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Briefing Paper

China's Emerging Financial Services Industry

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Introduction

Throughout 2010 China's financial services sector has presented strong growth by means of healthy credit advancements and a more confident promotion of its financial derivatives sector.
As a result of the rapid expansion of available credit, experts anticipate a corresponding increase in Non-Performing Loans (NPL); this, in turn, has created an ongoing concern about the financial stability of what is otherwise a rapidly developing and robust credit sector.

Although the Chinese banking system has recently improved credit standards, there is doubt concerning system sustainability in relation to the future levels of non-performing loans. In accordance with such anticipation, there is a fear that an overabundance of non-returning credit may result in the market not only lagging, but also becoming unstable in the face of China's economic development.

Need for Transparency

Foreign financial institutions have always been concerned about the presence of a level playing field. Unfortunately there are many aspects of China's regulatory environment that remain opaque and uncertain for a number of foreign financial institutions. Rules involving locally-rooted foreign banks, holds placed upon RMB licenses, and delays on certain financial procedures due to extensive sanction requirements have ensured that the balance of power in China's financial services industry is tilted towards local, rather than foreign firms.

In order to further support China's financial environment for more innovative products, Lehman, Lee & Xu recommends that Chinese authorities implement the type of standards and transparent administrative guidelines that will provide further liquidity and improve on China's 25% household savings rate. By opening up domestic funds to wholly-foreign owned banks the Chinese will have access to the proper financial products that will allow them invest and put their savings to work.

Lehman feels that Chinese savings have not been able to expand at the same rate as the overall economy. Without having outlets to proper portfolio analysis, experienced investment insight, and proven market systems, China's savings have not had the necessary tools to properly appreciate. As a result of granting wholly foreign-owned banks access to domestic funds, Chinese citizens will be able to reap the benefits of direct fund distribution and proper wealth management.

Electronic Payment Industry

In order to keep the financial service industry healthy and robust, the Chinese authorities need to promote competition and address the presence of monopolization. Currently China Union Pay controls the market for transaction clearing – this creates a faulty foundation for the overall financial services industry. By ending this monopoly and advocating for a more competitive environment the Chinese government could provide consumers with the type of environment that promotes innovation, not duplication.

By eliminating this monopoly, the electronic payment industry would not only be able to provide its customers with a greater variety of products and services, but would also be able to ensure a more stabilized, well-protected industry base in case of possible system failure. By distributing the market share amongst a competitive group of companies, the industry would be able to minimize its risk factor and further protect the economy's driving force—the Chinese consumer.

Private Equity

Since 2009, the private equity sector has been undergoing a process of decentralization that is placing the approval for foreign-invested projects in the hands of local and provincial level officials. Although this process of localization is meant to improve the efficiency of project requests, the lack of proper delegation has resulted in an increased amount of confusion for foreign companies seeking to implement their investment endeavors. In order to resolve current confusion there needs to be immediate notification concerning the distinct responsibilities assigned to certain ministries and commissions. To avoid the repetition of work and the presence of overlapping accountability, Lehman urges the central government to decentralize reform by laterally extending responsibility across the local government in order to distinguish the central from the provincial.

Foreign Invested Equity

Throughout Beijing, Tianjin, and Shanghai, owners and managers of overseas investments may now establish foreign-invested equity investment enterprises. During the summer of 2009 Pudong, Shanghai was able to pass provisional policy regulations accommodating the interests of foreign enterprises in accordance with the following measures:

- The domestic fund management enterprise must be a limited liability company
- The total amount of registered capital may not be lower than US $2 million
- A required 20% of registered capital must be paid within three months from the issuance date of the license
- Shareholder Requirement-One investor is required to be involved in equity investment
- Management requirement-There must be at least two managers who have had at least two years of equity investment experience, and over two years of maintaining a senior executive office position

Lehman urges the emergence of more regulations following this model, as well as an even and transparent implementation of the regulations. The Chinese government should continue towards creating a more hospitable environment for the foreign invested equity sector, and put forth additional measures that will encourage the flexibility that international investors are accustomed to when doing business outside of China.

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For more information on the topics discussed in this briefing paper, please contact our Labor and Employment team.

Lehman, Lee and Xu's Labor and Employment team has experience and expertise in advising Chinese and international clients on all employment issues in China.

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