
Financial regulation and the WTO:
Liberalization and restructuring in
China two years post-accession

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The University of Hong Kong's Asian Institute of International Financial Law is managing a project to monitor Asia's financial markets, working in conjunction with the Hong Kong Institute of Economics and Business Strategy, the Centre of Asian Studies and the Center for China Financial Research. The project forms part of the University's East Asian International Economic Law and Policy Programme.

Members of the project team are assisting national policy makers, international financial organizations and private sector participants in preparing recommendations for financial market reforms, both national and regional, and in assessing the value to the economies of the region of financial integration and continuing financial market development, including workable new financial structures.

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Executive summary

China has made numerous commitments in respect to financial services liberalization as part of its accession to the World Trade Organization (WTO) and the implementation of the General Agreement on Trade in Services (GATS) and its annexes concerning financial services. These commitments address banking, securities and insurance activities. However, the manner in which China liberalizes its financial sector in implementing GATS commitments needs to be examined from a broader perspective than mere compliance with WTO obligations. Significantly, financial liberalization has been a key precursor to financial crises in economies (developed, developing and transition) around the world over the past century. In the past ten years, financial liberalization without appropriate restructuring to develop a robust financial system has been a significant (if not the dominant) factor in financial crises worldwide.

Since 1979, China has been in the midst of a reiterative process of liberalization of financial services, which is accelerated by its WTO obligations. At the same time, such liberalization raises the potential vulnerability of China to financial crisis with both domestic and international implications. In order to reduce its vulnerability, China is seeking to develop a robust financial system by restructuring its financial regulatory and institutional structure in accordance with international standards implemented through legal and regulatory structures.

This study analyzes China's WTO obligations in the financial services sector and domestic legal system as of 31 December 2003. Subsequent studies will address the process of financial services restructuring in China and possible outcomes.

Since entering the WTO at the end of 2001, China has made outstanding progress in opening up financial services trade and gradually eliminated restrictions on financial market access and national treatment. Foreign-funded banks are permitted to transact in domestic currency in 13 cities (Shanghai, Shenzhen, Tianjin, Dalian, Guangzhou, Zhuhai, Qingdao, Nanjing, Wuhan, Jinan, Fuzhou, Chengdu and Chongqing). The fundamental laws and rules reflecting WTO commitments relating to financial sectors have been formulated, among which are three important regulations and rules, i.e. the Regulation on Administration of Foreign-Funded Financial Institutions (banking), the Regulation on Administration of Foreign-funded Insurance Companies (insurance) and the Rules for Establishing Foreign-invested Securities Companies (securities).

Two tendencies are found in these newly published financial laws, regulations and rules. The first is that China's system of financial regulation is addressing prudential regulation in the process of meeting its WTO commitments and obligations. The second is that an increasing number of laws, regulations and rules in China apply to both foreign and domestic financial institutions, with equal treatment. The experience of the past two years shows that China is seriously and positively implementing its WTO financial commitments. There exist some problematic issues, such as capital requirements. However, the real challenge for China's financial services sector will occur after the end of the five year transitional period, i.e. from December 2006.

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INTRODUCTION

As one aspect of its accession to the World Trade Organization (WTO) and the implementation of the General Agreement on Trade in Services (GATS) and its annexes concerning financial services, China has made numerous commitments respecting financial services liberalization. These commitments address banking, securities and insurance activities and institutions. However, the question of how China liberalizes its financial sector in order to implement commitments under the GATS needs to be looked at through an angle wider than mere compliance with WTO obligations.

Significantly, financial liberalization has been a key precursor to financial crises in economies (developed, developing and transition) around the world over the past century. In the past ten years, financial liberalization without appropriate financial restructuring to develop a robust financial system has been a significant (if not the dominant) factor in financial crises worldwide. It is now widely accepted that a robust financial system reduces the likelihood of crises and the severity of crises that do occur. A robust financial system is based upon key international standards for a sound financial system, which as analyses of recent crises indicate, need to be implemented through an appropriate and effective legal and regulatory framework. The choices made in implementing international standards through the legal and regulatory framework, in turn, are key determinants of financial structure.

Since 1979, China has been in the midst of an iterative process of liberalization of financial services, which is accelerated under its WTO obligations. At the same time, such liberalization raises the potential vulnerability of China to financial crisis, with both domestic and international implications. In order to reduce its vulnerability, China is seeking to develop a robust financial system by restructuring its financial regulatory and institutional structure in accordance with international standards implemented through legal and regulatory structures. This requires structural choices to be made in respect of both financial services liberalization commitments and international financial standards. These choices will have a significant impact upon the future development of China's financial system.

Yet, the ongoing reform of China's financial system is not without its challenges. At the international level, there is at present no explicit linkage between the required legal infrastructure that must be in place for the development of a robust financial system and financial liberalization under the WTO. At the domestic level, weaknesses remain, which are likely to be brought to the surface by financial liberalization resulting from WTO accession and implementation. China's challenge is strike an appropriate balance between a robust financial system and WTO compliance. Measures taken in this connection would also be indicative of potential disputes that may arise with other WTO members, including Hong Kong and Taiwan. A brief glance at China's general WTO commitments concerning its legal and administrative systems establishes the proper context for the analysis of these issues.

China confirmed, in paragraph 68 of the *Report of the Working Party on the Accession of China* (hereinafter referred to as the Working Party Report), that the Chinese central government would revise or annul administrative regulations or departmental rules if they were inconsistent with China's obligations under the WTO agreements and China's Accession Protocol. In other words, China's laws, regulations and other rules must comply with WTO rules because it is China's obligation under international law.¹

An outstanding change after China's accession to the WTO is the enhancement of judicial review in China's judicial system.² In August 2002, *Zuigao Renmin Fayuan* (the Supreme People's Court) promulgated the first judicial interpretation on administrative cases relating to the WTO — Rules on Relevant Issues in Adjudicating Administrative Litigations relating to International Trade, stipulating that individuals, juridical persons or other institutions may file an administrative action in the People's Court if they think that an agency, institution or its employee, with the authorization of national administrative powers, infringes their legal interests through concrete administrative activities.³ A foreign individual, foreign juridical person or foreign-funded institution may seek protection from a court against an illegal administrative decision. This administrative litigation is "judicial review" under China's current legal framework.⁴ The court of first instance with jurisdiction over administrative actions related to international trade is not a *Jicheng Renmin Fayuan* (Basic People's Court), but a *Zhongji Renmin Fayuan* (Intermediate People's Court) or a court at a higher level, indicating the great importance of such actions.⁵ Additionally, the review procedures include the opportunity for appeal.⁶ The appellate courts include *Gaoji Renmin Fayuan* (Higher People's Courts) or the Supreme People's Court. According to Article 58 of the Administrative Procedure Law of the People's Republic of China, if a party refuses to accept a judgment of first instance, he shall have the right to appeal to the court at the next higher level within 15 days of the serving of the written judgment.

¹ Art. 26 of the Vienna Convention on the Law of Treaties states: "every treaty in force is binding upon the parties to it and must be performed in good faith." This is the so-called the principle of *pacta sunt servanda*. See [1966] II Yb.I.L.C. 211. See also Lord McNair, *The Law of Treaties* 493 (Oxford Univ. Press 1961) (stating that "[n]o government would decline to accept the principle *pacta sunt servanda*...")

² China's Accession Protocol, Part I:2 (D) states: "China shall establish, or designate, and maintain tribunals, contact points and procedures for the prompt review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application referred to in Art. X:1 of the GATT 1994, Art. VI of the GATS and the relevant provisions of the TRIPS Agreement ..."

³ See Art. 3 of the Rules on Relevant Issues in Adjudicating Administrative Litigations relating to International Trade, Fashi [2002] No. 27, effective from 1 October 2002.

⁴ See Li Guoguang, a Speech at a News Conference, in *Ren Min Fayuanbao* (People's Court Daily), 30 August 2002 (Li Guoguang was one of the vice-chairmen of the Supreme People's Court of P.R.C., he left the position in April 2003.)

⁵ See Art. 5 of the Rules on Relevant Issues in Adjudicating Administrative Litigations relating to International Trade, Fashi [2002] No. 27.

⁶ See China's Accession Protocol, Part I:2 (D).

Noteworthy is the problem of implementation of WTO agreements in China. Although the WTO agreements are effective in China as an international treaty approved by the Standing Committee of the National People's Congress (NPC), it seems that they do not have direct effect, i.e. a Chinese court cannot invoke a WTO agreement as the legal basis of a judgment. Article 7 of the Rules on Relevant Issues in Adjudicating Administrative Litigations relating to International Trade excludes the WTO agreements as the legal basis of a judgment through an exhaustive statement on the legal basis, by specifying only PRC laws, administrative regulations and relevant local regulations. The two judicial interpretations immediately following the Rules on Relevant Issues in Adjudicating Administrative Litigations relating to International Trade reiterate the exhaustive applicable legal basis without mentioning any WTO agreement.⁷ From an academic perspective, the prevailing view is that WTO agreements should be implemented by way of transference into China's domestic laws.⁸ This view is also supported by the statement in paragraph 67 of the Working Party Report: "the WTO Agreements would be implemented by China in an effective and uniform manner through revising its existing domestic laws and enacting new ones fully in compliance with the WTO Agreement".⁹ In fact, paragraph 67 of the Working Party Report was the main reason for the exclusion of WTO agreements as applicable laws in administrative actions by the Supreme People's Court.¹⁰

Against this background, the main purpose of this study is to assess China's attempt to develop a WTO-compliant, robust financial system as of the end of 2003 (two years after China's accession to the WTO). In the following five chapters, it analyzes China's continuing financial services restructuring and liberalization pursuant to its WTO commitments and international financial

⁷ See Art. 6 of the Rules of Relevant Issues of Application of Laws in Adjudicating Administrative Cases concerning Countervailing (promulgated by Supreme People's Court on 21 November 2002 and came into force on 1 January 2003, *Fashi* [2002] No. 36); see also Art. 6 of the Rules of Relevant Issues of Application of Laws in Adjudicating Administrative Cases concerning Anti-dumping (promulgated by Supreme People's Court on 21 November 2002 and came into force on 1 January 2003, *Fashi* [2002] No. 35).

⁸ See Cao Jianming, *WTO yu Zhongguo Fazhi Jianshe (WTO and the Establishment of China's Rule of Law)*, *Bijiaofa Yanjiu* (Comparative Law Studies), Vol. 2, 2002, at 1-20. (Cao Jianming is the vice-chairman of the Supreme People's Court, in charge of day-to-day business of the Court.) See also Mu Yaping & Xian Yifan, *WTO Xieding zai Woguo Guonei Shiyong de Wenti (The Issue of Implementing WTO agreements in China)*, in *Study of Contemporary International Law: China and International Law in the 21st Century* 215-216 (Shanghai People's Publishing House 2002) (strongly objecting the direct invocability of the WTO agreements based on the theory of national sovereignty). See also Zhang Xin, *Domestic Effect of the WTO Agreement in China: Trend and Implications*, 3 *J.W.I.* 913, 934 (2002).

⁹ See para. 67 of the Report of the Working Party on the Accession of China. However, the issue of implementation of WTO agreements by China has not been completely resolved. First, the Constitution of the PRC is silent with respect of the implementation of international treaty in China. Second, para. 67 of the Report of the Working Party on the Accession of China has no binding force because it is not contained in para. 342 as commitments incorporated in China's Accession Protocol. Third, para. 68 of the Report of the Working Party on the Accession of China, which is contained in para. 342 as binding commitments, specifies that, if administrative regulations, departmental rules or other measures were not in place within expected time frames, authorities would still honor China's obligations under the WTO Agreement and Protocol. Does this mean China's courts would directly invoke WTO agreements or articles if there were no corresponding domestic regulations or rules? There is no clear answer.

¹⁰ Li Guoguang, a Speech at a News Conference, in *Ren Min Fayuanbao* (People's Court Daily), 30 August 2002 (Li Guoguang is one of the vice-chairmen of the Supreme People's Court of PRC.)

standards. Chapter One introduces and analyzes GATS/WTO rules with regard to trade in financial services. Chapter Two reviews China's commitments in respect to financial services on the date of entry to the WTO. Chapter Three examines China's financial laws, regulations, rules and other measures as of 31 December 2003 in the context of the GATS/WTO rules and commitments. Chapter Four focuses on the most complicated issue respecting financial services liberalization, i.e. its interaction with prudential regulation. Chapter Five discusses the Closer Economic Partnership Agreement between China and Hong Kong (CEPA), focusing on its impact on financial services and interrelationship with China's WTO commitments.

Subsequent studies will address the process of financial services restructuring in China and possible outcomes.

CHAPTER ONE

THE WTO AND FINANCIAL SERVICES

I. History of multilateral financial services negotiations

On 1 January 1995, the Marrakesh Agreement Establishing the World Trade Organization (hereinafter referred to as the WTO Agreement) entered into force, with its annexes, including, *inter alia*, the General Agreement on Tariffs and Trade 1994 (hereinafter referred to as the GATT 1994), and the General Agreement on Trade in Services (hereinafter referred to as the GATS).

The GATS covers all sectors of services,¹¹ with no exception for financial services. The twenty-nine articles (in addition to three *bis* articles) of the GATS therefore generally apply to financial services. In addition, the Annex on Financial Services and the Second Annex on Financial Services, as part of the GATS, directly relate to financial services. The Understanding on Commitments in Financial Services (hereinafter referred to as the Understanding), as part of the Final Act, stipulates higher requirements for financial liberalization for those Members who have adopted it. However, negotiations on financial services did not finish with the completion of the Uruguay Round of negotiations in 1994.¹² At the end of the Uruguay Round, 76 Members had commitments on financial services in their schedules of initial commitments.¹³ According to the Decision on Financial Services in the Final Act, within six months after the date of entry into force of the WTO Agreement, Members were free to improve, modify or withdraw all or part of their financial sector commitments without offering compensation. This meant all financial services commitments were temporary and effective only for six months from 1 January 1995. Therefore, the negotiations on financial services had to be continued after the establishment of the WTO, with an initial deadline of 30 June 1995, six months after establishment.

However, it was impossible to conclude a new agreement on financial services before 30 June 1995, largely because of the attitude of the United States (US),¹⁴ so the deadline was extended to 28 July 1995 at the suggestion of the European Union (EU).¹⁵ In the end, the negotiators concluded an “interim” agreement on financial services, since negotiators again viewed the results as unsatisfactory. According to the “interim” agreement, 29 Members (counting the EU as one Member) improved their

¹¹ GATS Art. I: 3(b): “‘services’ includes any service in any sector except services supplied in the exercise of governmental authority.”

¹² The main reason is that the United States was reluctant to undertake liberal and MFN-based commitments on financial services. The US was not satisfied with other Members’ commitments. See Roger Kampf, *Liberalisation of Financial Services in the GATS and Domestic Regulation*, I.T.L.R. 1997, 3(5), 155,155.

¹³ http://www.wto.org/english/news_e/pres95_e/addpr3.htm.

¹⁴ Roger Kampf, *A Step in the Right Direction: the Interim Deal on Financial Services in the GATS*, Int. T.L.R. 1995, 1 (5), 157,159.

¹⁵ Roger Kampf, *Liberalisation of Financial Services in the GATS and Domestic Regulation*, Int.T.L.R. 1997, 3(5), 155, 156.

schedules of specific commitments,¹⁶ and 13 of them removed, suspended or reduced the scope of their Most-Favored Nation (MFN) exemption in financial services.¹⁷

The 1995 interim agreement was only an interim agreement to expire on 30 December 1997.¹⁸ On 29 May 1997, the Council for Trade in Services adopted the Decision on Financial Services Negotiations, which extended the deadline to 12 December 1997.¹⁹ From April 1997, WTO Members began the third round of negotiation on financial services. On 12 December 1997, the negotiators concluded a new agreement, the so-called Financial Services Agreement. In contrast to the financial services commitments undertaken in the Uruguay Round and in the 1995 interim agreement, the specific commitments and MFN treatment undertaken in this 1997 Financial Services Agreement by the WTO Members are not temporary, but permanent, until the WTO Members conclude a new agreement through negotiations.

According to WTO statistics, 56 schedules of commitments representing 70 WTO Members and 16 lists of MFN exemptions were annexed to the Fifth Protocol to the GATS by the negotiating deadline of 12 December 1997.²⁰ Five Members made commitments in financial services for the first time.²¹ The Fifth Protocol to the GATS entered into force on 1 March 1999, and at the same time, those schedules of specific commitments and lists of MFN exemptions annexed to the Fifth Protocol replaced those undertaken in the 1995 interim agreement or in the Uruguay Round. These commitments form the basis for future financial services negotiations.

¹⁶ The 29 Members are: Australia, Brazil, Canada, Chile, Czech Republic, Dominican Republic, Egypt, the European Communities, Hong Kong, Hungary, India, Indonesia, Japan, Korea, Kuwait, Malaysia, Mexico, Morocco, Norway, Pakistan, Philippines, Poland, Singapore, Slovak Republic, South Africa, Switzerland, Thailand, Turkey and Venezuela. See http://www.wto.org/english/thewto_e/minist_e/min96_e/financia.htm.

¹⁷ The 13 Members are: Canada, Czech Republic, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Slovak Republic, Switzerland, Thailand, Turkey and Venezuela.

See http://www.wto.org/english/tratop_e/servfi_e/finsum.htm

¹⁸ Para. one of the Second Decision on Financial Services: “Notwithstanding Article XXI of the GATS, a Member may *during a period of sixty days beginning on 1 November 1997*, modify or withdraw all or part of the Specific Commitments on Financial Services inscribed in its Schedule.”

Para. two of the Second Decision on Financial Services: “Notwithstanding Article II of the GATS and paragraphs 1 and 2 of the Annex on Article II Exemptions, a Member may, *during the same period referred to in paragraph 1*, list in that Annex measures relating to financial services which are inconsistent with paragraph 1 of Article II of the GATS.”

¹⁹ S/L/39.

²⁰ http://www.wto.org/english/tratop_e/serv_e/finance_e/finance_fiback_e.htm. The 70 WTO Members are: Australia; Bahrain; Bolivia; Brazil; Bulgaria; Canada; Chile; Colombia; Costa Rica; Cyprus; Czech Republic; the Dominican Republic; Ecuador; Egypt; El Salvador; the European Communities (15 Member States); Ghana; Honduras; Hong Kong, China; Hungary; Iceland; India; Indonesia; Israel; Jamaica; Japan; Kenya; Korea; Kuwait; Macau; Malaysia; Malta; Mauritius; Mexico; New Zealand; Nicaragua; Nigeria; Norway; Pakistan; Peru; Philippines; Poland; Romania; Senegal; Singapore; Slovak Republic; Slovenia; South Africa; Sri Lanka; Switzerland; Thailand; Tunisia; Turkey; the United States; Uruguay and Venezuela.

²¹ Non-attributable Summary of the Main Improvements in the New Financial Services Commitments, 15 February 1999, http://www.wto.org/english/tratop_e/servfi_e/finsum.htm The five Members are Bolivia, Costa Rica, Mauritius, Senegal and Sri Lanka.

II. Legal structure of WTO financial services documents

The following sections outline the main legal components affecting international trade in services.

A. GATS text²²

Financial services represent merely one service sector, so trade in financial services is not independent from the GATS. In fact, the GATS covers principles or obligations applicable to every service sector, including undoubtedly financial services.²³ The main text of the GATS includes six parts:

- I. Scope and definition²⁴
- II. General obligations and disciplines²⁵
- III. Specific commitments²⁶
- IV. Progressive liberalization²⁷
- V. Institutional provisions²⁸
- VI. Final provisions²⁹

B. Annex on Financial Services

The Annex on financial services is one of the eight Annexes to the GATS, which form an integral part thereof.³⁰ The Annex on Financial Services contains five paragraphs. Paragraph 1, “Scope

²² According to the Results of the Uruguay Round of Multilateral Trade Negotiation, the GATS is composed of four parts: (1) the main text of the Agreement (The General Agreement on Trade in Services); (2) eight Annexes; (3) Schedules of specific commitments; (4) List of Art. II Exemptions. The GATS Text refers to only the first part.

²³ GATS Art. I:3(b): “‘services’ includes any service in any sector except services supplied in the exercise of governmental authority.” (emphasis added)

Para. 1 (b) of the Annex on Financial Service: “For the purpose of subparagraph 3(b) of Article I of the Agreement, ‘service supplied in the exercise of governmental authority’ means the following: (i) activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies; (ii) activities forming part of a statutory system of social security or public retirement plans; and (iii) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government.

²⁴ Part I only includes Art. I (Scope and Definition).

²⁵ Part II covers from Art. II (Most-Favored-Nation Treatment) to Art. XV (Subsidies).

²⁶ Part III contains three articles, i.e. Art. XVI (Market Access), Art. XVII (National Treatment) and Art. XVIII (Additional Commitments).

²⁷ Part IV also has three articles, including Art. XIX (Negotiation of Specific Commitments), Art. XX (Schedules of Specific Commitments) and Art. XXI (Modification of Schedules).

²⁸ Part V includes five articles, from Art. XXII (Consultation) to Art. XXVI (Relationship with Other International Organizations).

²⁹ Part VI has three articles: Art. XXVII (Denial of Benefits), Art. XXVIII (Definitions) and Art. XXIX (Annexes).

and Definition”, further interprets GATS Article I in the context of financial services. Paragraph 2 of the Annex is “Domestic Regulation”, and its counterpart in the GATS is GATS Article VI. Paragraph 3, “Recognition”, is the application of GATS Article VII in respect to financial services. Paragraph 4, “Dispute Settlement”, provides that panels for disputes on financial services matters shall have the necessary expertise relevant to the specific service at issue in the dispute. Paragraph 5, “Definitions”, includes three definitions: “financial service”, “financial service supplier”, and “public entity”.

