China's Recent Financial Regulatory Reform

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On 18 March 2018, China's lawmaker, the National People's Congress approved a reform plan for the institutional organizations of the State Council, China's top administrative authority (the "Reform"). Among various substantial restructuring of governmental departments, one of the key part is the restructuring of the financial regulators. This is a substantial reform since 2002 and ends up the framework of separate institutional regulation by one central bank plus three commissions.

1. Financial regulators Reform

According to the Reform, the regulator of banking industries and the regulator of insurance industry will be merged into China Banking and Insurance Regulatory Commission (CBIRC). Before the Reform, the banking industries had been regulated by China Banking Regulatory Commission (CBRC) since 2002 and the insurance industry had been supervised by China Insurance Regulatory Commission (CIRC) since 1998. The Reform also transfers the roles of drafting key regulations and macro prudential supervision of CBRC and CIRC to People's Bank of China (PBOC), the central bank of China.

It marks another big restructuring of the financial regulators, following the central government establishing the Financial Stability and Development Commission (FSDC) in November 2017.

2. New Financial Regulatory Framework

By the Reform, China's financial regulators consist of a committee (FSDC), the central bank (PBOC) and two commissions (CBIRC and CSRC).

2.1 FSDC

FSDC is an office of the State Council and is chaired by a Vice-Premier. FSDC focuses on deliberating major reform and development programs for the financial sector, coordinating financial reform, development and regulation, coordinating issues concerning monetary policy, and coordinating the making of financial policies and related fiscal and industrial policies. FSDC is also responsible for analysing international and domestic financial situations, addressing international financial risks, and conducting policy research on systemic risk prevention and treatment and financial stability.

2.2 PBOC

PBOC, as the central bank, is responsible for making and implementing monetary policy, financial stabilization and financial macroeconomic management. After the Reform, PBOC is given the power of macro-prudential regulation on all financial institutions. This will help the central bank to better implement its monetary policy.

PBOC will implement its macro-prudential regulation by focusing on (i) coordinating the supervision of important financial institutions and financial holding companies; (ii) coordinating planning, establishment and supervision of important financial market infrastructures; and (iii) coordinating comprehensive statistic of the financial industry.

2.3 CBIRC

As a new regulator, CBIRC will focus on policy implementation and market activity supervision in the banking and insurance industries. According to the Reform, its main responsibilities include: (i) enhancing supervision of both banking and insurance industries; (ii) protecting financial product consumers' rights; and (iii) preventing and mitigating financial risks to safeguard the stability of banking and insurance industries.

2.4 CSRC

There is no change to the role and organization of China Securities Regulatory Commission (CSRC), the securities and futures regulator. Its responsibilities will remain the same, which includes (i) formulating policies and regulations concerning markets in securities and futures; and (ii) supervising issuing, trading, and settlement of equity shares, bonds, investment funds, futures contracts, futures exchanges, and securities.

3. Market Impact and Outlook

The Reform is aimed at preventing systemic financial risks by solving existing problems such as unclear responsibilities, cross-regulation and absence of supervision.

The transfer to PBOC of key rule-making authority and macro prudential supervision will help to set a unified supervision standard on financial activities of different types of institutions. It will also enhance coordination between monetary and regulatory policies and therefore reduce systemic risks and to safeguard financial stability.

The merge of the banking and insurance regulators will reduce regulatory arbitrage and unify regulations on banking and finance activities. It will also help to restrict off-balance-sheet lending activities using pass-through channels which was common in the banking and insurance industries and leveraged financial risks. It is expected that CBIRC will adopt a more effective approach to regulating finance activities, especially with regard to shadow-banking.