans through Regular Wholesale Deposits, Commissioned Holdings, Embezzlement of Clients' Capital or Depositions, Misappropriation of the Capital of Affiliated Firms, Safe Bonds Financing Agreement, Trust Financing, Issuing Special Financial Bonds, Second Offerings or New Share Issuance, Flight of Registered Capital, Trust Management of Social Security Fund, Tickets Securities Financing and Employee Fund-raising.

[168] Refer to 'Doomsday of D'Long' (2006) <http://news.tom.com/2006-01-21/000N/76807177.html> accessed 1 February 2006

[169] '*D'Long* Affiliates Reach to 23 Provinces and Cities: Procurators Disclose the Story Beyond the Case' *Prosecution Daily* (Beijing 2 November 2006) <http://finance.ce.cn/law/home/alfx/200611/02/t20061102_9243385.shtml> accessed 5 July 2007

[170] Ibid

2005 and both parties discussed the term of imprisonment.[171] In addition, the fine of ￥10,300,000,000 was an important issue as both of them had huge debts. Many considered the fine of ￥10,000,000,000 for market-price manipulation as having only symbolic meaning. In fact, capital flow from low cash-flow companies to the high cash-flow companies controlled by the ultimate shareholder led to "capital black holes". In this case, the capital black-hole was approximately ￥30,000,000,000 in 2004.[172]

F. Local Government Controlled FHCs

The efforts of local governments' incorporation of FHC started from the Guangdong International Trust Investment Company (GITIC). The GITIC was founded in July 1980 upon the approval of Guangdong Province. In 1983, it was approved by the PBC as non-banking financial institute. In 1989, GITIC became the "window company" of Guangdong government and was permitted to borrow overseas loans. Its business scope involved finance, securities, international trade, hotels, investment consulting and various industries. In early 1980s, it was "charted" to borrow foreign loans and issue bonds as a "government window of openness". In nearly twenty years, GITIC expanded rapidly and became the second largest trust company next to the CITIC. However, it had a massive solvency crisis due to ill management. In June 1998, the PBC announced to close GITIC. The three-month liquidation found out that GITIC had assets valued at CNY 21.47 billion and liabilities valued at CNY 36.17 billion. On January 10, 1999, GITIC and its subsidiaries filed for bankruptcy at the Guangdong Province High Court, Shenzhen Municipal Intermediate Court and Guangzhou Municipal Intermediate Court. On January 16, 1999, the Guangdong Province High Court concluded adjudicated the bankruptcy of GITIC.[173] Foreign creditors like Citigroup, Merrill Lynch, HSBC, and Sumitomo Trust and Banking were compensated in proportion of surplus assets. In 1999, GITIC became the first bankrupted major financial institution in the PRC history.[174] Unlike in other similar events such as "BOC Trust",[175] the GITIC case set an example for exit of financial institutions.

Accompanying the rapid development of economy, local governments, especially in advanced economic regions such as Shanghai and Guangdong. For example, the

[171] 'The Case of *D'Long* Is Sentenced in Wuhan: Tang Wanxin Is Sentenced Eight Years in Jail and a Fine of ￥400,000 yuan' (2005) <http://www.zj198.com/gxyxnews/hangyedongtai_84.html> accessed 2 July 2007

[172] 'The Strength Dominates the Restructuring of *D'Long* Affiliates: Assets of RMB 20 Billion Transferred to Huarong' *21 Century Economic Herald* (Guangzhou 27 August 2004) <http://finance.beelink.com.cn/20040827/1664650.shtml> accessed 30 December 2006

[173] CITIC, "Case Analysis on the Bankruptcy of Guangdong International Trust & Investment Company – the First Bankruptcy Case of Financial Institution in China" (30 March 2015), available at: http://www.21cte.com/3373.html.

[174] John Christian and Peter Symonds, "A Sign of a Fragile Economic System: China's First Major Financial Bankruptcy" (30 January 1999), available at: https://www.wsws.org/en/articles/1999/01/chin-j30.html.

[175] In 1995, BOC Trust faces a credit crisis similar to GITIC, the PBC intervened and took it over. See "The PBC Announced to Take over BOC Trust" (5 October 1995), available at: http://finance.sina.com.cn/stock/company/memorabilia/106.shtml.