C. Second Annex On Financial Services

Unlike the Annex on Financial Services, the Second Annex on Financial Services is not relevant to the substantive obligations or rules respecting financial services. Rather, it only concerns the procedures for further negotiations on financial services commitments, leading to the 1995 interim agreement. Therefore, it is now only of historical interest.

D. Understanding On Commitments In Financial Services

According to the Final Act, the Understanding forms an integral part thereof. However, because the Understanding requires higher degrees of financial service liberalization than the GATS itself,³¹ not all negotiators accept it as an integral part of the GATS. Thus, the Understanding is only binding on those “*interested members*” who have inscribed this Understanding in their Schedules subject to conditions and qualifications.³² For example, in Japan’s Schedule of Specific Commitments (Financial services sector), there is a special statement:

In addition to Part III of this agreement (the GATS) and the Annex on Financial Services, Japan undertakes its specific commitments with respect to Financial Services under this Agreement *in accordance with the Understanding on Commitments in Financial Services*. Thus, the obligations under the Understanding are incurred in the sectors of Financial Services additionally to those covered by the provisions of Part III of this Agreement and the Annex on Financial Services.³³ (emphasis added)

There is a similar statement in the US Schedule of Specific Commitments (Financial services sector).³⁴ Generally, the *interested members* are members of the Organization for Economic Cooperation and Development (OECD).³⁵ In a word, the legal status of the Understanding

³⁰ GATS Art. XXIX.

³¹ Pierre Sauve, Assessing the General Agreement on Trade in Services, Half-Full or Half-Empty? 29 J.W.T. 125, 135 (1995).

³² See Understanding on Commitments in Financial Services.

³³ Japan Schedule of Specific Commitments, Supplements 3, GATS/SC/46/Suppl.3, 26 February 1998.

³⁴ United States of America Schedule of Specific Commitments, Supplements 3, GATS/SC/90/Suppl.3, 26 February 1998.

³⁵ Eric H. Leroux, Trade in Financial Services under the World Trade Organization, 36 J.W.T. 413, 433 (2002).

depends on a Member's voluntary act. If a Member inscribes the Understanding in its Schedule, it is binding on the Member, and all other WTO Members can obtain the benefits of the Understanding through MFN treatment. China has not made any such statement in its Schedule, meaning that the Understanding is not binding on China.

E. Second Protocol to the GATS

The Second Protocol to the GATS is the main document of the 1995 interim agreement. Its function was to replace the schedules of specific commitments and lists of MFN exemptions made at the end of the Uruguay Round with new commitments made in July 1995. Because it was only related to the specific commitments and MFN exemptions, generally, the Second Protocol to the GATS does not relate to other aspects of financial services.

F. Fifth Protocol to the GATS

The Fifth Protocol to the GATS is central to the 1997 Financial Services Agreement. Its function was to replace Members' existing schedules of specific commitments and lists of MFN exemptions on financial services, including those made at the end of the Uruguay Round or in 1995. It could not create any additional obligations, rights, or interpret definitions in financial services, except to replace relevant Members' specific commitments and MFN exemptions. Its legal significance is that it improved commitments regarding market access and national treatment, and reduced the scope of MFN exemptions.³⁶

G. Decisions

In the Final Act, there are eight ministerial decisions with respect to the GATS, one of which is the Decision on Financial Services.³⁷ Nevertheless, unlike the Annexes to the GATS, none of the decisions form part of the GATS. The Decision on Financial services was a procedural document for further negotiations on financial services within six months after the establishment of the WTO. Since the conclusion of the 1995 interim agreement, the Decision on Financial Services has only historical value. Additionally, the Council for Trade in Services (CTS) has adopted many decisions on financial services, but all related to the subject of procedures for negotiations or the acceptance of protocols.³⁸

³⁶ Roger Kampf, *Financial Services in the WTO: Third Time Lucky*, Int. T.L.R 1998 4(3), 111, 112.

³⁷ Others include: Decision on Institutional Arrangements for the GATS; Decision on Certain Dispute Settlement Procedures for the GATS; Decision on Trade in Services and the Environment; Decision on Negotiations on Movement of Natural Persons; Decision on Negotiations on Basic Telecommunications; Decision on Professional Services.

³⁸ The decision adopted by CTS with respect to financial services are the followings: Second Decision on Financial Services (adopted on 21 July 1995), Decision on Commitments in Financial Services (adopted on 21 July 1995), Decision Adopting the Second Protocol to the GATS (adopted on 21 July 1995), Decision Adopting the Fifth Protocol to the GATS (adopted on 14 November 1997), Decision of December 1997 on Commitments in Financial services (adopted on 12 December 1997), Decision on Financial Services Negotiations (adopted on

Last but not least, under the framework of the WTO, the dispute settlement mechanism is also related to financial services, thus the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereinafter referred to as the DSU) is generally applicable to financial services disputes, supplemented by relevant articles in the GATS and the Annex on Financial Services.³⁹ According to article 1 of the DSU, the DSU covers disputes concerning the agreements listed in Appendix 1 to the DSU and Appendix 1 (Agreements Covered by the Understanding), which includes the GATS.

III. General obligations on financial services

There are a number of general obligations respecting trade and financial services contained in the various agreements, including most-favored-nation (MFN) treatment, transparency, and the effect of domestic regulation.

A. MFN treatment

GATS Article II (Most-Favored-Nation Treatment) is comprised of three paragraphs, applicable to all services sectors. Paragraph 1 is the core rule identifying the MFN obligation with respect to trade in services. It requires that each Member accord to services and service suppliers of any other Member treatment no less favorable than that it accords to like services and service suppliers of any other country. “Service” is defined by Article I (1)(3)(b): “service includes any service in any sector except services supplied in the exercise of government authority.”⁴⁰ “Service supplier” means any *person* that supplies a service,⁴¹ while “person” is a legal term that is defined as either a natural person or a juridical person.⁴²

Paragraph 5(a) of the Annex on Financial Services stipulates the definition of a “financial service” as any service of a financial nature offered by a financial service supplier of a Member. It further states that “financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance).” This definition is broad and non-exclusive.⁴³

29 May 1997), Second Decision on the Acceptance of the Fifth Protocol (adopted on 26 May 2000), Third Decision on the Acceptance of the Fifth Protocol (adopted on 1 December 2000).

³⁹ GATS Art. XXII:1: “... The DSU shall apply to such consultation.” GATS Art. XXIII:1: “If any Member should consider that any other Member fails to carry out its obligations or specific commitments under this Agreement, it may with a view to reaching a mutually satisfactory resolution of the matter have recourse to the DSU.”

⁴⁰ GATS Art. I (1) (3) (c) states: “a service supplied in the exercise of governmental authority” means any service which is supplied neither on a commercial basis nor in competition with one or more service suppliers.

⁴¹ GATS Art. XXVIII (g).

⁴² GATS Art. XXVIII (j).

⁴³ Eric H. Leroux, Trade in Financial Services under the World Trade Organization, 36 J.W.T. 413, 428 (2002).

In fact, it uses the word “*all*” to describe the broad scope of insurance, banking and other related financial services.

According to paragraph 5(b) of the Annex on Financial Services, a financial service supplier means “any natural or juridical person of a Member wishing to supply or supplying financial services but the term ‘financial service supplier’ does not include a public entity”. Compared with the definition of “service supplier” in the GATS, the definition of “financial service supplier” is not as restrictive. GATS Article XXVII (g) provides that “service supplier” means any person that *supplies* a service, while paragraph 5(b) of the Annex on Financial Services uses the wording “*wishing to supply or supplying* financial services” (emphasis added). This broad definition of financial service supplier means that a person (natural person or juridical person) who has not actually supplied or does not supply financial services can still be regarded as a financial service supplier, provided that he wishes to supply financial services. This broad definition of service supplier can provide additional scope for a Member to invoke GATS Article XVII in order to assert claims relating to national treatment in financial services.

“Financial service supplier”, however, does not include a public entity.⁴⁴ According to the Annex on Financial Services, “public entity” means:

- *A government, a central bank or a monetary authority, of a Member, or an entity owned or controlled by a Member, that is principally engaged in carrying out governmental functions or activities for governmental purposes, not including an entity principally engaged in supplying financial services on commercial terms; (emphases added), or*
- a private entity, performing functions normally performed by a central bank or monetary authority, when exercising those functions.⁴⁵

In other words, “public entity” may include both government entities and private entities, depending on whether the entity principally carries out governmental functions or commercial functions. If a government entity principally and commercially engages in supplying financial services, it is not a public entity. If a Member accords more favorable treatment to its own government entities mainly engaging in commercial services than that it accords to financial service suppliers of other Members, this Member may be in breach of the national treatment obligation under GATS Article XVII.

Paragraph 2 and Paragraph 3 of GATS Article II stipulate two kinds of exceptions to the MFN obligation specified by Paragraph 1. The first relates to exemptions listed in a Member’s Article II Exemptions. The second is the reservation respecting frontier trade in services.

⁴⁴ Annex on Financial Services, para. 5(b).

⁴⁵ Annex on Financial Services, para. 5(c).

B. Transparency

The obligation of transparency provided by GATS Article III can be divided into three categories. The first is the obligation of publication of all relevant measures or international agreements pertaining to or affecting trade in services. The second is the obligation of notification to the WTO (the Council for Trade in Services) of any new laws (or any changes to existing laws) significantly affecting trade in services. The third is the obligation of responsiveness to requests by other WTO Members for information through the establishment of enquiry points.

C. Domestic regulation

The GATS does not prohibit Members' domestic regulation of trade in services, but it does establish some disciplines on such regulation in order to prevent Members from avoiding their obligations by way of domestic regulation. First, paragraph 1 of Article VI requires that all measures be administered in a "reasonable, objective and impartial" manner. Second, paragraph 2 requires that Members have judicial, arbitral or administrative tribunals (or procedures) to review and provide remedies for administrative decisions affecting trade in services. The third requirement concerning domestic regulation is that an applicant must receive a prompt decision from a competent authority of a Member respecting any application. The fourth requirement is related to the effect of domestic regulation on trade in services, meaning that licensing and qualification requirements, as well as technical standards may not be applied simply as a means to nullify or impair specific commitments made by Members. To this end, and pending the establishment of multilateral disciplines relating to qualifications and technical standards, Members must ensure that national requirements in these areas be based on objective and transparent criteria, not be more burdensome than necessary to ensure the quality of the service, and licensing procedures should not be a restriction on the supply of the service.⁴⁶

Given the significance of financial regulation, Members included a special rule relating to domestic regulation of financial services, commonly referred to as "prudential regulation or prudential measures". In particular, paragraph 2 (a) of the Annex on Financial Services states as follows:

Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for *prudential reasons*, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement (emphasis added).

⁴⁶ See GATS Art. VI:4 and VI:5.

This rule is generally called the “prudential carve-out”.⁴⁷ Pursuant to the prudential carve-out, a Member may take discriminatory measures against foreign financial services and financial service suppliers in order to protect domestic “investors, depositors, policy holders ...” or to ensure “the integrity and stability of the financial system”. Many members view the prudential carve-out as of such significance that “inclusion of financial services in the GATS would be unacceptable without a specific exception for prudential regulation and supervision.”⁴⁸

IV. Market access and national treatment obligations relating to financial services

From the structure of the GATS, market access and national treatment are in the same part of the GATS, i.e. Part III (Specific Commitments), which means that market access is not a general obligation under the GATS. Members are required to provide market access only to the services sectors that they have chosen to liberalize, and then only to the extent of the limitations on market access indicated in their Schedule of Commitments. Bernard Hoekman suggests that the introduction of a market access commitment reflects a characteristic of service markets that “their contestability is frequently restricted by nondiscriminatory measures”.⁴⁹ Discriminatory measures that change conditions of competition in favor of domestic service providers also affect market access and other benefits expected by WTO Members from negotiations leading to liberalization of trade in services. Therefore, once market access is granted to service providers of other Members, a WTO Member is required to comply with the National Treatment obligation under Article XVII of GATS, subject to any limitations that Member has indicated on its Schedule of Commitments.

A. Market access

The market access obligation is clearly identified by the GATS, though it cannot be found in the GATT.⁵⁰ It is set forth in Article XVI of the GATS. The provision reads as follows:

1. With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less

⁴⁷ See generally, Sydney J. Key, *Trade Liberalization and Prudential Regulation: the International Framework for Financial Services*, 75 *International Affairs* 61 (1999). See also Roger Kampf, *Liberalization of Financial Services in the GATS and Domestic Regulation*, 3 *INT’L T.L.R.* 155 (1997).

⁴⁸ Sydney J. Key, *Trade Liberalization and Prudential Regulation: the International Framework for Financial Services*, 75 *International Affairs* 61, 67 (1999).

⁴⁹ Bernard Hoekman, *Assessing the General Agreement on Trade in Services*, in *The Uruguay Round and the Developing Countries* 95 (Will Martin et al. eds., Cambridge Univ. Press, 1996).

⁵⁰ *Id.* at 93.

favorable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.⁵¹

2. In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:

(a) Limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;

(b) Limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;

(c) Limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;⁵²

(d) Limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;

(e) Measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and

(f) Limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

B. National treatment

The scope of GATS national treatment is limited to those sectors inscribed in each Member's Schedule.⁵³ This means that national treatment is not applicable to service sectors not covered by a Member's Schedule, so one Member of the WTO may take discriminatory measures against services and service suppliers of any other Member in those reserved sectors, without violation of the national treatment rule embodied in GATS Article XVII. This characteristic of national treatment in the GATS is the result of multilateral negotiations. According to the initial intention

⁵¹ If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(a) of Art. I and if the cross-border movement of capital is an essential part of the service itself, that Member is thereby committed to allow such movement of capital. If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(c) of Art. I, it is thereby committed to allow related transfers of capital into its territory. (footnote in the original text of Art. XVI).

⁵² Subpara. 2(c) does not cover measures of a Member which limit inputs for the supply of services. (footnote in the original text of Art. XVI).

⁵³ See GATS Article XVII:1.

of the US, national treatment would have to be a general obligation.⁵⁴ With the development of negotiations, however, there was a difference between the US and the EU regarding the national treatment obligation. The EU tended to regard national treatment in services as a soft obligation, instead of a binding general obligation as insisted by the US.⁵⁵ For developing countries, a general obligation of national treatment in services trade was unacceptable.⁵⁶ In the end, the view of the EU and the developing countries prevailed, so the national treatment obligation in the final agreement was not designed to be a general principle.⁵⁷

Another characteristic of national treatment is that it is not necessarily or fully applicable to the inscribed sectors because national treatment may be limited through “*any conditions and qualifications*” set out in its Schedule.

Moreover, the notion of “treatment no less favorable” is interpreted by paragraphs 2 and 3 of Article XVII.⁵⁸ The text of paragraph 2 and 3 of Article XVII is modeled on two Panel reports related to Article III of the GATT.⁵⁹ In the first, *United States—Section 337*, the Panel used the words “formally identical”,⁶⁰ and in the second, *Italian—Agricultural Machinery*, the Panel used the words “modify the conditions of competition”.⁶¹ Similar to GATT Article III:4, the GATS national treatment obligation under Article XVII covers measures that are implicated under both *de jure* and *de facto* circumstances giving rise to allegations of discrimination.⁶²

⁵⁴ Mary E. Footer, *The International Regulation of Trade in Services Following Completion of the Uruguay Round*, 29 Int'l Law. 453, 456 (1995).

⁵⁵ See *id.*, at 458. See also Jack W. Flader, JR., *A Call For a General Agreement on Trade in Services*, 3 Transnat'l Law 661, 675 (1990).

⁵⁶ Bernard Hoekman, *Developing Countries and the Uruguay Round: Negotiating on Services*, in World Bank Policy Research Working Paper No. 1220, at 5 (1993); Mary E. Footer, *The International Regulation of Trade in Services Following Completion of the Uruguay Round*, 29 Int'l Law. 453, 460 (1995). See also Dilip K. Das, *Trade in Financial Services and the Role of the GATS: Against the Backdrop of the Asian Financial Crises*, 32 J.W.T. 79, 101 (1998).

⁵⁷ It is worth noting that not everyone takes this view. For example, in Philip Ruttley's opinion, national treatment obligation is a general obligation set out by the GATS, as well as MFN treatment, transparency, mutual recognition, rules governing monopolies and other business practices restraining competitions. Philip Ruttley, *Financial Service and the General Agreement on Trade in Services*, in *Liberalization and Protectionism in the World Trading System* 186 (Philip Ruttley & Iain MacVay et al. eds., Cameron May 1999).

⁵⁸ In the view of the Panel of the *Banana* case, paragraphs 2 and 3 of Art. XVII do not impose new obligations on Members additional to those contained in para. 1. See Panel Report on *EC – Regime for the Importation, Sale and Distribution of Bananas*, adopted by the Dispute Settlement Body on 25 September 1997 as modified by the Appellate Body Report, WT/DS27/R, para.7.301,

⁵⁹ Werner Zdouc, *WTO Dispute Settlement Practice Relating to the GATS*, 2 JIEL 295, 335 (1999). See also Aaditya Mattoo, *National Treatment in the GATS, Corner-stone or Pandora's Box?* 31 J.W.T. 107, 123 (1997).

⁶⁰ *United States – Section 337 of the Tariff Act of 1930*, adopted on 7 November 1986, BIDS 36S/345, 386 para.5.11.

⁶¹ *Italian-Discrimination of Imported Agricultural Machinery*, L/833, BISD, Seventh Supplement, Geneva, February 1959, p60, 64, adopted 23 October 1958, para.12.

⁶² *Id.*

Paragraph 3 of Article XVII goes further to try to provide a criterion to determine what measures will accord “less favorable” treatment to foreign services or service suppliers. The criterion is whether the formally identical or formally different treatment “modifies the conditions of competition”.⁶³ It is inevitable that most of the disputes will focus on formally identical laws and regulations or formally different laws and regulations in that national treatment is best embodied in laws and regulations. However, the notion of “modification of the conditions of competition” is as vague as the notion of “like services and service suppliers”, all of which may have to be refined in future cases related to GATS under the WTO dispute settlement mechanism. For example, in the third iteration of the Bananas case, the Panel held that the issue of “likeness” under Article II (MFN obligation) may be analyzed in view of the nature of the services provided, characteristics of the services transactions as such, and the CPC headnote used to classify each of the services under examination. The same approach could be provided for in the case of Article XVII.

For those Members acceding to the Understanding, they must also ensure that financial service suppliers of any other Member established in its territory are accorded most-favored-nation treatment and national treatment as regards the purchase or acquisition of financial services by public entities of the Member in its territory. Another liberalization measure in the Understanding addresses new financial services: “A Member shall permit financial service suppliers of any other Member established in its territory to offer in its territory any new financial service.”⁶⁴

⁶³ It is worth noting that NAFTA also uses the similar standard, i.e. “equal competitive opportunities” to determine whether the treatment is less favorable in financial services. NAFTA Art. 1405(5) reads as follows:

A Party's treatment of financial institutions and cross-border financial service providers of another Party, whether *different or identical* to that accorded to its own institutions or providers in like circumstances, is consistent with paragraphs 1 through 3 if the treatment affords *equal competitive opportunities*. (emphasis added).

⁶⁴ Understanding, B:7.

CHAPTER TWO

CHINA'S FINANCIAL SERVICES COMMITMENTS UNDER THE WTO

I. Legal documents pertaining to China's WTO accession

The decision to accept China as a WTO Member was taken on 10 November 2001 in Doha, and the legal documents relating to China's accession were signed on that day. With respect to trade in services, the documents include the Protocol on Accession of the People's Republic of China. (hereinafter referred to as the China Accession Protocol), Schedule of Specific Commitments on Services (hereinafter referred to as the Schedule), and the Working Party Report. The three legal documents are interrelated and interconnected. The China Accession Protocol is the leading document, annexed by the Schedule and some parts of the Working Party Report. It must be pointed out that all of the official documents respecting China's accession are not in the Chinese language, for example, the Schedule is "authentic only in the English language".⁶⁵ This may lead to potential problems potentially unfavorable to China in the case of interpretation of some words or concepts in China's accession documents contrary to the understanding in Chinese.

II. China's specific commitments in financial services

China's commitments respecting financial services can be divided into two main categories: horizontal and specific.

A. Horizontal commitments

These commitments apply to financial services, as well as all service sectors included in the Schedule. China made the following horizontal commitments:

- First, it is permitted to establish foreign capital enterprises (wholly-foreign-owned enterprises), joint venture enterprises, branches and representative offices in China.
- Second, all land in the People's Republic of China is State-owned. Use of land by enterprises and individuals is subject to maximum term limitations, such as 50 years or 70 years.
- Third, managers, executives and specialists as senior employees of a representative office, branch or subsidiary in China shall be permitted entry for a period of time.

⁶⁵ See Annex 9 of the China Accession Protocol. See also the last paragraph of the China Accession Protocol.

B. Specific commitments

This section outlines China's specific commitments relating to insurance, banking, and securities.

1. Insurance

China's commitments with respect to insurance services address form of establishment, geographic coverage, business scope, licenses and national treatment.

(a) Form of establishment

Foreign non-life insurers will be permitted to establish as a branch or as a joint venture with 51 percent foreign ownership. Within two years after China's accession, foreign non-life insurers will be permitted to establish as a wholly-owned subsidiary; i.e. with no form of establishment restrictions.

Upon accession, foreign life insurers will be permitted 50 percent foreign ownership in a joint venture with the partner of their choice. The joint venture partners can freely agree the terms of their engagement, provided they remain within the limits of the commitments contained in this schedule.

For brokerage of insurance of large scale commercial risks and brokerage of reinsurance and brokerage of international marine, aviation, and transport insurance and reinsurance: upon accession, joint venture with foreign equity no more than 50 percent will be permitted; within three years after China's accession, maximum foreign equity share shall be increased to 51 percent; within five years after China's accession, wholly foreign owned subsidiaries will be permitted. For other brokerage services, there are no such limitations.

