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Recent Developments and Future Direction

A. Recent Developments

Recent major developments are considered those that occurred or have been announced in the PRC since the first publication of the ASEAN+3 Bond Market Guide in April 2012, with a particular focus on the exchange bond market.

1. Introduction of the Financial Stability and Development Commission

In November 2017, the Government of the PRC formally set up a committee under the State Council, the Financial Stability and Development Commission (FSDC), to oversee financial stability and development focusing on the deliberation and coordination of major issues concerning financial stability and related reform and development in the financial and capital markets.

According to a news release by the State Council, some of the primary purposes of the FSDC are to "strengthen financial regulatory coordination and supplement regulatory shortcomings," strengthen the regulatory role of financial regulatory departments, and ensure the safe and stable development of the Chinese financial sector."[91] Its remit includes structural optimization, improvements to financial markets, financial institutions, and the financial product system.

The FSDC is expected to firmly uphold quality as its chief priority, guide the financial sector's development in coordination with economic and social development, expedite the convenience of financing, reduce costs in the real economy, raise resource allocation efficiency, and ensure that risk is controllable.

In addition, the National People's Congress approved the State Council Organization Reform Plan in March 2018. Under the plan, a restructuring of the financial administration was carried out, including the integration of the CBRC and the CIRC, which led to the new CBIRC with more comprehensive functions. At the same time, the function of planning legislation and prudential policy from the CBRC and CIRC in their original form was transferred to the PBOC.

Traditionally, the functions of financial institution supervision and management were dispersed among the CBRC, CIRC, CSRC, and PBOC. In recent years, obstacles to the development of the domestic financial securities markets have been revealed due to the expansion of shadow banking and Internet finance, and the regulatory division in the bond markets was noted. Therefore, there has been an urgent need for more fluid, developmentally comprehensive cooperation among market participants across the traditional industry to address market barriers, and a rectification of imbalances with regard to enforcement. The financial supervisory control system under the initiative of

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[91] State Council, Government of the PRC. 2017. *News Release*. 9 November. http://english.gov.cn/news/top_news/2017/11/08/content_281475936107760.htm.

the FSDC will use this new environment toward further integration of financial market administration.

2. First Non-Public Placement of Innovation and Entrepreneurship Convertible Bonds

On 13 October 2017, the SZSE granted permission for the private placement of innovation and entrepreneurship convertible bonds of BlueSky Environmental Protection & Technology Co., Ltd., as applied for by Huafu Securities as sponsor.

Under the private placement, BlueSky Environmental Protection & Technology Co., Ltd., a company listed on the innovative board of NEEQ, was able to issue up to CNY150 million of innovation and entrepreneurship convertible bonds with tenors not exceeding 3 years. The bonds would enter a conversion period 6 months after their issuance. During the two declaration periods as prescribed in the bond prospectus, bondholders would be able to apply to convert the bonds into the stock of the issuer. The private placement was issued pursuant to the Guidance of China Securities and Regulatory Commission on Launching Pilot Bond Projects by Innovative Companies and Start-Ups, and the Rules for Private Placement of Convertibles Bonds by Innovative Companies and Start-Ups (for Trial Implementation) as jointly promulgated by the SZSE, NEEQ, and CSDC.

The SZSE was aiming to leverage this pilot issuance to improve its ability to serve innovative companies and start-ups during their offering of innovation and entrepreneurship bonds, and to help support the growth of the bond market overall.

3. SSE and SZSE Implemented New Rules for Collateralized Repo of Bonds

To improve the business of collateralized (pledged) repo of bonds, and as approved by CSRC, both the SSE and SZSE issued the Notice of Revision to Some Articles Related to Bond Trading in the Trading Rules and Detailed Rules for Implementation of Bond Trading on 14 April 2017. The new rules for the collateralized repo of bonds officially took effect on 22 May 2017. The revision of the rules was an important move to improve the rate formation mechanism for collateralized bond repo.