Guangdong Finance and Investment Holdings Ltd. (GFIH), which was founded in 1984, engages in trust, asset management, financial guarantees, equity investment and industrial fund management. GFIH controls thirteen financial and industrial companies, including GFIH Trust Co., Ltd., GFIH Venture Capital Co., Ltd. and BOC-GFIH Equity Investment Fund Management (Guangdong) Co., Ltd. [176] Another FHC incorporated by the local government is Shanghai International Group Co., Ltd. (SIG). The SIG was founded in April 2000. SIG is large shareholder of Shanghai Pudong Development Bank Co., Ltd., Shanghai Rural Commercial Bank Co., Ltd., Guotai Junan Securities Co., Ltd., Anxin Agricultural Insurance Co., Ltd. and Dazhong Insurance Co., Ltd.

Other local government financial platforms include the Tianjin Teda Group Co., Ltd. (Teda) and the Hefei Xingtai Financial Holding Group Co., Ltd. (Xingtai). Tianjin Teda has established financial development platform which is composed of China Bohai Bank, Northern International Trust Co., Ltd. And Bohai Securities.[177] Hefei Xingtai controls Hefei Xingtai Trust Co., Ltd. and Anhui Xingtai Lease Co., Ltd., Xingtai Capital Management Company, Xingtai Holdings (Hong Kong) Limited, Xingtai Equity Investment Company and Anhui Xingtai Pawn Co., Ltd. It is the large shareholder of Huishang Bank, Guoyuan Securities, Harfor Fund Management Co., Ltd., Guoyuan Agriculture Insurance Company, CCB Trust Co., Ltd. and Chizhou Jiuhua Rural Commercial Bank Company Limited. It has net assets of CNY 5.6 billion and its total assets reach CNY 12 billion.[178]

G. Foreign-funded Banks in China - One-stop Service

Investments of QFIIs are limited by quotas or proportion in China, though strategic investments are exception. Unlike Chinese FHCs, foreign-funded banks generally provide one-stop financial services through separate operation in front offices and mixed operation in back offices.[179] Thus a transaction is proceeded into stages of pre-trade, execution and post-trade. Take the example of UBS (China) Limited. UBS engages in investment bank, private bank and wealth management in China. UBS may help a private enterprise customer to get listed in overseas stock market first. Then UBS follows up to provide re-financing services after the IPO. After the listed company develops its business, UBS provides services of asset management. UBS also provides wealth management service for the listed company's management and shareholders.[180] By the end of 2014, 41 foreign banks, 97 foreign bank branches and 182 foreign bank representatives operated in China.[181] The CBRC supervises foreign-funded banks

[176] See the website of the Guangdong Finance & Investment Holdings, http://www.gdyctz.com.
[177] Refer to the website of Tianjin Teda Group Co., Ltd., http://www.tedagroup.com.cn/.
[178] Refer to the website of Hefei Xingtai Financial Holding Co., Ltd., http://www.xtkg.com.
[179] According to Investopedia, a financial services company can be divided into three parts: "the front office includes sales personnel and corporate finance, the middle office manages risk and IT resources, and the back office provides administrative and support services." Available at: http://www.investopedia.com/terms/f/frontoffice.asp.
[180] Liping Zhang, "Mr. ZHANG Liping of UBS: Pushing Hands of CCB and ICBC" (18 December 2006), available at: http://money.zjol.com.cn/05money/system/2006/12/18/008054022.shtml.
[181] The CBRC has established bilateral supervisory coordination mechanism with the U.S., U.K., Canada, Germany, S. Korea, Singapore, Hong Kong, Macau and Taiwan. See Foreign-funded Bank

through the *Administration of Foreign-funded Banks* and bi-lateral supervisory cooperation mechanism. In addition, regulators may enhance international coordination on financial stability through the Financial Sector Assessment Program (FSAP) and Financial System Stability Assessment (FSSA).

IV Major Issues on FHC

A. Regulatory Arbitrages and Regulatory gaps

An effective financial regulatory system should be consistent in principles and norms, allocation of duties and legal enforcement at international, nationwide and local levels. The separate regulatory system leaves room for regulatory arbitrages and regulatory gaps. There are conflicts among supervisory authorities. That is, the administrative allocation of financial supervision may result in repeating or absent supervision. For example, the four state owned asset management companies engaged in large amount of debt to equity business after 1999. However, according to the *PRC Securities Law* (1998), this business belongs to the business scope of comprehensive securities companies, whose names shall include the words "limited liability securities company" or "securities company limited by shares".[182] Another example is the supervision of enterprise bonds and corporate bonds. Under the *Administrative Regulations on Enterprise Bonds*, issuing enterprise by central enterprises must be examined and approved by the PBC and the State Planning Commission; issuing enterprise bonds by local enterprises must be examined and approved by the local branches institutions of the PBC and Planning Commission at the same level.[183] Under the *PRC Securities Law*, issuing corporate bonds must be approved by the CSRC.[184] Thus, the bond market regulation are divided by the administrative allocation.