(b) Geographic coverage

Upon accession, foreign life and non-life insurers, and insurance brokers will be permitted to provide services in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan. Within two years after China's accession, foreign life and non-life insurers, and insurance brokers will be permitted to provide services in the following cities: Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin. Within three years after China's accession, there will be no geographic restrictions.

(c) Business scope

Upon accession, foreign non-life insurers will be permitted to provide "master policy" insurance/insurance of large scale commercial risks, with no geographic restrictions. In accordance with national treatment, foreign insurance brokers will be permitted to provide "master policy" coverage no later than Chinese brokers, under conditions no less favorable.

Foreign non-life insurers are permitted to provide insurance of enterprises abroad as well as property insurance, related liability insurance and credit insurance of foreign-invested enterprises in China upon accession. Within two years after China's accession, foreign non-life insurers will be permitted to provide the full range of non-life insurance services to both foreign and domestic clients.

Foreign insurers are permitted to provide individual (not group) insurance to foreigners and Chinese citizens; within three years after accession, foreign insurers will be permitted to provide health insurance, group insurance and pension/annuities insurance to foreigners and Chinese citizens. Upon accession, foreign insurers will be permitted to provide reinsurance services for life and non-life insurance as a branch, joint venture, or wholly foreign-owned subsidiary, without geographic or quantitative restrictions on the number of licenses issued.

(d) Licenses

Upon accession, licenses will be issued with no economic needs test or quantitative limits on licenses. Qualifications for establishing a foreign insurance institution are as follows:

- The investor shall be a foreign insurance company with more than 30 years of establishment experience in a WTO member;
- It shall have a representative office for two consecutive years in China; and
- It shall have total assets of more than US\$5 billion at the end of the year prior to application, except for insurance brokers.

At accession, insurance brokers must have total assets of more than US\$500 million. Within one year after accession, they must have total assets of more than US\$400 million. Within two years after accession, they must have total assets of more than US\$300 million. Within four years after accession, they must have total assets of more than US\$200 million.

(e) National treatment

Foreign insurance institutions shall not engage in the statutory insurance business. Upon accession, a 20 percent cession of all lines of the primary risks for non-life, personal accident and health insurance business with an appointed Chinese reinsurance company shall be required; one year after accession, 15 percent shall be required; two years after accession, ten percent shall be required; three years after accession, five percent shall be required; and four years after accession, no compulsory cession shall be required.

2. Banking

China's commitments with respect to banking services address geographic coverage, clients, licensing and national treatment.

(a) Geographic coverage

For foreign currency business, there will be no geographic restriction upon accession. For local currency business, the geographic restriction will be phased out as follows: Upon accession, Shanghai, Shenzhen, Tianjin and Dalian; within one year after accession, Guangzhou, Zhuhai, Qingdao, Nanjing and Wuhan; within two years after accession, Jinan, Fuzhou, Chengdu and Chongqing; within three years after accession, Kunming, Beijing and Xiamen; within four years after accession, Shantou, Ningbo, Shenyang and Xi'an. Within five years after accession, all geographic restrictions will be removed.

(b) Clients

For foreign currency business, foreign financial institutions will be permitted to provide services in China without restriction as to clients upon accession. For local currency business, within two years after accession, foreign financial institutions will be permitted to provide services to Chinese enterprises. Within five years after accession, foreign financial institutions will be permitted to provide services to all Chinese clients. Foreign financial institutions licensed for local currency business in one region of China may service clients in any other region that has been opened for such business.

(c) Licensing

Criteria for authorization to deal in China's financial services sector are to be solely prudential (i.e. contain no economic needs test or quantitative limits on licenses). Within five years after accession, any existing non-prudential measures restricting ownership, operation, and juridical form of foreign financial institutions, including on internal branching and licenses, shall be eliminated.

Foreign financial institutions which meet the following condition are permitted to establish a subsidiary of a foreign bank or a foreign finance company in China: total assets of more than US\$10 billion at the end of the year prior to filing the application.

Foreign financial institutions who meet the following condition are permitted to establish a branch of a foreign bank in China: total assets of more than US\$20 billion at the end of the year prior to filing the application.

Foreign financial institutions who meet the following condition are permitted to establish a Chinese-foreign joint bank or a Chinese-foreign joint finance company in China: total assets of more than US\$10 billion at the end of the year prior to filing the application.

Qualifications for foreign financial institutions to engage in local currency business are as follows: three years business operation in China and being profitable for two consecutive years prior to the application; otherwise, none.

(d) National treatment

Except for geographic restrictions and client limitations on local currency business (listed in the market access column), foreign financial institutions may do business, without restrictions or need for case-by-case approval, with foreign-invested enterprises, non-Chinese natural persons, Chinese natural persons and Chinese enterprises. This national treatment limitation shows the relationship between market access and national treatment; that is, geographic restrictions and client limitations listed in market access also constitute national treatment limitations.

3. Securities

China made comparatively fewer commitments in its securities sector⁶⁶ than it did in the banking and insurance sectors, respectively, and the securities sector will open at a slower pace than either of the two aforementioned sectors. This slower pace is due, in part, to the Chinese government's desire to not have transnational capital flows potentially disrupt China's securities markets. These commitments include forms of establishment, business scope, licensing, and national treatment.

(a) Forms of establishment

Upon WTO accession, China committed to (a) allow foreign securities firms to engage directly in B-Share business without a Chinese intermediary; (b) permit the representative offices of foreign securities firms to become Special Members of all Chinese stock exchanges; and (c) allow foreign investors to establish a joint venture fund management company (FI-FMC) provided that foreign interest in a FI-FMC not exceed 33 percent of the venture's registered capital. By the third anniversary of WTO accession, 11 December 2004, China committed to (a) increase the foreign investment limit in a FI-FMC to 49 percent of the venture's registered capital; and (b) allow foreign investors to form a joint

⁶⁶ China's Securities Law defines a "securities company" as a limited liability company or limited company given approval to engage in securities business and divides securities companies into two (2) categories: (1) comprehensive securities companies; and (2) brokerage-type securities companies. Arts 118 & 120. Under Art. 129 of the Securities Law, comprehensive securities companies' scope of business may include (1) securities brokerage business; (2) securities proprietary business; (3) securities underwriting business; and (4) other securities businesses as approved by the CSRC. Pursuant to Art. 130 of the Securities Law, brokerage-type securities companies may only operate a brokerage business.

venture securities company (JVSC), provided that the maximum foreign interest in such entity is limited to 33 percent of the JVSC's registered capital.⁶⁷

(b) Business scope

China's Schedule of Specific Commitments does not define the permitted business scope for foreign invested securities ventures as comprehensively as it does for foreign invested banking or insurance ventures. Upon accession, China committed to allow: (a) foreign securities institutions to engage directly (without a Chinese intermediary) in B-Share business (brokering B-Shares); (b) representative offices of foreign securities firms to become Special Members of all Chinese stock exchanges; and (c) FI-FMCs to engage in domestic securities investment fund management. By the third anniversary of WTO accession, 11 December 2004, China committed to allow JVSCs to directly underwrite A-Shares, underwrite and broker B-Shares, H-Shares, and government and corporate bonds, and establish investment funds.

(c) Licensing

As in other financial services sectors, the criteria for licensing in China's securities sector are prudential and contain no economic needs test or quantitative limit on licenses.

(d) National treatment

China placed no limitations on national treatment, apart from those national treatment restrictions related to the presence of natural persons as provided in the Horizontal Commitments (as described above).

III. China's other GATS/WTO commitments concerning financial services

In addition to horizontal and specific commitments, China has made a number of other commitments affecting trade in financial services, including specific aspects of MFN treatment, transparency, judicial review, and transitional period.

⁶⁷ In its services sector horizontal commitments, the Chinese government notes that foreign investment in an equity joint venture shall be no less than 25% of the venture's registered capital. This is consistent with the terms of China's Equity Joint Venture Law. However, on 30 December 2002, MOFTEC, SAT, SAIC, and SAFE jointly issued the *Issues Relevant to Strengthening the Administration of the Examination, Approval, Registration, Foreign Exchange Issues and Taxation of Foreign-invested Enterprises Circular* (FIE Circular), effective on 1 January 2003. The new circular generally requires all FIEs to comply with the *Equity Joint Venture Law's* examination, approval and registration requirements and reiterates the 25% foreign equity interest requirement. The FIE Circular seems to create a "Special FIE", with less than 25%, which Special FIE, will not be eligible for any preferential tax policy. It is unclear whether "Special FIEs" will be allowed in China's securities sector.

A. MFN treatment

Part I:3 of the China Accession Protocol stipulates that foreign individuals and enterprises and foreign-funded enterprises shall be accorded treatment no less favorable than that accorded to other individuals and enterprises with respect to “... prices and availability of goods and services supplied by national and sub-national authorities and public or state enterprises”. Therefore, financial services providers that rely on such goods or services may not be discriminated against based upon their origin or the origin of their funding. The term “other individuals and enterprises” is sufficiently broad to include individuals and enterprises of other Members, which means MFN treatment. There is no MFN exemption relating to financial services in China’s MFN exemption list, so other WTO Members can enjoy full MFN treatment from China, with respect to trade in financial services.

B. Transparency

During the negotiation of China’s entry to the WTO, some Members expressed concerns about the lack of transparency regarding laws, regulations and other measures.⁶⁸ China undertakes that only those laws, regulations and other measures pertaining to or affecting trade in services that are published and readily available to other WTO Members, individuals and enterprises shall be enforced. China further undertakes to establish an enquiry point to provide information and publish all laws, regulations, measures in an official journal.⁶⁹ China even provided a full listing of official journals, including the following: Gazette of the Standing Committee of the National People’s Congress of the People’s Republic of China; Gazette of the State Council of the People’s Republic of China; Collection of the Laws of the People’s Republic of China; Collection of the Laws and Regulations of the People’s Republic of China; Gazette of the MOFTEC of the People’s Republic of China; Proclamation of the People’s Bank of the People’s Republic of China; and Proclamation of the Ministry of Finance of the People’s Republic of China. However, this list is far from a “full listing” and should be updated from time to time. For example, the list does not include the Proclamation of the China Securities Regulatory Commission or the Proclamation of the China Insurance Regulatory Commission, in which large numbers of measures affecting financial services are published. The newest change is the replacement of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) with a new Ministry of Commerce, so the Gazette of MOFTEC must be renamed as the Gazette of the Ministry of Commerce.⁷⁰ Another significant change is the establishment of the China Banking Regulatory Commission (CBRC), approved by the 10th National People’s Congress in March 2003, taking

⁶⁸ Working Party Report, para. 324.

⁶⁹ China’s Accession Protocol, Part I:2 (C).

⁷⁰ An interesting thing is the Ministry of Commerce cannot be abbreviated to be MOC because the Ministry of Construction has used the abbreviation for many years, hence “MOFCOM” is now commonly being used.

over banking regulatory powers from the People's Bank of China (PBOC), so there will be a new official journal regarding banking regulatory measures in the near future. Fortunately, the so-called "full listing" has no binding force because paragraph 330 providing the list journals was not annexed to the China Accession Protocol.

C. Judicial review

According to the China Accession Protocol, China shall establish, or designate, and maintain tribunals, contact points and procedures for the prompt review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application referred to in Article VI of the GATS. In fact, China has had such a judicial review system since the promulgation of the Administrative Procedure Law.⁷¹ The problem is not lack of relevant law, but lack of execution. As noted before, in August 2002, the Supreme People's Court promulgated the first judicial interpretation on administrative cases relating to the WTO — Rules on Relevant Issues in Adjudicating Administrative Litigations relating to International Trade. According to these rules, foreign individuals, juridical persons or other institutions may file an administrative action in a People's Court if they think that an agency, institution or its employee, with the authorization of national administrative powers, infringes their legal interests through concrete administrative activities. The judicial interpretation only reinforced the importance of administrative actions respecting WTO issues, without creating a newly independent administrative tribunal. Immediately before the issuance of the judicial interpretation, the general office of the Supreme People's Court issued the Reply to the Subject Qualification of Branches of the PBOC in Administrative Litigations on 31 May 2002,⁷² permitting relevant parties to file an administrative action against a branch of the PBOC in respect to regulatory administrative measures taken by the branch. If a branch of the PBOC can be sued in an administrative action, so can the PBOC itself.

D. Specific national treatment commitments

Part I:3 of the China Accession Protocol concerning treatment no less favorable than that accorded to "other individuals and enterprises" (emphasis added) also covers another aspect of non-discriminatory treatment, i.e. national treatment. Here too, Chinese national and sub-national authorities and public or state enterprises may not treat foreign (or foreign funded) financial services providers less favorably than like domestic financial services suppliers with respect to goods or services supplied. These specific commitments on national treatment in trade in services are in one sense wider than that under GATS Article XVII. Here, China's commitments focus on all foreign individuals and enterprises and foreign-funded enterprises, whereas GATS Article

⁷¹ See Li Guoguang, a Speech at a News Conference, in *Ren Min Fayuanbao* (People's Court Daily), 30 August 2002.

⁷² *Faban* (2002), No. 119.

XVII looks solely upon services and service suppliers. Another important characteristic of China's specific national treatment commitments is that all foreign-funded enterprises established in China shall enjoy national treatment, regardless of the investment percentage of the foreign investor. Presumably, Chinese enterprises with only a foreign minority shareholding would also be covered under this provision, which would mean that China's State-owned enterprises may not receive more favorable treatment than 'foreign-funded' Chinese enterprises with respect to goods or services supplied by the Government.

E. Non-prudential measures: five-year transitional period

In China's banking commitments, there is a particular statement following the prudential licensing requirement: "within five years after accession, any existing non-prudential measures restricting ownership, operation, and juridical form of foreign financial institutions, including on internal branching and licenses, shall be eliminated." This statement appears to be restrictive, but in fact it implies that any existing non-prudential measures could remain until 11 December 2006 (five years after China's accession). What does this five year transition period mean? Can China make new non-prudential measures after accession, and then eliminate them before 11 December 2006? The answer depends on the meaning of "existing non-prudential measures". If existing non-prudential measures refer only to those measures issued before WTO entry, the answer is no. If they include new non-prudential measures issued after accession, the answer is the opposite.

It could be argued that China's financial laws, regulations, rules and measures are not bound by a "standstill" clause in the Understanding because China has not acceded to the Understanding.⁷³ On the other hand, China's additional commitments are in some cases consistent with the Understanding. It should also be clarified that no implication could arise from China's horizontal commitments where China agrees to subject its measures to a standstill obligation.⁷⁴ While this commitment is applicable to all sectors in the Schedule – and thus also binding on banking services – it is essentially an "acquired rights" provision for the purpose of protecting the existing rights of foreign-funded institutions that were established in China prior to China's WTO entry.

The lack of clarity regarding the phase-out commitment relating to existing non-prudential measures restricting ownership, operation, and juridical form of foreign financial institutions has resulted in interpretations that China is entitled to make new non-prudential measures during the five-year transitional period. Other interpretations (with which the authors' accord) hold that

⁷³ Understanding (A: Standstill) states: "Any conditions, limitations and qualifications to the commitments noted below shall be limited to *existing* non-conforming measures." (emphasis added) Here "existing" means those measures existing on the date of accession to the Understanding.

⁷⁴ In China's Schedule of Commitments (Horizontal commitments – entry of limitation on market access), there is a special commitment: "The Conditions of ownership, operation and scope of activities, as set out in the respective contractual or shareholder agreement or in a license establishing or authorizing the operation or supply of services by an existing foreign service suppliers, *will not be made more restrictive than they exist as of the date of China's accession to the WTO.*" (emphases added).

China may delay the process of elimination of “existing non-prudential measures” to the end of 2006, but China cannot make any more restrictive measures, except for prudential measures or measures permitted by WTO agreements. It seems more reasonable to take the view that “existing non-prudential measures” only includes those existing measures as of 11 December 2002. Otherwise, the term “existing” would be unnecessary. We would therefore argue that the particular statement should not be interpreted to entitle China to take new non-prudential measures, which is contrary to China’s obligations under the WTO.

CHAPTER THREE

FINANCIAL REGULATION IN CHINA IN THE CONTEXT OF THE WTO

I. Overview Of China's legal structure

The legislative power in China does not rest exclusively in the hands of the National People's Congress (NPC) and its Standing Committee. Rather, it depends on the level of legislation involved. According to the Legislation Law of the PRC (2000), there are seven kinds of laws in the broadest meaning, including laws, administrative regulations, local regulations, autonomous regulations, separate regulations, rules of departments under the State Council, and rules of local governments.⁷⁵

A. Laws

In the strict sense, laws only refer to those enacted by the NPC and its Standing Committee. The NPC enacts and amends basic laws governing criminal offenses, civil affairs, State institutions and other basic laws, while the Standing Committee of the NPC enacts and amends laws other than those within the power of the NPC. Because the NPC only holds one national conference each year, its Standing Committee enacts most laws. As for banking laws, the Law on the People's Bank of China (the central bank law) and the Law on Commercial Banks were enacted by the NPC and the Standing Committee of the NPC, respectively, in 1995, and both were amended in 2003.

B. Administrative regulations

Administrative regulations are formulated by the State Council in accordance with the Constitution and laws enacted by the NPC and its Standing Committee. The main purpose of administrative regulations is to implement the laws and deal with the administrative matters within the powers of the State Council, so they are binding on the whole of China, except for Hong Kong Special Administrative Region (SAR), Macau SAR and Taiwan.

C. Local regulations

China's local regions include three forms: provinces, autonomous regions, and municipalities directly under the Central Government, each of which has its own local People's Congress and correspondent Standing Committee. These local People's Congresses and Standing Committees may formulate local regulations, provided such regulations do not conflict with the Constitution, national laws and/or administrative regulations.⁷⁶ In contrast to the nationally binding scope of laws and administrative regulations, local regulations are effective only within the relevant local

⁷⁵ Legislation Law, art.2.

⁷⁶ Legislation Law, art.63.

area. The local congresses at the level of comparatively larger cities in provinces and autonomous regions may also formulate local regulations subject to approval by provincial level congresses.

D. Autonomous regulations and separate regulations

With respect to the political, economic and cultural characteristics of the local nationalities,⁷⁷ local People's Congresses in autonomous areas, including autonomous regions at provincial level and autonomous prefectures or counties at lower level, may formulate autonomous regulations and separate regulations. All of the autonomous regulations and separate regulations must be approved by a higher People's Congress.

E. Rules of departments

Article 71 of the Legislation Law states:

The ministries and commissions of the State Council, *the People's Bank of China*, the State Audit Administration as well as the other organs endowed with administrative functions directly under the State Council may, in accordance with the laws as well as the administrative regulations, decisions and orders of the State Council and within the limits of their power, formulate rules.

Matters governed by the rules of departments shall be those for the enforcement of the laws or the administrative regulations, decisions and orders of the State Council.
(emphasis added)

The binding scope of the rules of departments is similar to that of administrative regulations, that is, the whole territory of China. The two terms, administrative regulations and rules of departments, are easily confused. In fact, administrative regulations (*Xingzheng Fagui* or *Xingzheng Tiaoli*) refer only to regulations issued by the State Council, while rules of departments (*Xingzheng Guizhang* or *Xingzheng Banfa*) refer only to rules issued by departments or ministries under the State Council. Therefore, all measures issued by the PBOC, the CBRC, the China Insurance Regulatory Commission (CIRC) or the China Securities Regulatory Commission (CSRC) should be termed "rules", instead of "regulations".⁷⁸

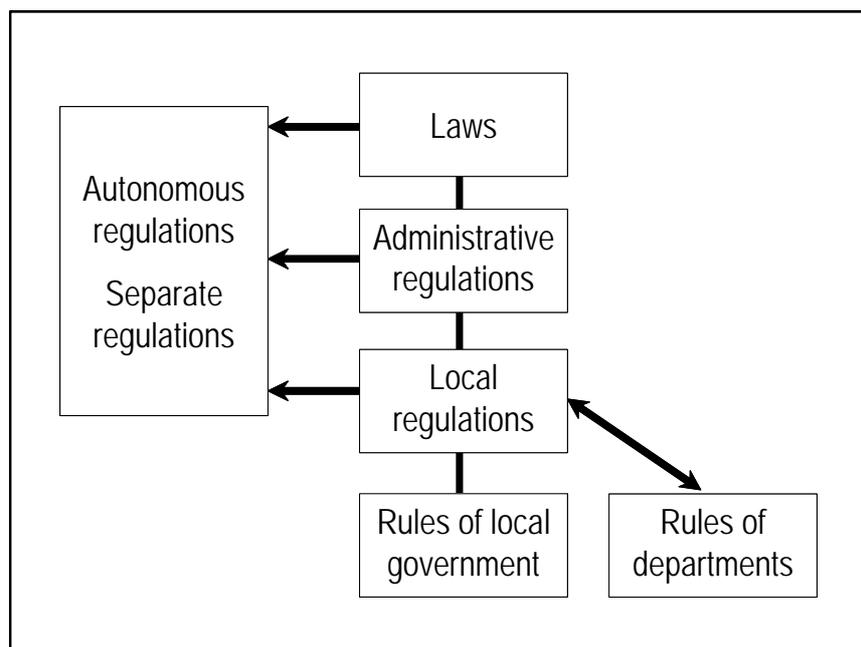
F. Rules of local governments

The local governments of the provinces, autonomous regions, municipalities directly under the Central Government and the comparatively larger cities, may formulate local rules.

⁷⁷ Legislation Law, art.66.

⁷⁸ The US Trade Representative (USTR) misused the term of "regulations" in its report. See USTR 2003 National Trade Estimate Report on Foreign Trade Barriers, p. 64. <http://www.ustr.gov/reports/nte/2003/>. (18 April 2003)

The following chart shows the levels of legal effect for different laws (in the broader meaning discussed above) under China's legal system.