4. Promulgation of the 2015 Measures

The 2015 Measures for the Administration of Corporate Bond Offering and Trading (No. 113) (公司债券发行与交易管理办法)—in this bond market guide frequently referred to as the 2015 measures—were promulgated by CSRC effective 15 January 2015 and quickly became a game changer in the exchange bond market. The 2015 measures introduced the Qualified Investor concept, as well as the ability for issuers to offer their bonds only to such Qualified Investors, effectively creating a private placement scheme. Furthermore, the 2015 measures also allowed for the issuance of debt securities via a public offering to Qualified Investors in cases when conditions for a public offering to all investors (e.g., prescribed credit rating quality) could not be met. Finally, the 2015 measures also empowered the exchanges to review the issuance applications for such offers under delegated authority from the CSRC. Please see Chapter III.N for information on the Qualified Investor concept and Chapter II.F for a complete description of the issuance approval processes in the exchange bond market.

Following the introduction of the new market features in the 2015 measures, there was a significant increase in the number and value of listed debt securities on the SSE and SZSE (see also Chapter I.B.4 for details).

5. Changes in the QFII and RQFII Schemes

The QFII scheme was introduced in 2002, allowing foreign investors direct access to the PRC's domestic securities market for the first time. At the time, the investment opportunities were limited to the exchange market.

The RQFII scheme was initiated in late 2011 and allowed the use of offshore Chinese renminbi raised by the subsidiaries of Chinese domestic fund management companies and securities companies in Hong Kong, China to invest in the PRC domestic securities market for the first time.

Since their inception, the QFII and RQFII schemes have evolved significantly from the point of market accessibility, regulatory reforms, and capital mobility, particularly in the last 3 years, with some of the measures for further liberalization of the QFII and RQFII concepts from 2016 to 2018 including the following:

i. In September 2016, RQFII rules set by SAFE were further relaxed regarding quota application and control, including simplifying the quota application process, easing restrictions on inward and outward remittances, and shortening the lockup period. In the same month, CSRC verbally advised and removed asset allocation restrictions on QFIIs and RQFIIs. In order to increase the convenience of investment operations and introduce more overseas funds with a longer-term commitment, policy bodies and CSRC in the future would no longer impose limitations on the allocation of QFII and RQFII assets, leaving asset allocation to their discretion, while also strengthening the continuous supervision of investment activities.

ii. In July 2017, the overall RQFII quota was increased to CNY1,740 billion.

iii. On 12 June 2018, to further ease restrictions on foreign institutional investors' access to the PRC's financial markets, the PBOC and SAFE issued the new Regulations on Foreign Exchange Administration for Domestic Securities Investment by QFII and the Circular on the Administration for Domestic Securities Investment by RQFII to facilitate the easier repatriation of capital and management of foreign exchange risks in association with securities investments by QFIIs and RQFIIs. The new regulations removed the 20% cap on the amount of capital that QFIIs could remit out of the country and the 3-month lockup period for redeeming the investment principal. In addition, QFIIs and RQFIIs were allowed to place corresponding hedges on their domestic investments in the foreign exchange market.

At the end of July 2018, the total QFII investment quota had reached USD100.5 billion, allocated among 287 license holders. At the end of September 2018, the total RQFII investment quota had reached CNY1,940.0 billion, shared between 20 countries and regions, with the actual invested amount of 203 entities reaching CNY640.0 billion.[92]

For further details on the QFII and RQFII schemes, please also see Chapter II.N.

6. Changes in Market Access Routes to the PRC Bond Market

Since its accession to the World Trade Organization in 2001, the Government of the PRC has established various concepts for opening the domestic bond and capital markets, in line with the needs of foreign investors and potential issuers.

[92] China Securities Network. http://news.cnstock.com/news,bwkx-201809-4279303.htm.

Specifically with regard to investment in the PRC bond market, these concepts included: (i) QFII, (ii) the Pilot Scheme for Three Types of Institutions (三类机构), (iii) RQFII, (iv) the CIBM Direct Scheme, and (v) Bond Connect (for the CIBM); please see Table 10.1 for a brief summary of each concept's features. Chapter III.M contains a full description of the features of the market access concepts available for investors into the CIBM.

The individual concepts introduced by the government served specific purposes in line with the various stages of development of the bond market.