Take the example of central SOEs' FHCs. Combination of industry and finance may result in moral hazards and contagion between industrial and financial capitals. The collapse of D'Long in 2004 has set an example of overexpansion. At present, the PetroChina hold 92% shares of Kunlun Bank[185] and has established FHC of Kunlun Affiliates;[186] China Resources controls Zhuhai Commercial Bank. Meanwhile, some

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Department of the CBRC, "Development and Supervision of Foreign-funded Banks under the New Situation" (17 July 2015), available at: http://www.cbrc.gov.cn/chinese/home/docView/0ED3C2296A93447592D312C3A3644EEA.html.

[182] Articles 120 and 129 of the *PRC Securities Law* issued on December 29, 1998.

[183] Article 11 of the *Administrative Regulations on Enterprise Bonds* issued by the State Council on August 2, 1993.

[184] Article 16 of the *PRC Securities Law* amended in 2004.

[185] Baidupedia, "Kunlun Bank", available at: http://baike.baidu.com/view/2408156.htm.

[186] The "Kunlun Affiliates" of PetroChina include Kunlun Bank, PetroChina Financial Company, Kunlun Trust, Kunlun Financial Leasing, Generali China Life Insurance Co., Ltd. and Generali China Property Insurance Co., Ltd. See Xinhua Financial Network, "The Big Wave of Central SOEs' Combination of Industry and Finance: The Framework of PetroChina's 'Kunlun Affiliates' Has Emerged" (20 April 2011), available at: http://news.xinhuanet.com/fortune/2011-04/20/c_121325662.htm.

FHCs established by private enterprises emerge. Under the current regulatory system, FHCs established by central SOEs, such as PetroChina, China Resources and Huaneng, are overseen by the State-owned Assets Supervision and Administration Commission (SASAC), although their subsidiaries are also overseen by other regulators. However, there is no regulator to oversee the consolidated management of FHCs. The SASAC is a government agency rather than a financial regulator. The SASAC may have different opinions on some issues. Although the SASAC supports central SOEs' development of FHC and acquiring financial institutions, the CBRC does not encourage the combination of industry and finance. The CBRC only permits those enterprises related to state strategic resources and upstream and downstream of the industrial business chain to become large shareholders of commercial banks.[187] The SASAC should enhance coordination with financial regulators in order to eliminate regulatory gaps.

B. Information Sharing Mechanism among Regulators

The 2004 Coordination Memo of Financial Regulation stipulated duties and allocation of four regulators: the PBC, CBRC, CSRC and CIRC. Thus it established the framework of separate regulation. However, this memo did not cover such key issues as affiliated transactions, information disclosure, consolidated supervision and risk segregation. Under the separate regulatory system, the PBC, CBRC, CSRC and CIRC supervise different subsidiaries of FHCs and each regulator does not have complete operation information of FHCs. The 2004 Coordination Memo of Financial Regulation proposed to establish an information sharing mechanism among financial regulators. The current information sharing mechanism among financial regulators is not good enough for indicating capital adequacy ratio, asset quality, management, earnings, liquidity and sensitivity to market risk. Incomplete information on FHCs and their subsidiaries may result in incorrect analysis on the risk assessment and weaken the efficiency and effectiveness of regulators' supervision.

Due to the rapid development of mixed operation, assets and equity relations between the financial group and its subsidiaries become more and more complicated. Cross holding among the group members, affiliated transactions and internal control may mislead risk control and result in financial contagion in the whole financial group when one subsidiary encounters crisis. The recent stock market crash shows the contagion among banks and securities companies triggered by the CSRC's clearing margin call.

C. Capital Adequacy

The financial group may repeat calculating capitals. That is, the input capital may be counted in the balance sheet of both the subsidiary, which brings in the funds, and the group company. The absorbing subsidiary may use the same fund to purchase shares of other subsidiaries or sub-subsidiaries. In particular, cross holding and pyramid structure in FHCs may enlarge the leverage of capital and make the repetitive calculation of capitals more complicated in assessing capital adequacy, liquidity and risks. The CBRC made efforts to oversee bank holding company. In 2009, commercial banks were required to bring the information that they hold equities of insurance company into the centralized

[187] Raisewin, "Central Enterprises: Combination of Industry and Finance Develops Rapidly" (14 July 2014), available at: http://www.raise-win.com/advisory/show32.html.