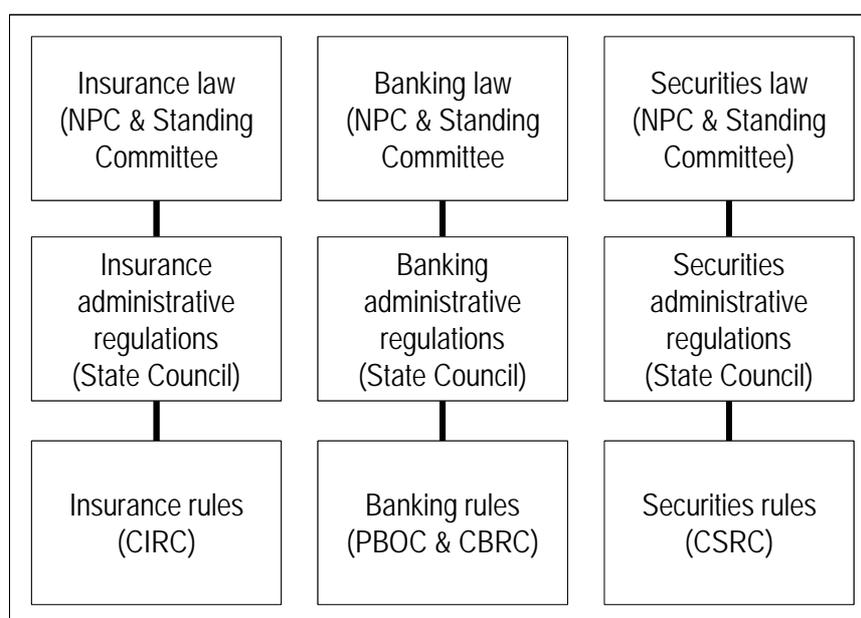


- First, the effect of laws is higher than that of administrative regulations, local regulations, and rules of departments.
- Second, the effect of administrative regulations is higher than that of local regulations and rules of departments.
- Third, the effect of local regulations is higher than that the rules of the local governments.
- Fourth, the effect of the rules of departments and the effect of the rules of local governments is equal. If there is inconsistency between local regulations and rules of departments, the State Council shall take the final decision.⁷⁹
- Fifth, the autonomous regulations and separate regulations shall apply in the autonomous areas concerned in accordance with the laws, administrative regulations and local regulations.

⁷⁹ If the State Council considers that local regulations should be applied, the local regulations shall be applied; if the State Council considers that rules of departments should be applied, the case shall be submitted to the Standing Committee of the NPC for a ruling.

II. Structure Of China's financial services laws

The above-mentioned six forms of law are not all relevant to finance. Given the uniform nature of China's financial market, China's financial laws take mainly three forms, i.e. financial laws, financial administrative regulations and financial rules, and the chart is as follows:



However, it should be noted that, following China's entry to the WTO, many laws, regulations, rules or other measures have been abolished or amended. For example, from the end of 2001 to the end of December 2003, the CSRC, the regulatory authority in China's securities market, announced the abolition of 59 regulations concerning approval requirements for certain operations of market participants in the securities business,⁸⁰ and this abolition and amendment process is still on-going. Therefore, it is necessary to study China's financial laws carefully in order to determine which rule is still valid.

A. Financial laws

The following sections address the major financial laws in the PRC.

1. Banking laws

Nineteen ninety-five was the watershed of China's banking legislation. Before that year, there were no banking laws in the strict sense. In that year, the NPC enacted *Zhongguo Renmin Yinhangfa* (Law on the People's Bank of China), and its Standing Committee enacted *Shangye Yinhangfa* (Law on Commercial Banks). The Law on the PBOC 1995 assigned both banking regulatory powers and money policy functions to the PBOC. However, in March 2003, the 10th NPC decided to separate the banking regulatory function from the PBOC to a

⁸⁰ See <http://www.csrc.gov.cn/CSRCsite/default.htm>

new agency: the China Banking Regulatory Commission (CBRC),⁸¹ thus necessitating the amendment of the Law on the PBOC and the Law on Commercial Banks, as well as other relevant regulations, rules, etc.⁸²

On 27 December 2003, the NPC passed China's first separate banking supervision law, *Yinhangye Jiandu Guanli Fa* (Law on Regulation and Administration of Banking Industry), together with the amendments to the Law on the PBOC (hereinafter referred to as Law on the PBOC 2003) and the Law on Commercial Banks (hereinafter referred to as Law on Commercial Banks 2003), all of which took effect on 1 February 2004. The Law on Commercial Banks 2003 is binding on all commercial banks in China's territory, including wholly-state-owned commercial banks, joint stock commercial banks, city commercial banks, rural cooperative banks, wholly-foreign-funded banks, Sino-foreign joint equity banks,⁸³ branches of foreign commercial banks, etc. According to Article 49 of the Law on Regulation and Administration of Banking Industry and Article 92 of Law on Commercial Banks 2003,⁸⁴ wholly-foreign-funded banks, Sino-foreign joint equity banks and branches of foreign banks shall be governed by the two laws; however, if other laws and administrative regulations provide otherwise, the provisions of those laws and regulations shall be applied. Therefore, with respect to foreign-related banks, the primary legal sources are not the two general banking laws enacted by the NPC, but the special banking laws and regulations. So far, neither the NPC nor the Standing Committee has enacted any special law on foreign-related banks, but there is a special administrative regulation issued by the State Council and relevant rules.

2. Insurance law

Also in 1995, the Standing Committee of the NPC enacted China's first Insurance Law (*Baoxianfa*). At that time, insurance regulation rested with the PBOC. (For example, the PBOC issued *Baoxian Guanli Zanxing Guiding* – the Interim Rules of Administration of Insurance – in 1996, stating that the PBOC was in charge of insurance regulation.⁸⁵) In 1998,

⁸¹ See *Guanyu Guowuyuan Jigou Gaige Fang'an de Jueding* (Decision on Institution Reform of the State Council) by the first Conference of 10th NPC, issued on 10 March 2003.

⁸² *Guanyu Zhongguo Yinhangye Jiandu Guanli Weiyuanhui Luxing Yuan You Zhongguo Renmin Yinhang Luxing de Jiandu Guanli Zhize de Jueding* (Decision on the Exercise of Regulatory Duty by the CBRC in Place of the PBOC), issued by the Standing Committee of the NPC on 26 April 2003.

⁸³ According to the definition of "foreign-funded financial institutions" in the Regulation on Administration of Foreign-Funded Financial Institutions issued by the State Council in 2001, there is no organization of Sino-foreign contractual joint venture banks.

⁸⁴ There is a similar article in the 1995 Law on Commercial Banks (Art. 88).

⁸⁵ See art.65 of Interim Rules of Administration of Insurance. This interim rule was abolished after the CIRC issued the Rules of Administration of Insurance Companies in 2000.

the China Insurance Regulatory Commission (CIRC) was established and the insurance regulatory function was transferred from the PBOC to the CIRC.⁸⁶

Article 148 of the Insurance Law 1995 is similar to Article 92 of the Law on Commercial Banks 2003, stipulating that the establishment of foreign-fund-participated (Waizi Cangu) insurance companies or branches of foreign insurance companies shall be subject to this insurance law, but the laws and regulations specifically related to foreign related insurance companies, if any, shall prevail. In October 2002, the Standing Committee of the NPC amended the Insurance Law 1995 (hereinafter referred to as the Insurance Law 2002),⁸⁷ at least partially to make the law consistent with China's WTO commitments.⁸⁸ For instance, Article 154 of the Insurance Law 2002 replaced Article 148 of the Insurance Law 1995, adding wholly-foreign-funded insurance companies as one of the forms of foreign-invested insurance companies.⁸⁹

3. Securities law

In December 1998, the Standing Committee of the NPC approved *Zhengquanfa* (Securities Law), a law that it had been drafting since the summer of 1992. The Securities Law took effect as of July 1999, but mainly complemented pre-existing securities rules issued by the State Council. Article 6 of the Securities Law formally separates the securities sector from the banking sector by stating: "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."

On 28 October 2003, the NPC Standing Committee enacted the *Zhengquan touzi Jijin fa* (Securities Investment Fund Law), to come into effect as of 1 February 2004.⁹⁰ However, since the Securities Investment Fund Law will not be effective until after the period addressed by this study (end-2003), it will not be reviewed in more detail herein.

⁸⁶ See *Guowuyuan Guanyu Chengli Zhongguo Baoxian Jiandu Guanli Weiyuanhui de Tongzhi* (Notification on the Establishment of the CIRC), *Guofa* [1998], No.37.

⁸⁷ The amended Insurance Law came into force from 1 January 2003.

⁸⁸ See CIRC's chairman's statement, Wu Dingfu, available at <http://www.circ.gov.cn/news/wudingfu.htm>

⁸⁹ According to China's insurance commitments, within two years after China's accession, foreign non-life insurers will be permitted to establish as a wholly-owned subsidiary.

⁹⁰ To establish a fund, a fund management company must apply to CSRC for approval. If approved, the fund management company may start selling fund units to the public. To achieve a valid public offering for a closed-end fund, the fund management company must sell more than 80 percent of the total amount of the units approved by CSRC. For an open-end fund, the fund management company must sell more than the minimum amount of units (as approved by CSRC) to a minimum number of buyers (as stipulated by CSRC). Funds may invest only in listed stocks, bonds and other securities products designated by CSRC. The Securities Investment Fund Law prohibits the use of fund assets for (a) underwriting securities, extending loans, or buying other funds; (b) making equity investments in the fund management company or custodian; and (c) buying securities issued or underwritten by the fund manager's or fund custodian's controlling shareholder.

In mid-1998, prior to the adoption of the Securities Law, the China Securities Regulatory Commission (CSRC) was elevated to ministry-level status. The adoption of the Securities Law further confirmed that the CSRC was to be the sole regulator of China's securities markets, supplanting the PBOC. The CSRC is tasked with regulating all aspects of China's securities markets, including securities issuance and establishment of securities firms and stock exchanges. As such, there are three independent regulators in China's financial services sector: the CSRC, CBRC, and CIRC, with the PBOC assigned some special banking regulatory powers. In addition, the China Ministry of Finance (CMoF), the National Development and Reform Commission (NDRC) and the State Administration on Foreign Exchange (SAFE) also continue to play various roles.

B. Financial administrative regulations

As summarized, there are only three banking laws, one insurance law and one securities law in China, and the articles of each are in fact very simple. In terms of length, the Law on PBOC 2003 has 53 articles;⁹¹ the Law on Commercial Banks 2003 has 95 articles;⁹² the Law on Regulation and Administration of the Banking Industry has 50 articles; the Insurance Law 2002 has 158 articles; and the Securities Law has 214 articles. Considering some of the articles pertain to civil law provisions,⁹³ the articles related to financial regulation are limited. Furthermore, China's legal system is a civil law legal system; therefore, all financial institutions and financial regulators have to rely on written laws, so the simple financial laws are not suitable for financial regulation and financial operation. The best way to supplement these weaknesses is through administrative regulations and rules.

1. Banking administrative regulations

Currently two administrative regulations closely related to China's WTO obligations exist in the banking field. The first is *Waizi Jinrong Jigou Guanli Tiaoli* (Regulation on Administration of Foreign-Funded Financial Institutions), effective 1 February 2002,⁹⁴ and the other is *Jinrong Jigou Chexiao Tiaoli* (Regulations on Revocation of Financial Institutions), effective 15 December 2001.⁹⁵ The former was formulated by the State Council

⁹¹ The 1995 Law on PBOC has 51 articles.

⁹² The 1995 Law on Commercial Banks has 91 articles.

⁹³ For example, Art. 36 of the Law on Commercial Banks 2003 concerns guarantee of loans; Art. 37 of the Law on Commercial Banks 2003 addresses loan contracts; Art. 42 provides that civil liability of borrowers for paying off loans and interest and the time limit for commercial banks to execute mortgage rights. As to insurance, the whole of chapter 2 (insurance contracts) of the Insurance Law 2002 contains civil law articles (in total 60 articles).

⁹⁴ Order of the State Council, No.340.

⁹⁵ Order of the State Council, No.324.

one day after China entered the WTO, replacing the previous version (with the same title) issued in 1994.

2. Insurance administrative regulations

The most important insurance regulation related to China's WTO obligations is *Waizi Baoxian Gongsi Guanli Tiaoli* (Regulation on Administration of Foreign-funded Insurance Companies), which came into force on 1 February 2002.⁹⁶ Under the Regulation, foreign-funded insurance companies may be of three forms: joint venture insurance companies, wholly-foreign-owned insurance companies, and branches of foreign insurance companies.⁹⁷

3. Securities administrative regulations

Since WTO accession and as of 31 December 2003, the State Council had not formulated any securities administrative regulations, although the CSRC has been active.

C. Financial rules

On 16 November 2001, a few days after the signature of the China Accession Protocol, the State Council issued *Guizhang Zhiding Chengxu Tiaoli* (Regulation on the Formulation Procedures of Rules). Article 6 of this Regulation stipulates that the titles of rules (*Guizhang*) are generally named "*Guiding*" (Rule) or "*Banfa*" (Rule),⁹⁸ but not "*Tiaoli*" (Regulation). Financial rules refer to those rules issued by the relevant financial regulators, i.e. the CBRC, the PBOC, the CSRC, and the CIRC.

1. Banking rules

Since the establishment of the CBRC in April 2003, most powers or duties to "issue orders and rules relating to financial regulation" have been transferred from the PBOC to the CBRC.⁹⁹ Therefore, the banking rules in China are mixtures of rules issued by both the PBOC and the CBRC.¹⁰⁰ The power to formulate banking regulatory rules arises from Article 4(1) of

⁹⁶ Order of the State Council, No.336.

⁹⁷ See Art. 2 of Regulation on Administration of Foreign-funded Insurance Companies.

⁹⁸ There is a subtle difference between *Guiding* and *Banfa*. Generally speaking, *Guiding* is suitable for financial activities in part or in whole; *Banfa* is suitable for detailed rules on financial activities. See art. 8 of *Jinrong Yewu Jiben Guizhang Zhiding Chexu Guiding Shixing* (Interim Rules on the Formulation Procedures of Basic Financial rules), issued by the PBOC in 1991. See also art. 3 of Rules on the Formulation Procedures of Insurance Administration Rules. It is difficult to find counterpart terms for "*Guiding*" and "*Banfa*" in English, so a general term "rule" is adopted here.

⁹⁹ See para. 1 of the Decision on the Exercise of Regulatory Duty by the CBRC in Place of the PBOC issued by the Standing Committee of the NPC on 26 April 2003. See also No. 1 Proclamation issued by the CBRC in 2003, para. 1 "Main Duties of the CBRC".

¹⁰⁰ Some banking regulatory powers remain in the PBOC by the Law on the PBOC 2003, for example, the function of supervising the inter-bank borrowing or lending market and inter-bank bonds markets, administering foreign exchange, and supervising inter-bank foreign exchange market, supervising gold market, maintaining the normal operation of the payment and settlement systems. See Art. 4 (4) (5) (6) (9) of the Law on the PBOC

the Law on the PBOC 2003, stipulating that one of the duties of the PBOC is to “issue orders and rules relating to the performance of its functions.” Further, Article 15 of the Law on Regulation and Administration of the Banking Industry states: “In accordance with the law and the administrative regulations, the banking regulatory institution of the State Council shall formulate and issue rules governing the supervision over banking institutions and their operations.”¹⁰¹ This situation adds difficulty to finding relevant banking regulatory rules considering the huge numbers of rules which had been issued by the PBOC. The CBRC has recognized the problem and begun to sort out the more than 2000 existing PBOC rules.

The forms of banking rules include “*Guiding*”, “*Banfa*”, “*Shishi Xize*” (Detailed Rules of Implementation), etc.¹⁰²

Table 1

Banking rule title (Chinese Pinyin)	Banking rule title (English)	Issue date	Effective date	Document number
<i>Jinrong Zulin Gongsi Guanli Banfa</i>	Rules on Administration of Financial Leasing Companies	30 June 2000	30 June 2000	PBOC Order [2000] No.4
<i>Waizi Jinrong Jigou Guanli Tiaoli Shishi Xize</i>	Detailed Rules for Implementation of Regulation on Administration of Foreign-Funded Financial Institutions (DRI)	29 January 2002	1 February 2002	PBOC Order [2002] No.1.
<i>Shangye Yinhang Zhongjian Yewu Zanxing Guiding</i>	Interim Rules on Intermediary Business of Commercial Banks	21 June 2001	21 June 2001	PBOC Order [2001] No.5.
<i>Wangshang Yinhang Yewu Guanli Zanxing Banfa</i>	Interim Rules on Internet Banking Business	29 June 2001	29 June 2001	PBOC Order [2001] No.6
<i>Shangye Yinhang Sheli Tongcheng Yingye Wangdian Guanli Banfa</i>	Rules on Administration of Establishment of Operation Networks in the Same City by Commercial Banks	10 February 2002	11 March 2002	PBOC Order [2002] No.3
<i>Shangye Yinhang Xinxi Pili Zanxing Banfa</i>	Interim Rules on Information Disclosure of Commercial Banks	15 May 2002	15 May 2002	PBOC Order [2002] No.6

/table continues

2003. See also Art. 32 of the Law on the PBOC 2003 (stipulating that the PBOC has the power to make inspection and supervision on financial institutions for some acts).

¹⁰¹ Art. 21 of the Law on Regulation and Administration of Banking Industry provides that the rules for prudent operations governing banking institutions may be provided for in the laws and administrative regulations, and also may also be formulated by the banking regulatory institution of the State Council.

¹⁰² See art. 8 of *Jinrong Yewu Jiben Guizhang Zhiding Chexu Guiding Shixing* (Interim Rules on the Formulation Procedures of Basic Financial rules), issued by PBOC in 1991, *Yinfa* [1991] No.166.

Banking rule title (Chinese Pinyin)	Banking rule title (English)	Issue date	Effective date	Document number
<i>Waizi Jinrong Jigou Zhuhua Daibiao Jigou Guanli Banfa</i>	Rules on Administration of Representative Offices of Foreign-Funded Financial Institutions in China	13 June 2002	18 July 2002	PBOC Order [2002] No.8
<i>Jinrong Xukezheng Guanli Banfa</i>	Rules on Administration of Financial Licenses	31 May 2003	1 July 2003	CBRC Order [2003] No.2
<i>Qiche Jinrong Gongsi Guanli Banfa</i>	Administrative rules governing auto financing company	3 October 2003	3 October 2003	CBRC Order [2003] No.4
<i>Qi Che Jinrong Gongsi Guanli Banfa Shishi Xize</i>	Detailed Rules for Implementing Administrative Rules Governing Auto Financing Company	12 November 2003	12 November 2003	Unavailable
<i>Jingwai Jinrong Jigou Touzi Rugu Zhongzi Jinrong Jigou Guanli Banfa</i>	Rules on Administration of Overseas Financial Institutions Investing Chinese-Funded Financial Institutions	8 December 2003	31 December 2003	CBRC Order [2003] No.6
<i>Jinrong Xukezheng Guanli Banfa</i>	Rules on Administration of Financial Licenses	31 May 2003	1 July 2003	CBRC Order [2003] No.2

All of these rules are applicable to both domestic-funded banks and foreign-funded banks.¹⁰³ This reflects a trend that, after WTO entry, China has paid attention to national treatment considerations and is endeavoring to apply the same rules to foreign-funded banks and domestic-funded banks.

Rules related to the WTO contain not only new rules, but also old rules published before China's entry to the WTO. In August 1994, the PBOC issued *Jinrong Jigou Guanli Guiding* (Rules on Administration of Financial Institutions), applicable mainly to domestic banks.¹⁰⁴ This administrative rule was not replaced by the Law on Commercial Banks 1995,¹⁰⁵ and is still effective to the extent not inconsistent with the Law on Commercial Banks 2003. This rule is an important banking regulatory measure for domestic commercial banks, supplemental to the Law on Commercial Banks 2003.

¹⁰³ See art. 2 of the Interim Rules on Intermediary Business of Commercial Banks. See also art. 2 of the Interim Rules on Internet Banking Business; art. 2 of the Rules on Administration of Establishment of Operation Networks in the Same City by Commercial Banks; art. 2 of Interim Rules on Information Disclosure of Commercial Banks.

¹⁰⁴ *Yinfa* [1994] No.198, issued and effective on 9 August 1994. See art. 3 of the Rules on Administration of Financial Institutions; art. 63 (stating that "PBOC will formulate other rules applicable to foreign-funded financial institutions")

¹⁰⁵ In a PBOC reply to an enquiry, PBOC clearly indicated that non-conflicting regulations and rules with the 1995 Law on Commercial Banks shall be enforced. See the Reply to the enquiry of execution of Law on Commercial Banks and the Rules on Administration of Financial Institutions, PBOC (Legal Department) No. 26, 1995.

2. Insurance rules

In accordance with Article 2 of *Baoxian Gongsì Guanli Guiding* (Rules on Administration of Insurance Companies),¹⁰⁶ the CIRC is entitled to supervise insurance companies by the authorization of the State Council.¹⁰⁷ The first duty of the CIRC granted by the State Council is “to formulate policies and rules concerning commercial insurance”.¹⁰⁸ For the purpose of formulating insurance rules, the CIRC formulated a special rule on how to formulate insurance administrative rules, “*Boxian Xingzheng Guizhang Zhiding Chengxu de Guidin*” (Rules on the Formulation Procedures of Insurance Administration Rules),¹⁰⁹ by which such rules generally take the name of “*Guiding*” (rule), “*Banfa*” (rule), or “*Shishi Xize*” (detailed rules of implementation).¹¹⁰ From 1999, the CIRC has published the following WTO-related insurance rules.