While the QFII concept at its inception in 2002 as a first foreign access method to the PRC's capital market overall focused on the exchange market and favored equities, other initiatives were established as part of the national policy of the internationalization of the Chinese renminbi, such as the Pilot Scheme for Three Types of Institutions and RQFII, to provide means of effective use of offshore Chinese renminbi that had been accumulated outside of the PRC.

In the earlier concepts, it had still been necessary for each foreign institutional investor to be approved by the competent authorities and to observe a quota.

The availability of foreign investment access methods was followed by opportunities for nonresident issuers as well, by introducing the issuance of Panda bonds.

Since 2015 in particular, further policy and regulatory measures to open the PRC bond market—as part of the broader liberalization of the capital market—have shifted from a framework with inherent limitations to a framework with a focus on enabling investment at the discretion of foreign investors.

In February 2016, overseas financial institutions were authorized to invest in the CIBM with only a notification to the PBOC. CIBM Direct, as it is now known, has emerged as a highly flexible framework without a need for approval, no investment limit, or repatriation restrictions.

The most recent measure, Bond Connect, introduced in July 2017, took a further step toward the opening of the domestic bond market in the PRC, allowing nonresident investors with established accounts in Hong Kong, China to access the CIBM with a streamlined approval and onboarding process. A variation of Bond Connect accessing the exchange bond market may be introduced in the near future.

Table 10.1: Overview of Market Access Routes into the PRC Bond Market

Items	QFII	Pilot Scheme for Three Types of Institutions	RQFII	CIBM Direct Scheme	Bond Connect (Northbound)
Market	(1) Exchange Market (2) CIBM	CIBM	(1) Exchange Market (2) CIBM	CIBM	CIBM
Commenced	(1) 2002 (2) 2011	2010	2011	2016	2017
Currency	FCY	CNY (CNH)	CNY (CNH)	CNY (CNH), FCY	CNY (CNH)
Approving Authorities	(1) CSRC, SAFE (2) CSRC, SAFE, PBOC	PBOC	(1) CSRC, SAFE (2) CSRC, SAFE, PBOC	PBOC, SAFE	N.A.
Original Scheme	Allowed foreign institutional investors who meet certain qualifications to invest in equities and bonds in domestic markets within an approved quota through CNY raised in the PRC in exchange for foreign currency to be remitted inbound.	Allowed three specific types of institutions to participate in the CIBM: (i) foreign central banks or monetary authorities, (ii) CNH settlement banks in Hong Kong, China and Macau, China; and (iii) cross-border CNH settlement participating banks in Hong Kong, China and Macau, China.	Allowed foreign institutional investors who meet certain qualifications to invest in equities and bonds in domestic markets within an approved quota allocated to eligible jurisdictions through CNH raised outside of the PRC.	Allowed foreign investors (QOII) to access the CIBM. Foreign institutions can trade bonds directly through banks holding a Type A license.	Allowed CMU account holders (including foreign investors) to access CIBM via a HKMA-CMU link to CCDC. No quota requirement or need for investors to identify the intended investment amount.
Original Restrictions	Investment quota (USD), regulations on remittance of principal injection period, asset allocation, and repatriation, including a lock-up period and outward remittance	Limitation of participating institutions; investment limit remained within the range of CNH holdings of each institution.	Investment quota (CNY) by countries and regions, and allocated quota by entities; other original restrictions were the same as for QFII.	Investors must invest (within a 9-month period) at least 50% of the investment amount mentioned in their filing form.	Each institution is required to submit an application to PBOC and CFETS via BCCL, a joint venture of HKEX and CFETS.
Size of the Scheme	Total allocated quota: USD100.46 billion for 287 approved QFIIs		Total allocated quota: CNY640.17 billion for 203 entities in 20 approved jurisdictions Total approved quota: CNY1,940 billion	Total foreign investors in CIBM: 373 Total foreign holdings in the CIBM: USD216.8 billion[a]	Total foreign investors registered through Bond Connect: 450

BCCL = Bond Connect Company Limited; CCDC = China Central Depository & Clearing Co., Ltd.; CFETS = China Foreign Exchange Trading System; CIBM = China Inter-Bank Bond Market; CNH = offshore Chinese renminbi; CMU = Central Moneymarkets Unit; CNY = Chinese renminbi; CSRC = China Securities Regulatory Commission; FCY = foreign currency; HKEX = Hong Kong Exchanges Limited; HKMA = Hong Kong Monetary Authority; N.A. = not applicable; PBOC = People's Bank of China; QFII = Qualified Foreign Institutional Investor; QOII = Qualified Overseas Institutional Investor; RQFII = Renminbi Qualified Foreign Institutional Investor; SAFE = State Administration of Foreign Exchange; USD = United States dollar.