information management system and the capital investment made by a commercial bank in an insurance company should be completely deducted from the commercial bank's capitalization when calculating capital adequacy ratio.[188] On January 1, 2013, the *Administrative Measures for the Capital of Commercial Banks*, which followed the capital adequacy criteria of Basel III, took into effect. Commercial banks shall consolidate domestic and overseas investees which commercial banks hold more than 50% of voting rights and commercial banks hold less than 50% of voting rights but have actual control rights.[189] The capital adequacy ratio shall be no lower than 8% and the capital reservation buffer shall be 2.5% of risk-weighted assets and be fulfilled by Core Tier 1 capital.[190] Commercial banks shall use standardized approach to measure the capital charges for interest rate risk, exchange rate risk, commodity risk, equity risk and option risk.[191]

D. Related-party Transactions

Affiliated transaction within FHCs are common. For example, in a FHC, the bank provides capitals for securities company's buying IPO shares; securities company deposit shareholders' deposits in bank; bank provides bridge capitals for securities company's underwriting; Insurance company. The CIRC recently took measures to manage the related-party transactions of insurance companies. Its new requirements include: (i) the amount of investment of the company in the unlisted equity assets, real estate assets or other financial assets of a related party shall not exceed 50% of the investment limit prescribed for the corresponding item of investment as demonstrated by the investment balance of the same item in the company's book; (ii) the total balances of the company's investments in a single legal entity of a related party shall not exceed 15% of the company's total assets at the end of the last quarter and 5% of the total assets of the legal entity at the end of the last quarter (whichever is higher); (iii) and the total balances of the company's investments in a related party shall not exceed 30% of the company's total assets at the end of the last quarter nor its net assets at the end of the last quarter; and (iv) any major related-party transaction which an insurance company wishes to conduct shall be subject to the prior approval of the company's board of directors and the required proportion of affirmative votes for passing any resolution by the board of directors shall be two-thirds of the directors not affiliated with the relevant related party.[192]

E. Rigid Redemption of Wealth Management Products

In practice, rigid redemption has been an implicit rule of various FIs' wealth management products. According to the interpretation of the PBC, 'rigid redemption' refers to "the situation when wealth management products may default or fail to deliver targeted

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[188] See Articles 15-16 of the *Administrative Measures for the Commercial Banks' Pilot Equity Investment in Insurance Companies*, issued by the CBRC on November 5, 2009.

[189] Article 12 of the *Administrative Measures for the Capital of Commercial Banks* issued by the CBRC on June 7, 2012.

[190] Ibid, Articles 23 and 24. Also see Article 29, "Core Tier 1 capital" includes: (1) paid-in capital or common equity; (2) capital reserves; (3) surplus reserves; (4) general risk provisions; (5) undistributed profits; and (6) qualifying capital from minority interests.

[191] Ibid, Article 89.

[192] *Circular of the China Insurance Regulatory Commission on Issues Concerning Further Regulating the Related-party Transactions of Insurance Companies* was issued by CIRC on April 1, 2015.

interest payment, the commercial banks, trust companies and insurance companies as the issuers or conduits must guarantee to pay off the principal and interests to the investors by means of seeking the third party's take-over, paying by own funds or providing compensation to investors, etc., so as to maintain their own reputation."[193] In March 2014, the Shanghai Chaori Solar Energy Science & Technology Co., Ltd. defaulted on paying interest of its corporate bond. The solar company could only pay CNY 4 million of CNY 89.8 million coupon due on March 4. This is the first onshore bond default.[194] The restructuring plan was surprisingly generous to creditors. The Great Wall AMC and a Shanghai investment company provided guarantee of CNY 880 million. It seems the government bailed out this company as an implicit state guarantee.[195] According to data of Standard Chartered, the ratio between domestic debts and China's GDP increased from 1.5 times in 2008 to 2.5 times in 2014, and many debts are trust products. Of 57 reported potential defaults, approximately 45% cases were in process; in 25% cases, trust companies paid with their own funds; in 20% cases, asset management companies or the third party companies paid; the other 10% defaults were changed into new products or deferred.[196]

On January 12, 2015, the Shenzhen Kaisa Group announced that it had missed USD 23 million in interest payments of an offshore debt due on January 9.[197] In April and May 2015, there were three defaults, including defaults of the Cloud Live Technology Group Co., Tianwei Group and Zhuhai Zhongfu Enterprise Co., Ltd., on the public offering bond market. Debt defaults become the "new normal". The central bank has made its standpoint on this issue. That is, the practice of "rigid redemption" of wealth management products should be orderly broken due to its moral hazard and overall risk to the financial system.[198]

F. Transition to Functional Supervision

The current financial regulatory system adopts the institutional approach, in which a financial institution is supervised by a certain regulator in accordance with the FI's business activity and business conduct. For example, Ping An Bank and Ping An Trust are overseen by the CBRC; Ping An Securities is overseen by the CSRC; Ping An

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[193] Financial Stability Analysis Group of the PBC, "China Financial Stability Report 2014" (June 2014), p. 155, available at: http://www.centerforfinancialstability.org/fsr/chn_fsr_201407.pdf.