Table 2

Insurance rule title (Chinese Pinyin)	Insurance rule title (English)	Issue date	Effective date	Document number
<i>Baoxian Gongsì Touzi Zhengquan Touzi Jijin Guanli Zanxing Banfa</i>	Interim Rules on Administration of Investment in Securities Investment Fund by Insurance Companies	29 October 1999	29 October 1999	<i>Baojianfa</i> [1999] No.206. This rule was slightly amended in 2000, <i>Baojianfa</i> [2000] No.96
<i>Waizi Baoxian Jigou Zhuhua Daibiao Jigou Guanli Banfa</i>	Rules on Administration of Representative Offices of Foreign Insurance Companies	26 November 1999	26 November 1999	<i>Baojianfa</i> [1999] No.225
<i>Baoxian Gongsì Guanli Guiding</i>	Rules on Administration of Insurance Companies	3 January 2000	1 March 2000	<i>Baojianfa</i> [2000] No.2
<i>Xiang Baoxian Gongsì Touzi Rugu Zanxing Guiding</i>	Interim Rules on Investment in Insurance Companies	1 April 2000	1 April 2000	<i>Baojianfa</i> [2000] No.49. This rule amended <i>Baojianfa</i> [1999] No.270.

/table continues

¹⁰⁶ This rule was published by CIRC in January 2000.

¹⁰⁷ See art. 10 of Organic Law of the State Council (1982).

¹⁰⁸ See *Guowuyuan Guanyu Chengli Zhongguo Baoxian Jiandu Guanli Weiyuanhui de Tongzhi* (Notification on the Establishment of CIRC), *Guofa* [1998], No.37.

¹⁰⁹ *Baojianfa* [1999] No.111.

¹¹⁰ “*Guiding*” is suitable for insurance regulation or insurance activities in part, while “*Banfa*” is suitable for detailed rules on insurance regulation or insurance activities; Detailed Implementation Rule is suitable for a complete and detailed rules for the enforcement or operation of one particular law or regulation. See art. 3 of Rules on the Formulation Procedures of Insurance Administration Rules.

Insurance rule title (Chinese Pinyin)	Insurance rule title (English)	Issue date	Effective date	Document number
<i>Baoxian Gonggu Jigou Guanli Guiding</i>	Rules on Administration of Insurance Assessors	16 November 2001	1 January 2002	CIRC Order [2001] No.3 Some articles of this rule was amended in 2002 in order to be inconsistent with the WTO.
<i>Baoxian Daili Jigou Guanli Guiding</i>	Rules on Administration of Insurance Agencies	16 November 2001	1 January 2002	CIRC Order [2001] No.4
<i>Baoxian Jingji Gongsi Guanli Guiding</i>	Rules on Administration of Insurance Brokers	16 November 2001	1 January 2002	CIRC Order [2001] No.5
<i>Zaibaoxian Gongsi Sheli Guiding</i>	Rules on Establishment of Reinsurance Companies	17 September 2002	17 September 2002	CIRC Order [2002] No.4

1. Securities rules

Pursuant to Article 167(1) of the Securities Law, the CSRC is empowered to formulate rules and regulations related to regulation of China's securities sector,¹¹¹ a power recently confirmed by the State Council.¹¹² The CSRC issued *Zhengquan Gongsi Guanli Banfa* (Rules on Administration of Securities Companies)¹¹³ applicable to all securities companies, domestic and foreign, registered in China.¹¹⁴ Article 3 of the Rules on Administration of Securities Companies state that the CSRC shall be responsible for examining and approving the establishment, conversion, and termination of securities companies in a unified way, and fulfilling the regulatory obligations for such companies according to law.

The special securities rules directly related to the WTO are shown in the next table.

¹¹¹ See art. 167 (1) of the Securities Law.

¹¹² See art. 2 (1) of CIRC *Zhineng Peizhi Neishe Jigou he Renyuan Bianzhi Guiding* (Rules on CSRC's Functions, Internal Institutions and Personnel Arrangement), *Guobanfa* [1998] No.131.

¹¹³ Rules on Administration of Securities Companies was issued on 28 December 2001, came into force on 1 March 2002.

¹¹⁴ See art. 2 of Rules on Administration of Securities Companies.

Table 3

Securities rule title Chinese Pinyin)	Securities rule title(English)	Issuing date	Effective date	Document number
<i>Guowuyuan Zhengquan Weiyuanhui Zhengquan Jingying Jigou Gupiao Chengxiao Yewu Guanli Banfa</i>	State Council Securities Commission, Administration of Share Distribution by Securities Firms Procedures	17 June 1996	17 June 1996	<i>Zhengweifa [1996] No. 18</i>
<i>Jingnei ji Jingwai Zhengquan Jingying Jigou Congshi Waizigu Yewu Zige Guanli Zanxing Guiding</i>	State Council Securities Commission, Tentative Measures of Administration of Qualifications of Domestic and Foreign Securities Trading Institutions for Engagement in Foreign Investment Shares Business	23 October 1996	1 December 1996	<i>Zhengjian [1996] No. 5</i>
<i>Zhengquan Jingying Jigou Zhengquan Ziying Yewu Guanli Banfa</i>	China Securities Regulatory Commission, Administrative Measures of Securities Trading Institutions Operating Business for Their Own Accounts	23 October 1996	23 October 1996, except for Article 20 (1 February 1997)	<i>Zhengjian [1996] No. 6</i>
<i>Zhengquan Jingying Jigou Gaoji Guanli Renyuan Renzhi Zige Guanli Zanxing Banfa</i>	Interim Rules on Administration of Qualification of Senior Officials in Securities Operation Institutions	11 November 1998	11 November 1998	<i>Zhengjianjizi [1998] No.46.</i> This rule was supplemented by a notification of CSRC <i>Zhengjianjigou zi [2001] No.240</i>
<i>Waiguo Zhengquanlei Jigou Zhuhua Daibiao Jigou Guanli Banfa</i>	Rules on Administration of Representative Offices of Foreign Securities Institutions in China	21 April 1999	21 April 1999	N/A
<i>Baoxian Gongs Touzi Zhengquan Touzi Jijin Guanli Zhanxing Banfa</i>	Interim Measures on Administration of Investment in Securities Investment Fund by Insurance Companies	29 October 1999	29 October 1999	<i>Baojianfa [1999] No.206</i>
<i>Shangshi Gongs Faxing Kezhuanhuan Gongs Zhaiquan Shishi Banfa</i>	Implementing Measures on Convertible Bonds by Listed Companies Implementing Procedures	26 April 2001	26 April 2001	CSRC Order [2001] No.2

/table continues

Securities rule title Chinese Pinyin)	Securities rule title(English)	Issuing date	Effective date	Document number
<i>Zhengquan Gongsi Guanli Banfa</i>	Rules on Administration of Securities Companies	28 December 2001	1 March 2002	CSRC Order [2001] No.5
<i>Waizi Cangu Zhengquan Gongsi Sheli Guize</i>	Rules for Establishing Foreign-invested Securities Companies	1 June 2002	1 July 2002	CSRC Order [2002] No.8
<i>Waizi Cangu Jijing Guanli Gongsi Sheli Guize</i>	Rules for Establishing Foreign-Invested Fund Management Companies	1 June 2002	1 July 2002	CSRC Order [2002] No.9
<i>Shangshi Gongsi Shougou Guanli Banfa</i>	Administrative Measures of the Takeover of Listed Companies Procedures	28 September 2002	1 December 2002	CSRC Order [2002] No.10
<i>Hege Jingwai Jigou Touzizhe Jingnei Zhengquan Touzi Guanli Zanxing Banfa</i>	Interim Rules on Administration of Securities Investment of Qualified Foreign Institutional Investors in China	5 November 2002	1 December 2002	CSRC Order [2002] No.12
<i>Zhengquanye Congye Renyuan Zige Guanli Banfa</i>	Administration Measures of the Qualifications of Personnel Engaged in the Securities Industry	16 December 2002	1 February 2003	CSRC Order [2002] No.14
<i>Zhengquan Gongsi Dingxiang Faxing Zhaiquan Xinxi Pilu Zhunze</i>	Rules for the Information Disclosure in the Directional Issuance of Bonds by Securities Companies	29 August 2003	8 October 2003	<i>Zhengjianfa</i> [2003] No. 106

D. Financial notifications or other measures

One of characteristics of China's legal system is the existence of a great number of notifications, replies, proclamations, decisions or other measures,¹¹⁵ which should not be ignored as they often "amend" or "supplement" higher level administrative regulations and/or rules. Sometimes, the notifications, replies, etc. are deemed to be confidential information available only to insiders, which will inevitably annoy outsiders, especially foreigners, as well as domestic scholars. However, these kinds of measures are often unstable and changeable, complicated and confusing, sometimes elusive, or even partly dependent on the preference or taste of the leader of a supervision authority. During the negotiations relating to China's entry to the WTO, some Members expressed concern about the lack of transparency regarding the laws, regulations and other measures that applied to matters covered in the WTO Agreement. In particular, some Members noted the difficulty in finding and obtaining copies of regulations and other measures undertaken by various ministries as well as those taken by provincial and other local

¹¹⁵ Here a measure means a detailed order or method (*Cuoshi*), not a rule (*Guizhang*).

authorities.¹¹⁶ Although China promised that none of the information required by the WTO Agreement or the China Accession Protocol to be disclosed would be withheld as confidential information except for very special reasons,¹¹⁷ it is still difficult to access all the relevant measures affecting trade in financial services.

Before going further, it is necessary to clarify the concept of “measure”. According to Article XXVIII(a) of the GATS, “measure” means any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or *any other form*. (emphasis added) “Any other form” is an all-inclusive expression.

Part I:2(2) of the China Accession Protocol states :

China shall apply and administer in a uniform, impartial and reasonable manner all its *laws, regulations and other measures* of the central government as well as *local regulations, rules and other measures* issued or applied at the sub-national level (collectively referred to as “*laws, regulations and other measures*”) pertaining to or affecting trade in goods, services, trade-related aspects of intellectual property rights (“TRIPS”) or the control of foreign exchange. (emphases added)

The expression in the China Accession Protocol implies that “measure” includes any measure, such as a law, regulation, rule, procedure, decision, administrative action, etc., which echoes the definition in the GATS. From the expression in the China Accession Protocol, “laws, regulations” are parallel to “other measures”, so “other measures” include any measures “pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange”, except for laws and regulations.

The Legislation Law only adopts three forms, i.e. laws, regulations and rules. Does this mean that “rules” are the same as “other measures”? The answer is no. The domain of “rules” is narrower than that of “other measures”. In other words, “rules” are part of “other measures”, not the whole. For example, “notification” is not included in the Legislation Law as a legal form, but in fact a ministerial notification has the same legal effect as a rule, and in most cases, a rule is amended through a notification. The most significant problem in relation to “notification” is lack of transparency because a notification is issued to the particular parties to be notified, not to the public, but the legal effect of the notification is not always precisely predictable, especially for potentially affected parties, like foreign banks. Since China has undertaken that only those laws, regulations and other measures “that are published and readily available to other WTO Members, individuals and enterprises” can be enforced, it is China’s obligation to publish all notifications or similar measures affecting trade in financial services.¹¹⁸

¹¹⁶ See para.324 of the Working Party Report

¹¹⁷ See para.333 of the Working Party Report.

¹¹⁸ See Part I:2 (C) of the China Accession Protocol.

1. Other banking measures

The following table summarizes other banking measures.

Table 4

Title (Chinese Pinyin)	Title (English)	Issue date	Effective date	Document number
<i>Guanyu Jiejue Waizi Yinhang Chao Guomin Daiyu Wenti Zhengce Jianyi de Han</i>	Recommendation Letter for Resolving the Issue of Super-National-Treatment to Foreign-Funded Banks	12 March 2001	12 March 2001	<i>Yinfa</i> [2001] No.69.
<i>Guanyu Waizi Jinrong Jigou Shichang Zhunru Youguan Wenti de Gonggao</i>	Proclamation by the PBOC on the Related Issues of Foreign-Funded Financial Institutions' Market Access	9 December 2001	9 December 2001	PBOC Proclamation [2001] No.1
<i>Guanyu Waizi Jinrong Jigou Guanli Tiaoli Shishi Xize Banbuhou Waizi Jinrong Jigou Shichang Zhunru Youguan Wenti de Tongzhi</i>	Notification on Relevant Issues on Market Access of Foreign-Funded Financial Institutions after Publication of the Regulation on Administration of Foreign-Funded Financial Institutions	29 January 2002	29 January 2002	<i>Yinfa</i> [2002] No.22
<i>Guanyu Waizi Yinhang yu Taiwan Diqu Shangye Yinhang Jianli Zhijie Yewu Wanglai Guanxi de Tongzhi</i>	Notification on Establishment of Direct Business Relation between Foreign-Funded Banks and Commercial Banks in Taiwan District	28 November 2002	28 November 2002	<i>Yinfa</i> [2002] No.361
<i>Guanyu Luoshi Shangye Yinhang Zhongjian Yewu Zanxing Guiding Youguan Wenti de Tongzhi</i>	Notification on Relevant Issues of Implementation of Interim Rules on Intermediary Business of Commercial Banks	10 April 2002	10 April 2002	<i>Yinfa</i> [2002] No.89 This notification supplemented the Interim Rules on Intermediary Business of Commercial Banks
<i>Guanyu Luoshi Wangshang Yinhang Yewu Guanli Zanxing Banfa Youguan Guiding de Tongzhi</i>	Notification on Relevant Issues of Implementation of Interim Measures on Internet Banking Business	24 April 2002	24 April 2002	<i>Yinfa</i> [2002] No.102 This notification supplemented Interim Measures on Internet Banking Business

*/table
continues*

Title (Chinese Pinyin)	Title (English)	Issue date	Effective date	Document number
<i>Guanyu Waizi Yinhang Yewu Zhunru Zhidu he Chengxu Youguan Wenti de Tongzhi</i>	Notification on Relevant Issued of Market Access and Procedures of Foreign-Funded Banks	18 October 2002	18 October 2002	<i>Yinfa</i> [2002] No.323 This notification supplemented Regulation on Administration of Foreign-Funded Financial Institutions, as well as its DRI
<i>Guanyu Shangye Yinhang Shenqing Congshi Hege Jingwai Jigou Touzizhe Jingnei Zhengquan Touzi Tuoguan Yewu Youguan Wenti de Tongzhi</i>	Notification on Relevant Issued of the Application of the Business of Custody of Securities Investment of Qualified Foreign Institutional Investors in China	11 December 2002	11 December 2002	<i>Yinfa</i> [2002] No.371 supplementing Interim Rules on Administration of Securities Investment of Qualified Foreign Institutional Investors in China
<i>Guanyu Tiaozheng Yinhang Shichang Zhunru Guanli Fangshi he Chengxu de Jueding</i>	Decision on Adjusting Administrative Ways and Procedures for Banking Market Access	29 May 2003	1 July 2003	CBRC Order [2003] No.1
<i>Shangye Yinhang Jituan Kehu Shouxin Yewu Fengxian Guanli Zhiyin</i>	Guideline for Administration of Credit-granting Risks for Group Customers	23 October 2003	23 October 2003	CBRC Order [2003] No.5
<i>Guanyu xiang Waizi Jinrong Jigou Jinyibu Kaifang Renminbi yewu de Gonggao</i>	Proclamation on Further Opening RMB Business for Foreign-Funded Financial Institutions	24 October 2003	24 October 2003	CBRC Proclamation [2003] No.2

2. Other insurance measures

The following table summarizes other insurance measures.

Table 5

Title (Chinese Pinyin)	Title (English)	Issue date	Effective date	Document number
<i>Guanyu Baoxian Gongs Ziben Baozhengjin Cunfang Shangye Yinhang Youguan Guiding de Tongzhi</i>	Notification on Relevant Issues of Insurance Companies' Capital Deposit for Security in Commercial Banks	9 January 2001	9 January 2001	<i>Baojianfa</i> [2001] No.6
<i>Guanyu Jiaqiang dui Baoxian Gongs Sheli Fenzhi Jigou Guanli de Tongzhi</i>	Notification on Enhancement of Administration of Establishment of Branches of Insurance Companies	14 December 2001	14 December 2001	<i>Baojianfa</i> [2001] No.199
<i>Guanyu Guifan Zhongzi Baoxian Gongs Xishou Waizi Cangu Youguan Shixiang de Tongzhi</i>	Notification on Relevant Issues of Guiding Participation of Foreign Capital in Chinese-Funded Insurance Companies	19 June 2001	19 June 2001	<i>Baojianfa</i> [2001] No.126
<i>Guanyu Baoxian Daili Gongs Baoxian Gonggu Gongs Shenpi Chengxu de Gonggao</i>	Proclamation of Approval Procedures for Insurance Agencies and Insurance Assessors	13 September 2001	13 September 2001	CIRC Proclamation [2001] No.30
<i>Guanyu Daxing Shangye Baoxian he Tongkuo Baodan Yewu Youguan Wenti de Tongzhi</i>	Notification on Relevant Issues of Large Scale Commercial Insurance and Master Policy Insurance Business	11 February 2002	20 February 2002	<i>Baojianfa</i> [2002] No.16. This notification was supplemented by a further notification, <i>Baojianfa</i> [2002] No.32
<i>Guanyu Xiugai Baoxian Gongs Guanli Guiding Youguan Tiaowen de Jueding</i>	Decision on Amending Relevant Provisions of Rules on Administration of Insurance Companies	15 March 2002	15 March 2002	CIRC Order [2002] No.3
<i>Guanyu Xiugai Baoxian Gongs Gaoji Guanli Renyuan Renzhi Zige Guanli Guiding Youguan Tiaowen de Jueding</i>	Decision on Amending Relevant Provisions of Rules on Administration of Qualification of Senior Officials in Insurance Companies	3 July 2003	3 July 2003	CIRC Order [2003] No.2
<i>Guanyu Luxing Youguan Rushi Chengnuo de Gonggao</i>	Proclamation of Performing Relevant WTO Commitments	11 December 2003	11 December 2002	CIRC Proclamation [2003] No.59

3. Other securities measures

The following table summarizes other securities measures.

Table 6

Title (Chinese Pinyin)	Title (English)	Issue date	Effective date	Document number
<i>Guanyu Jinyibu Jiaqiang Zhengquan Gongsijianguan de Ruogan Yijian</i>	Relevant Opinions on Enhancing Supervision of Securities Companies	16 March 1999	16 March 1999	<i>Zhengjianjigouzi</i> [1999] No.14
<i>Guanyu Zhengquan Gongsizengzi Kuoguyouguan Wenti de Tongzhi</i>	Notification on Relevant Issues of Adding Capital and Shares in Securities Companies	23 November 2001	23 November 2001	<i>Zhengjianfa</i> [2001] No.146
<i>Guanyu Jijin Guanli Gongsishi Shenhe Chengxuyouguan Wenti de Tongzhi</i>	Notification on Relevant Issues of Approval Procedures of Establishment of Fund Management Companies	7 January 2002	7 January 2002	<i>Zhengjianjijinzi</i> [2002] No.1
<i>Guanyu Tiaozheng Zhengquan Jiaoyi Yongjin Shoufei Biaozhun de Tongzhi</i>	Notification on Adjusting the Standard of Commission Charges for Securities Trading	4 April 2002	1 May 2002	N/A
<i>Guanyu Zhengquan Touziji jin Sheli Shenhe Youguan Wenti de Tongzhi</i>	Notification on Questions Relevant to the Examination and Approval for the Establishment of Securities Investment Funds	26 November 2002	26 November 2002	<i>Zhengjianjijinzi</i> [2002] No.89
<i>Guanyu Diyipi Quxiao Xingzheng Shenpi Xiangmu de Tongzhi</i>	Notification on Abolishment of the First Batch of Items Related to Administrative Examination and Approval	21 December 2002	21 December 2002	N/A
<i>Guanyu Dierpi Quxiao Xingzheng Shenpi Xiangmu Ji Gaibian Bufen Shenpi Xiangmu Guanli Fangshi de Tongzhi</i>	Notification on Abolishment of the Second Batch of Items Related to Administrative Examination and Approval and Change of Administrative Methods for Some Items	1 April 2003	1 April 2003	N/A

In addition to the above financial measures issued by financial regulators, there are various local rules concerning financial regulation.¹¹⁹ Given the small number and relative unimportance of such local rules, they are not considered in this study.

¹¹⁹ The PBOC branches in China's territories have the right to formulate some concrete administrative rules in line with financial regulations and rules. See the Reply to the Issue of Legal Effect of Those Rules by PBOC Branches at Provincial Levels. *Yinfu* [1991] No.379, *Yinfu* [1992] No.390.

III. Financial regulation in China in the context of its WTO commitments and obligations

Following WTO accession, China has been active in amending and enacting laws and other legal instruments relating to trade in financial services.

A. Change and development: compliance

After China's entry to the WTO, the State Council immediately issued a new Regulation on Administration of Foreign-funded Financial Institutions (the Regulation 2001),¹²⁰ replacing the Regulation 1994. Furthermore, the PBOC issued new Detailed Rules for Implementation of Regulation on Administration of Foreign-funded Financial Institutions (the DRI 2002),¹²¹ in place of the DRI 1996. Comparing the Regulation 2001 with the Regulation 1994 and the DRI 2002 with the DRI 1996, one can easily find that the new Regulation and DRI, as a whole, are more compliant with GATS/WTO rules, despite certain problems. The following two tables summarize the details of the changes.

¹²⁰ State Council Order, No.340.

¹²¹ PBOC Order [2002] No.1.