[a] Present-day number of foreign investors include QFIIs and RQFIIs under their original approval.

Sources: Bank of China, BNP Paribas, BNY Mellon, Bond Connect Company Limited, Clifford Chance, King & Wood Mallesons, K&L Gate, Linklaters, Mizuho Securities; for size of schemes: for QFII, SAFE and Shanghai Stock Exchange (data as of July 2018); for RQFII, SAFE and other publicly available sources (data as of September 2018); for CIBM Direct, PBOC (data as of May 2018); for Bond Connect, Bond Connect Company Limited (data as of October 2018).

B. Future Direction

1. Further Opening of the PRC Capital Market (Bond Market)

On 11 April 2018, at the Boao (博鳌) Forum for Asia Annual Conference, President Xi Jinping announced that the PRC would significantly broaden market access, and PBOC Governor Yi Gang announced specific measures and timeframes for the further opening of the financial industry.

The PRC is expected to continue with capital account convertibility reform and deepen the reform of the CNY exchange rate formation mechanism. Market participants are expected to be more involved and active in the CNY exchange market and the CNY-denominated bond market.

Financial institutions, especially commercial banks, will need to provide better services in CNY clearing and settlement, investment and financing, trading and asset management; and facilitate the use of CNY in payment, settlement, investment, and as a reserve currency, so that the breadth and depth of the Chinese renminbi's internationalization will be enhanced.

The release of the associated PBOC notice improved the institutional arrangements for overseas institutions to issue bonds in the CIBM, aligned the domestic institutional rules with international standards, and helped further the internationalization of the PRC bond market.

Furthermore, on 30 August 2018, the State Committee of the State Council proposed a 3-year exemption from CIT and VAT on interest income derived by foreign investors from their investment in the PRC bond market. The MOF and SAT are expected to issue detailed regulations in due course.

In recognition of the importance of eliminating potential anxiety factors over the medium- to long-term, it is expected that more permanent tax exemption measures will be put in place to support the development of a stable and sustainable domestic bond market.

2. ASEAN+3 Multi-Currency Bond Issuance Framework

The introduction of AMBIF in regional markets in the course of 2015 signaled another potential opportunity for bond issuance activities in markets other than the original adopters, which were Hong Kong, China; Japan; Malaysia; the Philippines; Singapore; and Thailand.

Potential issuers have identified the PRC as one of the markets of particular interest, largely due to the size and attractiveness of such a large market but also to support the decentralized funding of domestic business operations in the PRC.

Aimed particularly at the issuance of corporate bonds to professional investors in participating markets, AMBIF encourages domestic and regional issuers to take advantage of streamlined issuance approval processes across the region.
For additional information on AMBIF, kindly refer to the ADB website.[93]

[93] See ADB. 2015. *Implementation of the ASEAN+3 Multi-Currency Bond Issuance Framework: ASEAN+3 Bond Market Forum Sub-Forum 1 Phase 3 Report*. https://www.adb.org/publications/implementation-ambif-asean3-bond-market-forum-sf1-p3.

The key advantage of AMBIF for the PRC lies in the ability of regional issuers (including those from the PRC) to tap multiple markets in addition to their domestic bond market while using the same or similar key disclosure documentation and comparable approval processes. This offers an alternative for corporate issuers to issue bonds across markets instead of (or in addition to) relying on other forms of funding.

AMBIF prescribes, among other elements, the presence of a professional investor only market segment and the use of documentation in English. The exchange bond market in the PRC already contains many of the features necessary for the issuance of AMBIF bonds in the near future.

Notably, the use of English issuance documentation and disclosure information, possibly in addition to documentation in Chinese, remains a subject for the consideration of the policy bodies and regulatory authorities in the PRC.