[194] "China Gets 1st Onshore Bond Default as Chaori Doesn't Pay" (7 March 2014) *Bloomberg*, available at: http://www.bloomberg.com/news/articles/2014-03-07/chaori-solar-fails-to-make-interest-payments-on-bond-wsj-says.

[195] "Chaori Bailout Shows Beijing's Desire to Protect Bond Market" (9 October 2014) *Reuters*, available at: http://www.reuters.com/article/2014/10/09/china-chaori-solar-bondholders-idUSL3N0S43EP20141009.

[196] "Why Large Scale Defaults Have Not Yet Presented in China?" (31 July 2014) *Financial Times*, available at: http://big5.ftchinese.com/story/001057528#adchannelID=2000.

[197] Fiona Law, "Kaisa Group Defaults on Offshore Debt: Chinese Firms Seek Asset Freeze from Shenzhen Court" (12 January 2015) *The Wall Street Journal*, available at: http://www.wsj.com/articles/kaisa-asset-freeze-sought-by-chinese-financial-organizations-1421042965.

[198] Financial Stability Analysis Group of the PBC, "China Financial Stability Report 2014" (June 2014), pp. 155-156, available at: http://www.centerforfinancialstability.org/fsr/chn_fsr_201407.pdf.

Insurance Group is overseen by the CIRC. This separate regulatory system leaves room of regulatory gaps and regulatory arbitrages.

This regulatory framework, in contrast with functional supervisory system,[199] is based upon the administrative allocation of supervisory agencies and the separation of administrative division of financial markets and financial products. Due to the massive economic stimuli and financial innovations after the financial crisis, financial products and financial activities are becoming more complicated than ever before. It is suggested to adopt the functional approach to improve regulatory efficiency and reduce regulatory arbitrages.

V Conclusion

In mid-1990s, the State Council decided to establish the separate operation of financial industry. In 2005, the government proposed to steadily make progress in the pilot mixed operation of financial industry in its 11th Five Year Plan.[200] In 2012, there were more than 300 financial holding companies in the mainland.[201] Nowadays China's financial industry has entered an era of *de facto* mixed operation. The tendency of mixed operation has greatly challenged the separate regulatory system. Considering the capital adequacy ratio (CAR), affiliated transactions, insider trading, tax avoidance, legal remedies and financial risks, it is essential to formulate an act on financial holding companies, referring to other jurisdictions' statutes and practices. The Ministry of Finance has noticed the tendency of mixed operation in financial industry and absence of a special law on financial holding company and the exit mechanism of financial institutions.[202] The PBC is conducting investigation on a FHC Act. The FHC act should regulate the market access, supervision of business operation and exit mechanism of financial conglomerates. In order to carry out effective regulation on financial sectors, it is suggest to implement a transition to functional approach.

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[199] In general, there are a few approaches to financial supervision: Institutional approach, functional approach, integrated approach, twin peaks approach plus the umbrella approach in the U.S. "The Functional Approach is one in which supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Each type of business may have its own functional regulator." See Group of Thirty, "The structure of Financial Supervision: Approaches and Challenges in a Global Marketplace" (2008), available at: http://www.group30.org/images/PDF/The%20Structure%20of%20Financial%20Supervision.pdf.

[200] Article 25 of the *Proposals of the Central Committee of the Communist Party of China on Formulating the 11th Five Year Plan for the National Economy and Social Development* passed on October 11, 2005.

[201] Zhiren Li, "Observation on the Tendency and Transition of Financial Development in Mainland Chinese" (November 2012) *Fair Voice*, available at: http://www.kpwan.com/news/viewNewsPost.do?id=576.

[202] The Ministry of Finance, "A Few Suggestions on Improving the Financial Supervisory System" (2 July 2014), available at: http://dl.mof.gov.cn/lanmudaohang/dcyj/201407/t20140702_1107724.html.