Table 7: Comparison of the 1994 and 2001 regulations

Regulation 1994	Regulation 2001	Comments
Art. 2. The geographic area of FFFI shall be determined by the State Council.	None.	Geographic limitation will be eliminated step by step according to China's Schedule, so it is not necessary to incorporate Art.2 of the Regulation 1994 in the new one.
Art.5. Minimum registered capital for FFB and JEB is RMB300m in freely convertible currency; the actual received capital shall not be less than 50% of the registered capital.	Art. 5. Minimum registered capital for FFB or JEB is RMB300 million in freely convertible currency; the registered capital shall be paid-up capital.	Registered capital requirements are the same, but the Regulation 1994 is not as strict as the Regulation 2001 with respect to actually received capital. However, the Regulation 2001 has the same requirement as Law on Commercial Banks regarding paid-up capital.
Art. 5. FBB shall receive from head office non-callable allocation of at least RMB100m as operating capital.	Art. 5. FBB shall receive from head office non-callable allocation of at least RMB100m as operating capital.	Same.
Art. 6. To set up FFB: <ul style="list-style-type: none"> • Applicant must be financial institution. • Rep. office in China for over 2 years. • Total assets US\$10 billion. • Effective supervision in home country. 	Art. 6. To set up FFB or FFFC: <ul style="list-style-type: none"> • Applicant must be financial institution. • Rep. office in China for over 2 years. • Total assets US\$10 billion. • Effective supervision in home country. • Home country approval of application. • Other PBOC prudential requirements. 	The Regulation 2001 is more complete regarding prudential measures. It does not mean that the Regulation 2001 is stricter or inconsistent with the WTO.
Art.7. To set up FBB: <ul style="list-style-type: none"> • Rep. office in China for two years. • Total assets US\$20 billion. • Effective supervision in home country. 	Art. 7. To set up FBB: <ul style="list-style-type: none"> • Rep. office in China for two years. • Total assets US\$20 billion. • Effective supervision in home country. • Home country approval of application. • Other PBOC prudential requirements. 	The Regulation 2001 is more complete regarding prudential measures. It does not mean that the Regulation 2001 is stricter or inconsistent with the WTO.

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Regulation 1994	Regulation 2001	Comments
<p>Art.8 to set up JEB:</p> <ul style="list-style-type: none"> • Each party must be financial institution. • Foreign partner has set up representative office in China. • Total assets of foreign partner not less than US\$10 billion. • Complete financial regulatory system of home country. <p>Art. 13-15. The initial examination period is 90 days. Applicant must fill in the formal application form within 60 days. There was no formal examination period limitation. No stage of preparation for establishment.</p>	<p>Art.8 To set up JEB:</p> <ul style="list-style-type: none"> • Foreign partner should be financial institution. • Foreign partner has set up representative office in China. • Total assets of foreign partner not less than US\$10 billion. • Effective supervision in home country. • Home country approval of application. • Other PBOC prudential requirements. <p>Art. 13-15. Formal application form for application for FFFI to be issued within six months (nine in exceptional circumstances) of application. Applicant to complete within six months (three month extension possible), failing which application invalid. The PBOC to decide within two months of receiving formal application.</p>	<p>The Regulation 2001 accords Chinese party more favorable treatment regarding qualification of investors, i.e. a non-financial institution can be a party of a JEB.</p> <p>As for effective supervision and home country approval, the Regulation 2001's requirements are normal.</p> <p>It seems that the application procedures of the Regulation 1994 are simpler for FFFI, but given domestic banks' application procedures, the Regulation 2001 is fundamentally consistent with national treatment.</p> <p>However, because there was no clear examination period requirement for the PBOC in the Regulation 1994, the PBOC had unlimited discretion to make a decision, perhaps more than two months. On this point, the Regulation 2001 is better regarding two months examination period.</p>
None.	<p>Art. 20. To conduct local currency business FFFI:</p> <ul style="list-style-type: none"> • Must have operated in China for three years. • Been profitable for last two years. 	Art. 20 of the Regulation 2001 is in China's Schedule.
Art. 24. 30% of operating capital of FBB must be in interest-bearing assets as prescribed by the PBOC.	Art. 24. 30% of operating capital of FBB must be in interest-bearing assets as prescribed by the PBOC.	Same.
None.	Art.25. Capital Adequacy Ratio of FFB, JEB, not less than 8%.	In 1994, capital adequacy ratio was not yet in use in China. 8% capital adequacy ratio in the Regulation 2001 is normal for prudential regulation purpose, and consistent with national treatment.

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Regulation 1994	Regulation 2001	Comments
Art. 25. Total assets of FFB, JEB, FFFC and JEFC cannot exceed 20 times of actually-received capital plus reserves.	None.	The Regulation 2001 eliminated the limitation; so new one is more open.
Art. 26. FFB and JEB may not lend more than 30% of actually-received capital plus reserves to one enterprise and associated enterprises, unless approved by the PBOC.	Art. 26. FFB and JEB may not lend more than 25% of capital to any one enterprise and associated enterprises without PBOC approval.	The Regulation 2001 reduces the lending percentage, but just by 5%, and 25% is better than that applying to domestic banks (10%), therefore not in violation of national treatment.
Art. 28. Fixed assets owned by FFB and JEB are not to exceed 40% of its actually received capital and reserves.	Art. 27. Fixed assets owned by FFB, JEB are not to exceed 40% of its equity.	Almost the same.
None.	Art. 28. Ratio of share of RMB assets in capital to share of RMB assets in risk assets not less than 8% for FFB, JEB. For FBB, ratio of share of RMB assets in total amount of operating capital plus reserves to share of RMB assets in risk assets not less than 8%	Art. 28 of the Regulation 2001 could be argued as prudential measures.
Art. 29. FFFI must ensure the liquidity of its assets. Art. 22 of DRI (1996), FFFI must ensure that current assets must not be less than 25% of total amount of deposit.	Art. 29. Ratio of current assets to current liabilities not less than 25%.	Almost the same (total amount of deposit is similar to current liabilities). But 25% is the same as for domestic banks, so consistent with national treatment.
Art. 30. Total deposits taken in China by FFFI may not exceed 40% of its total assets in China.	Art. 30. Total of foreign exchange deposits taken in China by FFFI may not exceed 70% of its total foreign exchange assets in China.	There is no percentage limitation for RMB deposit taken from China.
Art.33. FFFI should employ at least one Chinese citizen as a senior management official.	None.	The Regulation 2001 eliminated the limitation, so the senior management officials could be all foreigners.

/table continues

Regulation 1994	Regulation 2001	Comments
<p>Art. 35 of 1994 Regulation only mentioned the establishment of branches of wholly-foreign-owned banks and JEB in China must register, but did not provide any requirements for their establishment. In 1996, PBOC issued Interim Rules on Establishment of Branches of Foreign-funded Banks in China. Art.3 and art.5 of this rule required:</p> <ul style="list-style-type: none"> • Five years operation in China, no violative record or bad record, profitable for three consecutive years. • Actually received capital above RMB200m. • Loan more than USD100m, good quality assets. • Assign at least RMB100m as working capital to a branch. 	<p>Art.15. The requirements for establishment of branches of wholly-foreign-owned banks and JEB in China:</p> <p>Three years operation in china, profitable for two consecutive years, no materially violative record.</p> <p>Capital adequacy ratio not less than 8%, good quality assets.</p> <p>One year gap between new application and last approval.</p> <p>Assign at least RMB100m (equivalent) as working capital, total working capital for branches not more than 60% of the registered capital.</p> <p>Other prudential conditions.</p>	<p>The Regulation 2001 is more open. From five years operation to three years operation, from three years profitability to two years profitability, from no violation, no bad record to no materially violative record. Cancel the requirement of USD100m loan amount, replaced by 8% capital adequacy ration. 60% investment limitation to branches is the same to that for domestic banks (consistent with national treatment).</p> <p>One year application gap is a minor problem.</p>

Table note:

FFFI Foreign funded financial institution

FFB Wholly-foreign-funded bank

JEB Joint equity bank

FBB Foreign bank's branch

Table 8: Comparison of the 1996 and 2002 DRIs

DRI 1996	DRI 2002	Comments
None.	Arts. 4-5. Foreign owner or joint venture participant must be commercial bank (rate of capital sufficiency at least 8%) or financial company.	The DRI 2002 narrowed the scope of financial institutions provided by Art. 6 and 7 of the Regulation 2001. It is difficult to find any prudential rationale in this limitation measure.
Art. 4. To increase a branch, a FBB must: <ul style="list-style-type: none"> • The applicant and its existing branches in China must be in good condition, and have made outstanding operating achievements. • The latest-approved branch in China must be in operation for at least one year. None.	Art. 14. To increase a branch, a FBB must <ul style="list-style-type: none"> • The existing branch in China must be in good condition, no material violative record; • One year after last approval of establishment of a branch. Art. 15. If FFB or JEB applies to open branch bank: <ul style="list-style-type: none"> • Must have practiced in China for at least 3 years and made profits in 2 years before filing • Rate of capital sufficiency at least 8% and good asset quality • Application for additional branch cannot be filed until one year after last branch approval • Convertible currency of at least RMB1000m to be allocated as working capital; total amount of working capital allocated to all branch banks in China not to exceed 60% of registered capital 	The DRI 2002 eliminated the requirement of “outstanding operating achievements”, which makes it easier for FBB to open a new branch in China. Now the waiting period is shorter because approval is ahead of operation.
Art. 12. FFFI must start operation within 12 months of receiving approval certification.	Art. 28. FFFI must start business within 90 days from the date of PBOC approval, unless extension under special circumstances, approved by the PBOC.	Art. 15 of the DRI 2002 has no counterparts in the limitations listed in China’s schedule, only prudential measures can justify, without considering the 5 years interim period.
None.	Art. 20. Rejected applicant may not file again for same city within one year.	It seems the DRI 2002 is stricter, but there was no stage of preparation for establishment in the DRI 1996, so it was normal for granting FFFI longer period to start business
Art. 12. Before starting business, FFFI must make a public announcement according to the rules of the PBOC.	Art. 27. Before starting practice FFFI to make announcement in designated national and local newspapers.	New DRI is stricter. China argued that it is a prudential measure when asked in the WTO transitional review meeting in 2002.
None.	Arts. 31-36. Working/registered capital requirements, varying from RMB100 million to 1billion, depending on scope of activities.	Almost the same
None.	Art. 38. Local currency requirements (three years operation, last two years profitable) applied city-by-city.	New DRI is stricter. China argued that these are prudential measures when asked in the WTO transitional review meeting in 2002.
		New DRI reflected the requirements in China’s Schedule, but city-by-city application is China’s interpretation of commitments <i>ex parte</i> .

From the above two tables, one can see an interesting phenomenon. The Regulation 2001 issued by the State Council seems more consistent with GATS/WTO requirements, while the DRI 2002 issued by the PBOC, the central bank under the State Council, adds new limitations (or makes constraining interpretations) on the establishment and operation of foreign-funded banks in China. The legal effect of the Regulation 2001 is certainly higher than that of the DRI 2002, but in practice, the banking regulators and their branches are more likely to firstly conform to the DRI 2002. It is not an exaggeration to say that the DRI 2002 and some other rules or measures issued by the PBOC and the CBRC have partly offset the effect of the Regulation 2001 with regard to its effort to be consistent with GATS/WTO requirements. The focus of consideration is on the additional working capital and registered capital requirements embodied from article 31 to article 36 of the DRI 2002. This issue was a concern for WTO Members, for example, the EU and Chinese Taipei.¹²² Under pressure from some WTO Members, the CBRC has decided to decrease the working capital requirements for foreign bank branches, and reduce the working capital requirements for branches of wholly-foreign-owned banks and joint equity banks.¹²³

However, it is also widely acknowledged that China is taking a positive attitude toward opening its financial market in accordance with its WTO commitments, and most of those commitments would be phased-in within five years after entry to the WTO. One obvious example is a change in insurance law. According to China's insurance commitments, upon accession, a 20 percent cession of all lines of the primary risks for non-life, personal accident and health insurance business with an appointed Chinese reinsurance company shall be required; one year after accession, 15 percent shall be required; two years after accession, ten percent shall be required; and three years after accession, five percent shall be required; and four years after accession, no compulsory cession shall be required. In order to be in line with the commitments, China amended its Insurance Law in 2002, to state that insurance companies shall engage in reinsurance business according to relevant rules issued by the CIRC, eliminating the old provision with a 20 percent legal reinsurance requirement for non-life insurance business.¹²⁴

The current trend of financial regulation in China is that more and more financial rules equally apply to both domestic and foreign financial institutions. The recent rule issued by the CBRC, Guideline for Administration of Credit-granting Risks for Group Customers, applies to commercial banks, which include Chinese-funded banks, joint-equity banks, wholly-foreign-funded banks, as well as foreign bank branches.¹²⁵ It must be noted that, according to this rule,

¹²² See Communication from the European Communities and their member states, S/FIN/W/18, 23 September 2002; See also Communication from the Separate Customs Territory of Taiwan, Penhu, Kinmen and Matsu, S/FIN/W/22, 11 October 2002.

¹²³ See the speech of the chairman of the CBRC, Liu Mingkang, in a news conference on 1 December 2003. <http://www.cbrc.gov.cn/lingdaojianghua/detail.asp?id=65>

¹²⁴ See Art. 102 of Insurance Law 2002, c.f. Art. 101 of the Insurance Law 1995.

¹²⁵ See Art. 2 of CBRC Order [2003] No.5.

policy banks, city cooperatives, rural cooperatives and trust investment companies all follow this guideline,¹²⁶ meaning not only equality among domestic and foreign banks, but also equality among domestic banks. This trend is especially obvious in the insurance sector, reflecting that the WTO national treatment obligation is clearer in China's insurance laws than in banking laws.

Table 9: Insurance rules applicable to both foreign and domestic insurance suppliers

Rule title (Chinese Pinyin)	Rule title (English)	Application scope provision	Official document number
<i>Baoxian Gongsì Touzì Zhengquan Touzì Jìjīn Guānlì Zhānxíng Bānfā</i>	Interim Measures on Administration of Investment in Securities Investment Fund by Insurance Companies	Article 22:1: "The measures (also) apply to joint-equity insurance companies, wholly-foreign-funded insurance companies, branches of foreign insurance companies, unless otherwise provided by laws, regulations."	<i>Baojianfa</i> [1999] No.206
<i>Baoxian Gongsì Guānlì Guīdìng</i>	Rules on Administration of Insurance Companies	Article 115: "The Rules (also) apply to foreign-funded insurance companies, unless otherwise provided by laws, regulations or other rules issued by the CIRC."	<i>Baojianfa</i> [2000] No.2
<i>Baoxian Gonggù Jìgòu Guānlì Guīdìng</i>	Rules on Administration of Insurance Public Appraisal Institutions	Article 78: "The rules (also) apply to foreign-funded insurance appraisal institutions established in China's territories, unless otherwise provided by laws, administrative regulations and international treaties where China's a party."	CIRC Order [2001] No.3
<i>Baoxian Dailì Jìgòu Guānlì Guīdìng</i>	Rules on Administration of Insurance Agencies	Article 81: "The Rules apply (also) to foreign-funded insurance Agency companies established in China's territories, unless otherwise provided by laws, administrative regulations and international treaties where China's a party."	CIRC Order [2001] No.4
<i>Baoxian Jìngjì Gongsì Guānlì Guīdìng</i>	Rules on Administration of Insurance Brokers	Article 81: "The Rules apply (also) to foreign-funded insurance brokers established in China's territories, unless otherwise provided by laws, administrative regulations and international treaties where China's a party."	CIRC Order [2001] No.5
<i>Zaibaoxian Gongsì Shèlì Guīdìng</i>	Rules on Establishment of Reinsurance Companies	Article 8: "The Rules apply (also) to branches of foreign reinsurance companies established in China's territories, with respect to the standards and requirements of operating capital."	CIRC Order [2002] No.4

¹²⁶ See Art. 30 of CBRC Order [2003] No.5.

B. Compliance issues

Although China has changed some financial laws, regulations and rules in order to fulfill its WTO commitments, there are still many provisions inconsistent with GATS/WTO requirements. The reasons for such non-compliance are complicated. In terms of general compliance with systemic issues related to the financial services sector, on the one hand, China has just joined the WTO, and some time is required to deal with issues arising from pre-existing financial laws, regulations or other measures, as well as other related domestic laws. For this reason, and to achieve progressive liberalization in the financial service sector, China has negotiated for a five-year transitional period. However, this five-year period is only transitional, meaning China's financial laws, regulations and rules should eliminate any non-conforming measures by the end of 2006. This process of elimination is a step-by-step process, and the five-year period is not an excuse to deviate from GATS/WTO obligations. The obligation to eliminate non-conforming measures should be gradually performed from the date of China's entry to the WTO. On the other hand, GATS/WTO law itself is full of ambiguities, especially in the financial service area. For example, one such ambiguity arises in the context of "prudential measures". What is the definition of and criteria for a "prudential measure"? In what circumstances can a Member be regarded to abuse the prudential carve-out? This apparent weakness of GATS/WTO law would need to be considered in future multilateral negotiations or through the practice of WTO dispute settlement. For the time being, it is difficult to assess the conformity of some of China's financial measures taken under the prudential measures clause. In spite of this dilemma, it is still very important to consider those measures that appear to be inconsistent with China's commitments and GATS/WTO requirements. Prudential measures are not a panacea or an excuse for protectionist measures at any time. It would be better to positively change those possible non-conforming measures than to be forced by the pressure of the dispute settlement mechanism of the WTO or the transitional review mechanism for China.

The remainder of this section reviews specific compliance issues that arise in the context of China's financial laws, regulations, rules and other measures. Specifically, a number of problems are shown in the following two tables, the first being a comparison between the Regulation 2001 and relevant domestic banking law provisions, and the second a comparison between the DRI 2002 and relevant domestic banking law provisions.

Before analyzing the tables, one should understand the relationship between the Regulation 2001, the Law on Commercial Banks 2003, and the Law on Regulation and Administration of the Banking Industry. Article 92 of the Law on Commercial Banks 2003 states:

Foreign-funded commercial banks, Sino-foreign joint equity commercial banks and branches of foreign commercial banks shall be governed by the provisions of this Law;

where other laws and administrative regulations provide otherwise, the provisions of those laws and regulations shall prevail.¹²⁷

Article 49 of the Law on Regulation and Administration of Banking Industry states:

Where it is otherwise provided for the regulation and administration of foreign-funded banking financial institutions, Sino-foreign joint equity banking financial institutions and the branches of foreign banking financial institutions established within the People's Republic of China in other laws and administrative regulations, the relevant laws and administrative regulations shall prevail.

In fact, these articles authorize the State Council to formulate administrative regulations on foreign-funded banks, which may be different from the provisions of the Law on Commercial Banks 2003 and of the Law on Regulation and Administration of the Banking Industry. If there were no such authorization, the Regulation 2001 should be fully consistent with the provisions of the basic commercial banking law because administrative regulations cannot conflict with laws. Therefore, it seems China has adopted a dual legal system for commercial banking supervision. One is for foreign-funded banks, including three categories (wholly-foreign-owned banks, Chinese-foreign joint equity banks and branches of foreign banks). Another system is for domestic banks, including wholly-state-owned banks, joint stock banks, city commercial banks, and rural cooperative banks. However, the dual system is not completely separate. The Law on Commercial Banks 2003 and the Law on Regulation and Administration of the Banking Industry apply not only to domestic banks, but also to foreign-funded banks unless otherwise provided by the Regulation 2001.

1. Compliance with National Treatment Obligations

The test used in this study to analyze whether China's financial laws conform to GATS/WTO requirements is to compare the treatments accorded to foreign financial institutions and domestic financial institutions, embodied in relevant laws, regulations, rules and other measures.

(a) Banking sector

The following tables compares foreign banking regulations (the Regulation 2001 and the DRI 2002) and domestic banking regulations.

¹²⁷ There was a similar provision in the Law on Commercial Banks 1995 (Art. 88).

Table 10: Comparison between the 2001 regulations and domestic law provisions

Regulation 2001	Domestic law provisions	Comments
Art. 5. Minimum registered capital for FFB or JEB - RMB300m in freely convertible currency.	Art. 13 of the Law on Commercial Banks 2003: Minimum registered capital for a commercial bank - RMB 1 billion.	Consistent with national treatment.
Art. 5. FBB shall receive from head office non-callable allocation of at least RMB100m as operating capital	Art. 2 of Interim Measures on the Establishment of Banks and Their Branches: The head office shall allocate at least RMB100m as operating capital	Consistent with national treatment obligation.
Art. 6. To set up FFB: <ul style="list-style-type: none"> • Applicant must be financial institution. • Rep. office in China for over 2 years. • Total assets US\$10 billion. • Effective supervision in home country. • Home country approval of application. • Other POBC prudential requirements. 	For incorporation of domestic banks, applicants need not to be financial institutions, e.g., wholly-state-owned banks, joint stock banks, city commercial banks.	For FFB, its applicant must be financial institution, this requirement is implied in China's Schedule, so this requirement is not inconsistent with national treatment. Total assets requirement is also in the Schedule. Other requirements are prudential.
Art. 7. To set up FBB: <ul style="list-style-type: none"> • Representative office in China for two years. • Total assets US\$20 billion. • Effective supervision in home country. • Home country approval of application. • Other PBOC prudential requirements. 	No counterpart for domestic banks.	Total assets requirement for FBB is in China's Schedules. Others could be prudential measures.
Art. 8. To incorporate JEB : <ul style="list-style-type: none"> • Applicant must be financial institution. • Foreign party has rep. office in China. • Total assets of foreign party US\$10 billion. • Effective supervision in home country. • Home country approval of application. • Other POBC prudential requirements. 	According to the Interim Measures on the Investment in Financial Institutions issued by the PBOC (1994): China's Industrial Corporations may invest in financial institutions.	With respect to the qualification of shareholders or investors of financial institutions, foreign applicants are granted less favored treatment than domestic applicants, but this difference is not in violation of National treatment, because China has listed such limitations in its Schedule.

