PIFS

CDRF

2024

China - U.S. Symposium on Building the Financial System of the 21st Century



The U.S.-China Financial Relationship

Causes of U.S.-China Tensions

- Rising competition
  - China has moved up the value chain
  - Technological leadership
  - Excess capacity
- Industrial policy
  - US views Chinese industrial policy as unfair competition
  - China views rise of US industrial policy as anti-Chinese protectionism
- Supply chains
  - Realization of fragility to natural disasters and conflict
  - Diversification as response
- National security concerns
  - Closing military gap
  - Mutual concerns over intentions and declining trust
  - Mutual vulnerability due to interdependence
  - Rise of security dilemma

National Security and Economic Policy

- Defining national security
  - How to draw the line between national security and economic competition?
    - Any disagreement can potentially be read as threat
  - How small is the yard, how high the fence?
  - Moving target
- How national security concerns manifest in economic policy
  - Technology controls
  - CFIUS, outward investment controls, and Chinese national security reviews
  - Can affect access to capital markets
  - Chilling effect on numerous industries - semiconductors, quantum computing, AI, biotech
  - Financial containment
- Future areas of concern
  - Weaponization of USD?
  - Effects on third countries
    - Secondary sanctions and technology controls
    - Discouraging adoption of Chinese AI
    - Preference for payment in RMB?

Chinese Responses to Security Tensions

- China remains open to FDI
  - But challenges remain for foreign businesses
  - Declining profitability for U.S. businesses in China
- But security considerations rising in law, regulation, enforcement
  - Foreign Investment Security Review Working Mechanism in covered sectors
  - Law on Guarding State Secrets
  - Ambiguous definition of state secrets creates uncertainty
- How will China react to U.S. security-driven economic policies?
  - The long road to de-risking
  - Could U.S. tech controls lead to Chinese embargoes of critical goods?
  - Chinese leadership likely to avoid conflict with 2024 election approaching

Managing Tensions

- Role of business
  - Don't rely on politicians to dampen tensions
  - Business must make value proposition
  - Finance is particularly well-suited
- Addressing economic concerns
  - Better Chinese and U.S. business environment
    - Ensuring Chinese access to U.S. capital markets
    - Business facilitation
  - Address core causes of imbalances - China overinvestment, U.S. overconsumption
  - Rebuilding multilateral management trade issues
  - Finding areas of mutual interest - e.g., green finance
- More dialogue!
  - More intergovernmental working groups
  - More internal dialogue among local governments, business, legislature, leaders
  - Lessons of U.S.-Japan trade tensions of 1980s and 1990s

Promoting Public Capital Markets – Innovation and Regulation

Chinese Firms and U.S. Capital

- Chinese access to U.S. capital markets
  - IPOs still in single digits
  - Effects of U.S. regulations and enforcement
    - PCAOB agreement
    - Threat remains - industrial policy, political pressures
  - Chinese review process for external IPOs
- Chinese access to U.S. investors
  - Restrictions on federal, some state-level pension investments
  - Entity-level restrictions in sensitive sectors
  - More to come?

U.S. Access to Chinese Capital Markets

- U.S. investors benefit from access to Chinese markets
  - Diversification and non-correlation of returns
  - Strong returns on some Chinese stocks (e.g. small-cap A-shares)
  - Could be endangered by further enforcement actions
- U.S. financial institutions progressing in China
  - Increase in wholly-owned financial institutions
  - Expansion into variety of spaces - insurance, payments, banks, quant traders
  - Stock and Bond Connects as option for non-residents
  - Data localization rules are a challenge
    - Introducing more flexibility in Chinese implementation of PIPL?
- Fears of decoupling
  - Is decoupling even possible?
  - Potential effects on USD