/table continues

Regulation 2001	Domestic law provisions	Comments
Art. 13-15. Formal application form for application for FFFI to be issued within six months (nine in exceptional circumstances) of application. Applicant to complete within six months (three month extension possible), failing which application invalid. PBOC to decide within two months of receiving formal application.	Art.15 of the Rules on Administration of Financial Institutions (1994) states that the application process of establishment should include two stages: preparation for the establishment, starting business. The period of examination of application of preparation for the establishment is 3 months. Art. 19 provides that the formal approval period is 30 days.	The approval procedure for domestic financial institution is more preferential or generous. It is inconsistent with national treatment, but may be argued as a prudential measure, given the difficulties of examination and investigation of foreign financial institutions.
Art. 20. To conduct local currency business FFFI: <ul style="list-style-type: none">• Must have operated in China for three years.• Been profitable for last two years. Art. 24. 30% of operating capital of FBB must be in interest-bearing assets as prescribed by the PBOC.	No comparison base due to the fact that China's domestic banks naturally engage in RMB business.	The requirement of art.20 is in China's Schedule.
Art.25. Capital adequacy ratio of FFB, JEB should be not less than 8%.	For domestic banks, there is no counterpart article, meaning that it is not necessary for domestic banks' branches to allocate 30% of operating capital as interest-bearing assets deposited in commercial banks designated by the PBOC.	Formally different treatment. Prudential measure for the purpose of assuring the payment capacity of FBB.
Art.25. Capital adequacy ratio of FFB, JEB should be not less than 8%.	Art. 39 (1) of the Law on Commercial Banks 2003: capital adequacy ratio of commercial banks not less than 8%.	Compliance with national treatment.
Art. 26. FFB, JEB, FFFC, and JEFC may not lend more than 25% of capital to any one enterprise and associated enterprises without PBOC approval.	Art.39 (4) of the Law on Commercial Banks 2003: the ratio of the outstanding of loans granted to the same borrower to the balance of the capital of the commercial bank may not exceed 10%.	Super-national treatment.
Art. 27. Fixed assets owned by FFB, JEB, FFFC or JEFC not to exceed 40% of its equity.	Art.43 of the Law on Commercial Banks 2003 provides that commercial banks cannot invest to real estate of non-self use, which implies that there is no limit on investment to real estate of a commercial bank's own use.	It seems to be inconsistent with national treatment obligation, however this limitation on foreign bank investment to fixed assets could be a prudential measure.
Art. 28. Ratio of share of RMB assets in capital to share of RMB assets in risk assets not less than 8% for FFB, JEB. For FBB, ratio of share of RMB assets in total amount of operating capital plus reserves to share of RMB assets in risk assets not less than 8%.	No rules specifically related to RMB assets ratio for domestic banks. Only the general 8% capital adequacy ratio.	May be prudential measure.

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Regulation 2001	Domestic law provisions	Comments
Art. 29. Ratio of liquid assets to liquid liabilities not less than 25%.	Art. 39 (3) of the Law on Commercial Banks 2003: the ratio of the balance of liquid assets to the balance of liquid liabilities may not be lower than 25%.	Compliance with national treatment obligation.
Art. 30. Total of foreign exchange deposits taken in China by FFFI may not exceed 70% of its total foreign exchange assets in China.	No counterpart limitation on domestic banks.	Inconsistent with market access and national treatment obligation.

Table notes:

FFBWholly-foreign-funded bank)

JEBJoint-equity Bank

FBBForeign Bank Branch

FFFIForeign-funded Financial Institution

Table 11: Comparison between the 2002 DRI and domestic law provisions

DRI 2002	Domestic law provisions	Comments
Arts. 4-5. The largest or sole foreign owner or joint equity participant must be commercial bank (rate of capital sufficiency at least 8%) or financial company.	According to the Interim Measures on the Investment in Financial Institutions issued by the PBOC (1994): China's Industrial Corporations may invest in financial institutions, so it is not necessary for the main shareholder to be commercial bank.	Different treatment, may be inconsistent with national treatment obligation.
Art.14. If a Foreign bank wants to add more branches in China, the established branch(es) must be in good operating condition, etc.	Under several rules issued by the PBOC, branching and sub-branching of a commercial bank are restricted based on the amount of deposits and GDP of a proposed location, prudential measures, and sometimes on profits and asset requirements.	Good operation conditions are applied to both domestic banks and foreign banks.

/table continues

DRI 2002	Domestic law provisions	Comments
<p>Art. 15. If FFB or JEB applies to open branch bank:</p> <ul style="list-style-type: none"> • Must have practiced in China for at least 3 years and made profits in 2 years before filing. • Rate of capital sufficiency at least 8% and good asset quality. • Application for additional branch cannot be filed until one year after last branch approval. • Convertible currency of at least RMB100million to be allocated as working capital; total amount of working capital allocated to all branches in china not to exceed 60% of registered capital. 	<ul style="list-style-type: none"> • As to the requirement of 3 years residency and 2 years profitability, there is no counterpart for domestic banks. • As to the 8% capital adequacy ratio, art.2 of the Notification on Establishment of Commercial Banks provides: if less than 8%, the PBOC will suspend or cancel the branch-establishing plan for such commercial bank, except for wholly-state-owned commercial banks. • According to the Notification on Adjustment the Approval System for Establishment of Branches of Joint Stock Commercial Banks, a joint stock commercial bank may open three branches in one year and there is no one-year application gap. • According to the Interim Rules on Establishment of Banks and Branches, the head office must allocate at least RMB100million as working capital. • According to Article 19 of the Law on Commercial Banks 2003, total amount of working capital allocated to all branches shall not exceed 60% of its registered capital. 	<ul style="list-style-type: none"> • 3 years practice and 2 years profits are conditions for local currency operation in China's Schedule, not condition for the establishment of branch banks. Such requirements are new requirements for establishment of branches in China, which is inconsistent with China's commitments, thus in violation of market access obligation. • As to the 8% capital adequacy ratio, wholly-state-owned banks enjoy preferential treatment, thus inconsistent with national treatment. • One year gap is inconsistent with national treatment. • As to working capital, it is consistent with national treatment. <p>60% limitation is the same for both foreign and domestic banks.</p>
<p>Art. 19. The PBOC to decide whether to accept application within 6 months of receiving application. Application form to be drawn within 15 days, failing which may not file in same city for one year. Preparation time is 6 months.</p>	<p>Art.15 of the Rules on Administration of Financial Institutions (1994) states that the application process of establishment should include two stages: preparation for the establishment, starting business.</p> <p>The period of examination of application of preparation for the establishment is 3 months. Preparation time is 6 months.</p>	<p>The approval procedure for domestic financial institution is more preferential or generous. It is inconsistent with NT, but may be argued as a prudential measure, given the difficulties of examination and investigation of foreign financial institutions.</p>
<p>Art. 20. Rejected applicant may not file again for same city for one year.</p>	<p>Art.15 of the Rules on Administration of Financial Institutions (1994): Rejected applicant may not file again for the same application for 6 months.</p>	<p>Concern expressed in WTO. Not fully consistent with domestic banks.</p>
<p>Art. 25. The PBOC to make decision within two months of receiving formal application form.</p>	<p>Art. 19 of the Rules on Administration of Financial Institutions (1994) provides that the formal approval period is 30 days.</p>	<p>Concern expressed in WTO interim review about multi-stage approval process different treatment.</p>

/table continues

DRI 2002	Domestic law provisions	Comments
Art. 26. After receiving PBOC approval applicant to file with PBOC branch bank for examination. If it fails may apply for reexamination after ten days	Unclear for domestic banks.	No comparison base.
Art. 27. Before starting practice FFFI to make announcement in designated national and local newspapers.	Art.23 of the Rules on Administration of Financial Institutions (1994): make announcement in designated newspapers.	Consistent with national treatment.
Art. 28. FFFI must start business within 90 days (extension up to 90 days permitted) after approval. Failure to do so invalidates license, and may not reapply in the same city for one year.	Art. 22 of the Rules on Administration of Financial Institutions (1994): financial institutions must start business within 90 days after approval. Failure to do so invalidates license, except for <i>force majeure</i> with the approved extension. by the PBOC.	Consistent with national treatment.
Arts. 31-36. Working/registered capital requirements, varying from RMB100 million to RMB1 billion, depending on scope of activities.	No counterpart for domestic banks	Inconsistent with market access and national treatment obligation, except for prudential reasons. Concern expressed in WTO.
Art. 38. Local currency requirements (three years operation, last two years profitable) applied city-by-city.	No comparison base for domestic banks because it is natural for domestic banks to engage in RMB business.	The requirements of three years operation and two years profitability are in China's schedule, but city-by-city application is a new condition or interpretation. Concern expressed in the WTO.
Art.44. Application for a new type of business must be firstly approved by a branch of the PBOC, then sent to the head office of the PBOC for final approval.	Art.13 of the Interim Rules on Intermediary Business of Commercial Banks, the applications of wholly-state-owned commercial banks and joint stock commercial banks shall be sent directly to the head office of the PBOC for approval.	For foreign-funded banks, there are double approval procedures, but for main domestic banks, just one time approval, that is, approval of the head office of the PBOC. Inconsistent with national treatment.

Some of the provisions above in the DRI 2002 are problematic. It was reported that the introduction of “largest shareholder” and “commercial bank” was done for prudential concerns. However, in our opinion, safety and soundness of a foreign bank does not depend on whether it is a commercial bank, but on whether it is subject to comprehensive consolidated supervision by its home country regardless of whether it is a financial institution or a commercial bank. Also, only the sole or largest shareholder’s capital adequacy shall not be less than 8 percent while other commercial bank shareholders’ capital adequacy is not required to be maintained at 8 percent or more. Is it in conflict with prudential regulation? Another issue is which one will be the largest shareholder if there are 20 shareholders making the same contribution. The third issue is that a subsidiary can only be established where a commercial bank investor holds more shares than other non-bank financial institutions, even if 0.1 percent more. In contrast, a subsidiary cannot be set up if a non-bank financial institution holds shares 0.1 percent more than a commercial bank. Is the equity structure in the former case safer than the latter case?

In addition, there are several problems with the application procedures. Firstly, it remains unclear whether the PBOC conducts qualification checks on proposed senior management and major shareholders. Under the DRI 2002 [article 12 (3)] and the Regulation 2001 [article 14 (1)], applicants are only required to submit the list of major shareholders, and of major responsible persons and their resumes. It is unclear whether other law enforcement authorities are consulted when making qualification checks, if any. Secondly, it is unclear whether the licensing authority shall revoke the license if it appears to it that the approved bank has not fulfilled or no longer fulfils one or more of the entry conditions. Thirdly, in the event that a foreign applicant challenges the licensing authority’s decision to refuse its application, does the applicant have a right to apply to the licensing authority for reconsideration? Both the Regulation 2001 and the DRI 2002 are silent on this issue. Under the Measures on Administrative Reconsideration of the PBOC issued by the PBOC in January 2001, the right to apply for reconsideration is granted only to financial institutions which are set up in the Chinese territory subject to the approval of the PBOC and to institutions engaging in other financial businesses subject to the approval of the PBOC. Therefore, except the Chinese applicant of a joint-venture bank, other foreign applicants have no right to apply for reconsideration.

(b) Insurance sector

The following table summarizes issues relating to insurance services, with a comparison of treatment of foreign insurance companies and domestic insurance companies.

Table 12: Comparison between foreign insurance laws and domestic insurance laws

Foreign Insurance Laws	Domestic Insurance Laws	Comments
Regulation on Administration of Foreign-Funded Insurance Companies (Regulation) Article 1, "In order to... strengthen and improve the supervision and administration of foreign-funded insurance companies, to facilitate the sound development of insurance industry, this Regulation is formulated."	Insurance Law, Article 1: "In order to... strengthen the supervision and administration of insurance industry, to facilitate the sound development of insurance industry, this Law is formulated."	Legislative purposes are the same. The Regulation only emphasizes that its object is foreign-funded insurance companies.
Regulation Article 2 specifies three forms of foreign-funded insurance companies: a) joint venture insurance company; b) wholly-foreign-owned insurance company; c) branch of foreign insurance company.	None.	These are characteristics of provision of foreign-funded insurance companies, based on China's WTO commitments.
Paragraph 1 of Article 3 of the Regulation: "foreign-funded insurance companies shall abide by China's laws, regulations, shall not be harmful to China's social and public interests.	Article 4 of Insurance Law: "The insurance activities shall conform to laws, administrative regulations, respect social and public moral..."	Same principles of conduct.
Establishment and Registration (10 articles)		
Article 4 of Regulation: "The CIRC is responsible for the supervision and administration of foreign-funded insurance companies."	Article 9 of Insurance Law: "The insurance regulatory agency under the State Council is responsible for the supervision and administration of insurance industries."	Same regulatory agency.
Article 5 of Regulations: "The establishment of foreign-funded insurance companies shall be approved by the CIRC."	Article 71 of Insurance Law: "The establishment of insurance companies shall be approved by insurance regulatory agency."	Same approval agency.

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
Article 6 of Regulation: “The Organization forms, percentage of foreign investment shall be specified by the CIRC according to relevant rules.”	Article 70 of Insurance Law: “Insurance companies shall adopt following organization forms: a) joint stock company; b) wholly-state-owned company.	There is no clear provision on the organization forms of foreign-funded insurance companies. According to article 154 of Insurance Law, if there is no specific rule, Insurance Law shall apply. Thus, Insurance Law applies to the organization forms of foreign-funded insurance companies. Subsequently, it could be inferred that the organization forms of foreign-funded insurance companies should be joint stock companies. However, there is a potential conflict with joint venture law and wholly-foreign-funded enterprises law, which provide that the organization forms should be limited liability company.
<p>The first paragraph of Article 7 of Regulation: “The minimum registered capital of a joint venture or wholly-foreign-funded insurance company is 200 million RMB or equivalent free convertible foreign currency; the registered capital must be paid-out currency capital...”</p> <p>Paragraph 3 of Article 7 provides: “The CIRC may increase the minimum registered capital...according to the business scope, operation scale of foreign-funded insurance companies.”</p>	<p>Article 73 of Insurance Law: “To establish a insurance company, the minimum registered capital is 200 million RMB.</p> <p>The minimum registered capital must be paid-out currency capital.</p> <p>Insurance Regulatory and Administrative Agency may, according to business scope, operation scale of insurance company, adjust the minimum amount of registered capital, but not less than the amount in the first paragraph.”</p>	Same minimum registered capital, same form of subscription of capital, same adjustment condition of registered capital requirements.
Article 8 of Regulation provides the conditions of establishment of foreign insurance companies: a) more than 30 years insurance business experience; b) 2 years of representative offices in China; c) total assets by the end of the year prior to application not less than 5 billion USD...	None.	Specific limitation on foreign insurance companies, based on China’s WTO commitments.

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>Article 9 of Regulation: “To establish a foreign-funded insurance company, the applicant shall file a written application to the CIRC and submit the following materials:</p> <ol style="list-style-type: none"> 1. An application signed by the legal representative of the applicant; if the application is for establishing a joint insurance company, it shall be signed by the legal representatives of the parties to the joint insurance company; 2. The business license (duplicate) issued by the relevant authority of the country or region, a certificate that proves its meeting the solvency standards and the opinions about the application; 3. The articles of incorporation of the foreign applicant and the annual statements the recent 3 years; 4. Relevant materials of the Chinese applicant if the application is for establishing a joint insurance company; 5. A feasibility study report and plan of preparatory establishment of the company to be established; 6. The names, resumes of the persons to be in charge of the company to be established and certificate of appointment; 7. Other materials as provided by the CIRC. 	<p>Article 8 of Rules on the Administration of Insurance Companies:</p> <p>“The application for establishing an insurance company shall be accompanied by the following documents in triplicate:</p> <ol style="list-style-type: none"> 1. an application for establishment; 2. a feasibility study report; 3. plans for establishment; 4. letter of intent of the investors for subscription of shares and background materials of the investors, including the nature of the institution, type of organization, time of establishment, authority of approval, legal representative, registered capital, etc;” 	<p>The application documents are almost the same.</p>
<p>Article 10 of the Regulation:</p> <p>“The CIRC shall make preliminary examinations over the application for establishing a foreign-funded insurance company and shall decide, within 6 months after receiving the complete set of application documents, whether to accept the application or not. If it decides to accept the application, it shall issue a formal application form to the applicant; if it decides not to accept, it shall inform the applicant in writing and state the reasons.”</p>	<p>Article 9 of Rules on the Administration of Insurance Companies:</p> <p>“The CIRC shall make preliminary examinations over the application for establishing a foreign-funded insurance company and shall decide, within 6 months after receiving the complete set of application documents, whether to accept the application or not. If it decides to accept the application, it shall issue a formal application form to the applicant; if it decides not to accept, it shall inform the applicant in writing and state the reasons.”</p>	<p>Same examination period, same notification of the examination results.</p>

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>Article 11 of Regulation: “The applicant shall complete the preparatory establishment within one year after receiving the formal application form. If it can justify its failure to complete the preparatory work within the time limit, the time limit may be extended for three months upon the approval of the CIRC. If it fails to complete the preparatory work within the extended period, the acceptance decision made by the CIRC shall be automatically invalidated...”</p> <p>The last paragraph of Article 11 of Regulation: “After the completion of the preparatory work, the applicant shall fill in the application form and submit it together with the following documents to the CIRC for examination and approval:</p> <ol style="list-style-type: none"> 1. A report for preparatory establish; 2. The articles of incorporation of the company to be established; 3. The contributors and amount of contributions thereof of the company to be established; 4. A certification of verification of capital issued by a legal appraisal institution; 5. A letter of attorney issued to the person-in-charge of the company to be established; 6. Names and resumes of the senior management personnel and certificates of appointment of the company to be established; 7. Plans of the company to be established during the future three years and plans of reinsurance; 8. The insurance clauses and premiums of the types of insurance as well as a specification of the calculation of liability reserve funds of the company to be established within the territory of China; 9. Materials of the site of business and other facilities relating to business operation of the company to be established; 10. In the case of establishing branch companies by a foreign insurance company, a letter of guarantee of being responsible for the taxes and debts of the branch companies issued by the head office; 11. In the case of establishing a joint insurance company, the contracts for joint business operation; 12. Other documents as required by the CIRC.” 	<p>Article 10 of Rules on the Administration of Insurance Companies: “The applicant shall complete the preparatory establishment within one year after receiving the formal application form. If it can justify its failure to complete the preparatory work within the time limit, the time limit may be extended for three months upon the approval of the CIRC.”</p> <p>Article 11 of Rules on the Administration of Insurance Companies: “After the completion of the establishment, the insurance company may file an application for start of business, subject to the submission of the following documents in triplicate to the CIRC:</p> <ol style="list-style-type: none"> 1. an application for start of business; 2. a certification of assessment of capital issued by an assessment organization approved by the SISAC and a duplicate of the original documents of entry into account of registered capital; 3. resumes of the persons to be employed as executive officers, and an introduction of the setup of the departments of the company and the composition of staff; 4. certification of ownership or land use right to the business ground or office; 5. articles of incorporation (draft); 6. a three-year plan of management and scheme of reinsurance; 7. the terms of insurance and rate of premium for the type of insurance to be engaged in; 8. a report on the configuration of computer facilities and software; 9. other materials as required by the CIRC.” 	<p>Same preparatory work period, same extension period, same legal result of failing completion.</p> <p>Formal application documents are the same.</p>

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>Article 12 of Regulation:</p> <p>“The CIRC shall, within 60 days after receiving the complete formal application materials for establishing a foreign-funded insurance company, decide whether to approve or disapprove. If approval is to be granted, it shall issue a License of Engaging in the Insurance Business; if disapproval is to be granted, it shall inform the applicant in written and state the reasons.”</p>	<p>Article 76 of Insurance Law:</p> <p>“Insurance supervision and administration department shall take the decision of approval or disapproval within six months starting from the date of reception of the official applications for establishment of insurance companies.”</p> <p>Article 77 of Insurance Law:</p> <p>“If the establishment of an insurance company is approved, the department of approval shall issue the permit for insurance operation, and the insurance company shall, on the strength of the operational permit, go through the registration procedures with the administrations for industry and commerce and draw the business license.”</p>	<p>The formal examination periods are different, but foreign-funded insurance companies have super-national treatment. Except that, other procedures, like issuing certificate, obtaining business license are the same.</p>
<p>Article 13 of Regulation:</p> <p>“The foreign-funded insurance company shall, after being established, draw a caution money at the rate of 20% of the total amount of registered capital or operating funds and deposit it in a bank designated by the CIRC. The caution money may not be used for any purpose other than clearing the debts of the company under liquidation.”</p>	<p>Article 79 of Insurance Law:</p> <p>“After the establishment of an insurance company, it shall draw 20 percent of the registered capital as the guaranty funds and deposit them in the banks designated by the insurance supervision and administration department. The deposits shall not be used unless for liquidation purposes.”</p>	<p>The percentage of guarantee fund, the depository institution, and the purpose are the same.</p>
<p>Article 14 of Regulation:</p> <p>“The establishment of branches within the territory of China by a foreign-funded enterprise shall be subject to the examination and approval of the CIRC.”</p>	<p>Article 80 of Insurance Law:</p> <p>“In opening subsidiaries within the territory of the People's Republic of China, an insurance company shall get the approval from the insurance supervision and administration department and obtain insurance business permits for the subsidiaries.”</p>	<p>The conditions and approval procedures for establishment of branches are the same.</p>

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
Business scope (4 articles)		
<p>Article 15 of Regulation: A foreign-funded insurance company may engage all or part of the types of insurance business as mentioned below: 1. Property insurance, including indemnity insurance, liability insurance, credit insurance, etc; 2. Personal insurance, including life insurance, health insurance, accidental injury insurance, etc. Article 16 of Regulation: A same foreign-funded insurance company may not be engaged in the property insurance and personal insurance at the same time.</p> <p>Article 18 of Regulation: The specific scope of business, geographic area of business and the range of clients shall be subject to the verification of the CIRC according to relevant provisions. A foreign-funded insurance company may be engaged in the insurance business within the verified scope of business only.</p>	<p>Article 92 of Insurance Law: “The business scope of an insurance company: 1. Property insurance, including property loss insurance, liability insurance and credit insurance; 2. Personal insurance, including life insurance, health insurance and accidental injury insurance.</p> <p>No insurer is allowed to engage in property insurance and life insurance concurrently; however, an insurance company undertaking property insurance business may undertake short-term health insurance and accidental injury insurance businesses upon verification of the insurance supervision and administration department.</p> <p>The business scope of an insurance company shall be verified by the insurance supervision and administration department. An insurance company shall operate within the business scope verified.</p> <p>An insurance company may not concurrently operate any businesses other than those specified in this Law and other laws and administrative regulations.”</p>	Same business scope.
<p>Article 17 of Regulation: “A foreign-funded insurance company may be engaged in the following reinsurance of the insurance businesses as mentioned in Article 15 of the present Regulation: 1. outward reinsurance; 2. inward reinsurance.”</p>	<p>Article 93 of Insurance Law: “With the approval of the insurance supervision and administration department, an insurance company may undertake the following re-insurance businesses of the insurance operations provided for in the preceding article: 1. Outward re-insurance; 2. Inward re-insurance.”</p>	Same reinsurance business.