Public Markets in China

- Nature of Chinese capital markets
  - Shifting from financing market to investor-focused market
    - Need for alternative to housing and commodities
    - Opportunity to release stuck capital
  - Prevalence of retail investors
  - Predominance of controlling shareholders in SOEs and private-sector
  - Party committee as parallel element of corporate governance
- Challenges
  - Information and disclosure
  - Multiple standards - MOF, stock exchanges
  - Multilayered and long IPO approval process
    - Weak exit options
    - Slows access to key funding
    - But IPO market beginning to “normalize”
  - Corporate governance - minority shareholder protection
  - Lack of institutional investors
  - Bond markets still illiquid, especially for corporates
  - Concerns over market manipulation, investor protection

Ongoing Reforms

- Nine Guidelines
  - Distribute more dividends
  - FI supervision
  - Regulation of listed companies
  - Regulation of IPOs and delisting
  - To be made official policy with upcoming Third Plenum
- CSRC and exchanges drafting rules to implement
  - High-level commitment to opening markets
    - Easier for foreigners to get licenses in banking, insurance, asset management, etc.
    - Official encouragement of cross-border flows through multiple channels
  - Desire to improve quality of financial markets
  - High credibility - CSRC crackdown on fraud and manipulation
- Recent introduction of shareholder litigation
  - Use of AI to calculate minority investor loss

State Council's 9 New Guidelines for the Capital Markets

China issued an unprecedented set of policy guidelines for the development of its stock markets, sketching out what it could look like by 2050 with a significant improvement in the quality of investing and fundraising – targeting 2035

	Previous: January 31, 2004	Previous: May 9, 2014	New: April 12, 2024
1.	Fully recognize the significance of vigorously developing the capital markets.	Expand the market and increase the proportion of direct financing.	Overall: Clearly define the capital market tasks for the next 5-10 years.
2.	Guide thoughts and tasks for advancing the reform, opening, and stable development of capital market.	Develop a multi-tiered stock market.	Strictly control the entry gate for issuance and listing process.
3.	Further perfect related policies to promote the stable development of the capital markets.	Regulate the development of the bond market.	Strengthen ongoing supervision of listed companies.
4.	Improve the capital market system and enrich the types of securities investments.	Cultivate the private equity market.	Intensify supervision of delisting.
5.	Further enhance the quality of listed companies and their standardized operations.	Promoting the development of the futures market.	Strengthen supervision of securities and funds institutions, return to basics, and enhance strength.
6.	Promote standard development of capital market intermediaries and improve professional levels.	Enhance the competitiveness of the securities and futures services industry.	Enhance trading supervision to increase stability of the capital markets.
7.	Strengthen legal systems and integrity construction and improve the level of capital market supervision.	Expand the openness of the capital markets.	Strongly promote the entry of long-term funds into the market.
8.	Strengthen coordination and cooperation, prevent and resolve market risks.	Prevent and mitigate financial risks.	Deepen reforms and opening up comprehensively.
9.	Seriously summarize experiences, actively and prudently advance opening up to the outside world.	Create a favorable environment for the development of the capital market.	Promote synergies that foster high-quality development of the capital markets.
	Main Theme: Market Development and Improvement	**Main Theme**: Development, Construction, and Market Openness.	**Main Theme**: Supervision and Promotion (entry of long-term funds).

Alternatives to Public Markets

- Private credit
  - Rapid growth globally, especially in U.S.
    - Addresses limits of public markets and banks
    - Efficient model of corporate governance
    - New financing sources, including insurance and BDCs
  - Limited growth in China
    - Contrasts with private equity prior to 2021
  - Regulatory concerns about transparency and systemic linkages in many countries
- Shadow banking
  - Rapid growth of trust companies and wealth management products in 2010s
  - Reigned in due to concerns over illegal activity and risk-taking
  - Likely to limit regulators' openness to private credit?
- Government is encouraging alternative SME lending programs through banks

UPCOMING EVENTS

Japan-U.S. Symposium (Washington, DC)
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To receive an invitation to other PIFS Symposia,
or to recommend your colleagues for participation, please contact:

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