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
Supervision (7 articles)		
<p>Article 19 of Regulation:</p> <p>“The CIRC shall be empowered to inspect the business operations, financial affairs and expenditure of funds of the foreign-funded insurance companies, to demand the foreign-funded insurance companies to provide relevant documents, materials and written reports within a prescribed period of time, and to punish the companies according to law for their violation of laws or regulations.</p> <p>The foreign-funded insurance companies shall accept the lawful supervision and regulation of the CIRC, provide relevant documents, materials and written reports in a true-to-the-fact way, and may not refuse or impede its supervision and inspection or conceal any information.”</p>	<p>Article 109 of Insurance Law:</p> <p>“An Insurance supervision and administration department shall have the right to check the operations, financial situation and operation of funds of insurance companies and have the right to demand for the supply of related written reports and materials within the prescribed time limit.</p> <p>Insurance companies shall be subject to the supervision and check pursuant to law...”</p>	<p>Supervisory power of the CIRC on the supervision of foreign insurance companies in China and domestic insurance companies is the same; the obligation of cooperation with the CIRC is the same.</p>
<p>Article 20 of Regulation:</p> <p>“A foreign-funded insurance company may not have any of the following dealings with its connected enterprises unless approval of the CIRC is obtained:</p> <ol style="list-style-type: none"> 1. The outward or inward reinsurance of reinsurance; 2. The buying or selling of assets or other dealings. <p>The term “connected enterprise” as mentioned in the preceding paragraph shall refer to an enterprise that has any of the relations with the foreign-funded insurance company as mentioned below:</p> <ol style="list-style-type: none"> 1. The controlling of shares or contributions; 2. Being jointly controlled by a third party in terms of shares of contributions; 3. Other relations that are connected in interests.” 	<p>Article 66 of Rules on the Administration of Insurance Companies:</p> <p>“The associated transactions of the insurance company shall be subject to the approval of the CIRC.</p> <p>Associated transactions as mentioned in the previous paragraph refer to:</p> <ol style="list-style-type: none"> 1. the insurance and reinsurance between the connected companies; 2. the management, guaranty of assets and agency service between the connected companies; 3. the sale of fixed assets or assignment of credits and debt between the connected companies. <p>The transactions between an insurance company and other organizations with legal person status whose chairman of the board of directors or whose general manager is the chairman of the board of directors or the general manager of the insurance company or a relative of his lineal descent.”</p> <p>Article 89 of Rules on the Administration of Insurance Companies:</p> <p>“The inward or outward reinsurance business between the affiliated companies shall be subject to the approval of the CIRC.”</p>	<p>As to related transactions, the rules are the same.</p>

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>The first paragraph of Article 24 of Regulation:</p> <p>“A foreign-funded insurance company that is engaged in the insurance of foreign exchange shall abide by the pertinent provisions concerning foreign exchange.”</p>	<p>Article 49 of Rules on the Administration of Insurance Companies:</p> <p>An insurance company which, upon the approval of the CIRC and the competent foreign exchange authorities, may engage in the insurance business, shall limit its foreign exchange business to the head office. Where a branch organization needs to engage in the foreign exchange business, it shall apply for approval separately.</p> <p>(This article also applies to foreign-funded insurance companies.)</p>	<p>The administration of foreign exchange insurance is the same.</p>
<p>Article 25 of Regulation:</p> <p>“The documents, materials and written reports to be submitted or reported to the CIRC as provided in the present Regulation shall be provided in the Chinese language.”</p>	<p>Article 116 of Rules on the Administration of Insurance Companies:</p> <p>“All the statements and materials of the insurance company submitted to the SISAC shall be written in Chinese. If the original is in a foreign language, a Chinese version shall be attached, and the Chinese version shall prevail in case there is any discrepancy between the two versions.”</p>	<p>Document language requirements are the same.</p>
Termination and Liquidation (5 articles)		
<p>Article 26 of Regulation:</p> <p>“In case a foreign-funded insurance company needs to be dissolved as a result of split, merger or other reasons for dissolution as stipulated in the articles of incorporation, it may not be dissolved until approval of the CIRC has been obtained. To dissolve a foreign-funded insurance company, a liquidation team shall be formed so as to carry out liquidation.”</p>	<p>Article 85 of Insurance Law:</p> <p>“In the cases of separation, consolidation or the occurrence of the causes for dissolution according to the articles of association, an insurance company shall be dissolved with the approval of the insurance supervision and administration department. The company shall set up a liquidation group according to law to conduct liquidation.”</p>	<p>Conditions of termination, procedures of liquidation are the same.</p>
<p>Article 27 of Regulation:</p> <p>“Any foreign-funded insurance company whose License of Engaging in the Business of Insurance is revoked by the CIRC due to violation of laws or administrative regulations shall be revoked according to law, and a liquidation team shall be formed in time so as to carry out liquidation.”</p>	<p>Article 86 of Insurance Law:</p> <p>“If an insurance company has its insurance operational permit revoked by insurance supervision and administration department due to violations of law or administrative decrees, the insurance company shall be cancelled according to law. The insurance supervision and administration department shall undertake to form a liquidation group to carry out liquidation according to law.”</p>	<p>Revocation conditions, liquidation procedures are the same.</p>

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>Article 28 of Regulation:</p> <p>“The liquidation of a foreign-funded insurance company as a result of being dissolved or revoked shall be publicized at least three times in newspapers within 60 days after the formation of the liquidation team. The content to be publicized shall be subject to the verification of the CIRC.”</p>	<p>Article 37 of Rules on the Administration of Insurance Companies:</p> <p>“In the event the insurance is dissolved, withdrawn or declared bankrupt according to law, the liquidating group shall notify the creditors within ten days after its formation and shall make a public announcement in the newspapers designated by the CIRC for at least three times.”</p>	<p>The times of public announcement are the same.</p>
<p>Article 29 of Regulation:</p> <p>“In case a foreign-funded insurance company cannot pay off its due debts, it may, upon the consent of the CIRC, be declared bankrupt by the people’s court according to law. If a foreign-funded insurance company is to be declared bankrupt, a liquidation team shall be formed by relevant departments like the people’s court, the CIRC, etc. and relevant persons to carry out the liquidation.”</p>	<p>Article 87 of Insurance Law:</p> <p>“If an insurance company becomes insolvent, it shall be declared bankrupt by the People’s Courts and with the approval of the insurance supervision and administration department. If an insurance company is declared bankrupt, the liquidation group shall be organized by the people’s courts, insurance supervision and administration department and related personnel to carry out liquidation according to law.”</p>	<p>Bankruptcy conditions, bankruptcy procedures are the same.</p>
<p>Article 30 of Regulation:</p> <p>“Where a foreign-funded insurance company is dissolved or revoked or declared bankrupt according to law, it may not transfer any of its assets to beyond the territory of China before it has paid off its debts.”</p>	<p>None</p>	<p>Article 30 of Regulation is specifically designed for foreign-funded insurance companies.</p>
<p>Legal Liabilities(7 articles)</p>		
<p>Article 31 of Regulation:</p> <p>“Any one who establishes a foreign-funded insurance company as against the provisions of the present Regulation or is engaged illegally in the insurance business shall be clamped down by the CIRC. In case the violation constitutes the crime of establishing financial institutions without authorization or the crime of illegal business operations or any other crime, the offender shall under take criminal liabilities; if the violation is not serious enough for criminal punishment, the illegal gains shall be confiscated by the CIRC, and a fine of not less than 1 time but not more than 5 times the illegal proceeds shall be imposed upon the offender; if no illegal proceeds have been incurred or the illegal proceeds are not as much as 200,000 yuan, the offender shall be fined not less than 200,000 yuan but not more than 1 million yuan.”</p>	<p>Article 142 of Insurance Law:</p> <p>“ Those who establish insurance companies or engage in commercial insurance activities without authorization in violation of this Law shall be stopped by the insurance supervision and administration department; if a crime is constituted, the offender shall be subject to criminal liabilities pursuant to law; if the case is not serious to constitute a crime, the insurance supervision and administration department shall confiscate the illegal gains, and impose a fine ranging from 1 time to 5 times of the illegal gains, if there are no illegal gains or the illegal gains are less than RMB 200,000, a fine ranging from RMB 200,000 to RMB 1,000,000 shall be imposed.”</p>	<p>Same legal liabilities for establishing insurance companies or engaging in commercial insurance activities without authorization.</p>

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>Article 32 of Regulation:</p> <p>“In case a foreign-funded insurance company violates the provisions of the present Regulation by engaging in the insurance business beyond the verified scope of business or geographic area or scope of clients and such violation has constituted the crime of illegal business operations or any other crime, the offender shall be held to take criminal liabilities; if the violation is not serious enough for undertaking criminal liabilities, it shall be ordered by the CIRC to make corrections and to refund the premiums that have been collected, to have its illegal proceedings be confiscated and be imposed upon a fine of not less than 1 time but not more than 5 times the illegal proceeds; if no the illegal proceeds have been incurred or the illegal proceeds are not as much as 100,000 yuan, it shall be fined not less than 100,000 yuan but not more than 500,000 yuan. In case the offender fails to make corrections within the time limit or serious consequences have resulted, it shall be ordered to suspend business for a certain period of time or its License of Engaging in the Insurance Business shall be revoked.”</p>	<p>Article 143 of Insurance Law;</p> <p>“If an insurance company, in violation of this Law, operates beyond the business scope approved or concurrently operates any business other than those provided for by this Law or any other law and administrative regulation, the offender shall be subject to criminal liabilities pursuant to law if a crime is constituted; if the case is not serious enough to constitute a crime, the insurance supervision and administration department shall order it to correct, and to return the premiums collected, confiscate the illegal proceeds and impose a fine ranging from one time to five times the illegal proceeds; if there are no illegal proceeds or the illegal proceeds are less than RMB 100,000, a fine ranging from RMB 100,000 to RMB 500,000 shall be imposed; if the acts are not corrected within the prescribed time limit or have caused serious consequences, the insurance company shall be ordered to suspend operation for overhaul or its insurance business permit shall be revoked.”</p>	<p>Same legal liabilities for engaging in the insurance business beyond the verified scope of business.</p>

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>Article 33 of Regulation:</p> <p>“In case a foreign-funded insurance company violated the provisions of the Regulation and does any of the following acts, it shall be ordered by the CIRC to make corrections and be fined not less than 50,000 yuan but not more than 300,000 yuan; if the circumstances are serious enough, it may be ordered to stop accepting new transactions or its License of Engaging in the Insurance Business may be revoked:</p> <ol style="list-style-type: none"> 1. Failing to draw and deposit a caution money or use the caution money in violation to the relevant provisions; 2. Having dealings with connected enterprise as in violation of relevant provisions; 3. Failing to make up the registered capital or operating funds as pursuant to relevant provisions.” 	<p>Article 145 of Insurance Law:</p> <p>“If any of the following acts is committed in violation of the provisions of this law, the insurance supervision and administration department shall order the law violators to correct and concurrently impose a fine ranging from RMB 50,000 to RMB 300,000; if the case is serious, the business scope may be limited or handling of new operations shall be suspended or even the insurance operation permit shall be revoked:</p> <ol style="list-style-type: none"> 1. To fail to draw and deposit guaranty funds or use guaranty funds in violation of the regulations; 2. To fail to draw or carry down various kinds of liability reserves or fail to draw reserve for outstanding losses according to the provisions of this law. 3. To fail to draw insurance guarantee fund or public accumulation funds;... <p>Article 112 Where an insurance institution commits one or all of the acts as mentioned below, it shall be ordered to make corrections. In case it fails to make corrections in due time, it may be restricted in the scope of business, ordered to suspend the acceptance of new transactions or its licenses may be withdrawn:</p> <ol style="list-style-type: none"> 1. having failed to submit relevant reports, statements, documents or other materials; 2. having failed to report the designated terms of insurance or rate of premium for record; 3. having failed to obtain approval for affiliated transactions.” 	<p>Same legal liabilities for failing to draw and deposit guarantee fund.</p> <p>Only Regulation provides the legal liabilities for failing to make up the registered capital or operating funds.</p> <p>The legal liabilities for illegal related transactions by foreign-funded insurance companies are heavier than those on domestic insurance companies, which is in violation of national treatment.</p>

/table continues

Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>Article 34 of Regulation:</p> <p>“Any foreign-funded insurance company that violates the provisions of the present Regulation by doing any of the following acts shall be ordered by the CIRC to make corrections; in case it fails to make corrections within the prescribed time limit, it shall be fined not less than 10,000 yuan but not more than 100,000 yuan:</p> <ol style="list-style-type: none"> 1. Failing to submit or report relevant documents, materials or written reports as pursuant to relevant provisions; 2. Failing to make public announcements.” 	<p>Article 146 of Insurance Law:</p> <p>“If any of the following acts is committed in violation of the provisions of this Law, the insurance supervision and administration department shall order correction, and for failure in the correction within the prescribed time limit, a fine ranging from RMB 10,000 to RMB 100,000 shall be imposed.</p> <ol style="list-style-type: none"> 1. To fail to submit relevant reports, statements, documents and materials according to related provision; 2. To fail to submit for the record the insurance clauses or rates of the categories of insurance that shall be submitted for record according to related provisions.” 	<p>The legal liabilities for failing to submit or report relevant documents, materials or written reports as pursuant to relevant provisions are the same.</p> <p>However, the legal liabilities for failing to make public announcements are not the same, which only apply to foreign-funded insurance companies. It seems that this loophole is in violation of national treatment.</p>
<p>Article 35 of Regulation:</p> <p>“Any foreign-funded insurance company that violates the present Regulation by doing any of the following acts shall be imposed upon a fine by the CIRC of not less than 100,000 yuan not more than 500,000 yuan:</p> <ol style="list-style-type: none"> 1. Providing false documents, materials or written reports; 2. Refusing or impeding lawful supervisions or inspections.” 	<p>Article 147 of Insurance Law:</p> <p>“If any of the following acts is committed in violation of the provisions of this law, the offender shall be subject to criminal liabilities pursuant to law if a crime is constituted; if the case is not serious enough to constitute a crime, the insurance supervision and administration department shall order the violator to correct and impose on a fine ranging from RMB 100,000 to RMB 500,000; if the case is serious, the business scope may be limited or handling of new operations shall be suspended or even the insurance operation permit shall be revoked:</p> <ol style="list-style-type: none"> 1. To provide false reports, statements, documents or materials; 2. To refuse or obstruct the checks and supervision according to law.” 	<p>The legal liabilities for providing false documents, materials or written reports, for refusing or impeding lawful supervisions or inspections, are the same.</p>
<p>Article 36 of Regulation:</p> <p>“Any foreign-funded insurance company that violates the provisions of the present Regulation by transferring its assets out of the territory of China shall be ordered by the CIRC to transfer back the assets that have already been transferred and be imposed upon a fine of 20% of the value of the transferred assets.”</p>	None	<p>Since domestic insurance companies also may transfer assets out of China, there should be similar legal liabilities for domestic insurance companies. Otherwise, it is in violation of national treatment.</p>

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Foreign Insurance Laws	Domestic Insurance Laws	Comments
<p>Article 37 of Regulation:</p> <p>“In case any foreign-funded insurance company violates the relevant laws or administrative regulations of China or the present Regulation, the CIRC may revoke disqualify the senior management staff of the company from taking posts in China during a certain period of time or for the whole of his life.”</p> <p>Supplementary Provisions (3 articles)</p>	<p>Article 28, 29 of the Rules on Administration of Senior Officials in Insurance Companies (CIRC Order 2002, No.2).</p>	<p>Same procedure of disqualifying senior officials.</p>
<p>Article 38 of Regulation:</p> <p>“In case anything concerning the administration of foreign-funded insurance companies is not provided in the present Regulation, the Insurance Law of the People’s Republic of China or other relevant laws or administrative regulations or other relevant provisions of the State shall be applied.”</p>		<p>National Treatment.</p>
<p>Article 39 of Regulation:</p> <p>“The present Regulation shall be applicable to the establishment and business operations of insurance companies within the Mainland of China by insurance companies from the Hong Kong and Macau Special Administrative Regions and from Taiwan.”</p>		<p>National treatment.</p>
<p>Article 40 of Regulation:</p> <p>“The present Regulation shall take force of February 1, 2002.”</p>		

Another issue relates to a change in China's insurance laws addressing the qualification of senior officials for foreign-funded insurance companies. According to the previous Rules on Administration of Qualification of Senior Officials in Insurance Companies, the senior officials from a foreign party in wholly-foreign-owned insurance companies or joint-equity insurance companies shall have proper Chinese language ability.¹²⁸ In 2003, the CIRC deleted this qualification requirement by a new order.¹²⁹ Therefore, there is no special language requirement for foreign senior officials who are expected to do business in China.

The above tables indicate the differences of treatment between domestic and foreign banks and insurance companies, but it must be noted there is a weakness in such kind of analysis, i.e. the comparison base is limited to the Regulation 2001, the DRI 2002, the Regulation on Administration of Foreign-Funded Insurance Companies, and correspondent domestic banking and insurance laws, regulations, rules or other measures. In China, foreign-funded financial institutions and insurance companies are regulated not only by the special regulation and detailed rules for implementation, but also by laws, regulations, rules or measures which may apply to all kinds of banks or insurance companies. In order to address this weakness, we must take a full view of almost all relevant financial laws, regulation, rules and other measures. At the same time, the standards to judge China's compliance level are varied, including not only national treatment, but also economic needs test, quantitative limits, etc.

(c) Securities sector

This section of the study reviews WTO-driven legislation in China's securities sector. China made comparatively fewer securities sector commitments than banking sector or insurance sector commitments, respectively, and as such, this section of the study will present its information in textual, not tabular, format. This section will review: (a) regulations allowing foreign securities institutions to obtain a B-Share Seat on China's securities exchanges, and thus engage in B-Share business; (b) regulations allowing representative offices of foreign securities institutions to become Special Members of a Chinese stock exchange; (c) regulations governing formation and regulation of foreign invested fund management companies and securities companies; and (d) China's qualified foreign institutional investor (QFII) framework. While China has implemented some of its securities commitments on or ahead of schedule, such as joint venture securities company regulations, China has been tardy in implementing other commitments, such as

¹²⁸ See Art. 10 of CIRC Order [2002] No.2.

¹²⁹ See *Guanyu Xiugai Baoxian Gongsu Gaoji Guanli Renyuan Renzhi Zege Guanli Guiding Youguan Tiaowen de Jueding* (Decision on Amendment of Relevant Provisions in Rules on Administration of Qualification of Senior Officials in Insurance Companies), para.2 of CIRC Order [2003] No.2, effective on 23 July 2003.

foreign invested fund management company regulations. Further, prudential licensing requirements in the securities sector, specifically capital requirements, have been criticized as has the seeming opaqueness of regulatory formation in the securities sector.

(i) B-Share activities

Interests traded on China's securities market are divided into several share categories. Two of the principal share categories are A-Shares and B-Shares. A-Shares are shares of Chinese companies denominated in Renminbi traded on the Shanghai and Shenzhen exchanges that may be held only by Chinese individuals and legal persons. B-Shares are shares of Chinese companies traded on the Shanghai and Shenzhen exchanges that are denominated in foreign currency (Hong Kong dollars on the Shanghai exchange, United States dollars on the Shenzhen exchange) and reserved for foreign investors and Chinese individuals.¹³⁰ As indicated in its Schedule of Specific Commitments on Services, China committed to allow foreign securities institutions to engage directly in B-Share business as of the date of its WTO accession. Foreign securities institutions' B-Share business is regulated by the pre-accession Tentative Measures of Administration of Qualifications of Domestic and Foreign Securities Trading Institutions for Engagement in Foreign Investment Shares Business (hereinafter B-Share Tentative Measures) issued by the State Council Securities Commission, as implemented by the WTO-driven Shenzhen Securities Exchange Foreign Institutions B Share Seat Administration Rules (hereinafter B-Share Seat Rules) on 19 June 2002 (effective from the same date) and a similar regulation issued by the Shanghai Stock Exchange. The B-Share Tentative Measures regulated both Chinese and foreign securities institutions involved in the B-Share business, and Article 2 required domestic and foreign securities institutions seeking to engage in B-Share business to obtain a Qualification Certificate for Engagement in Foreign Investment Shares Business issued by the CSRC. In addition, Article 6 of the B-Share Tentative Measures required a foreign securities institution to either enter into an agency agreement with a Chinese securities institution or engage in another stock exchange-approved approach to engage in B share business.¹³¹ The B-Share Seat Rules modify these requirements and generally regulate the application for, and use of, B-share trading seats by foreign securities institutions. Although issued more than six months after China's WTO accession, the B-Share Seat Rules are consistent with China's WTO commitments in the securities sector. Note that the B-Share Seat

¹³⁰ As a practical matter, about 70% of all an average Chinese public enterprise's shares are not tradable. The B-Share market is relatively illiquid and B-Shares often trade at a significant discount to A-Shares in the same enterprise.

¹³¹ See B-Share Tentative Measures, Art. 6.

Rules are not considered part of China's domestic laws, regulations, rules, or other measures because they are not issued by government authorities, but by a stock exchange.

A foreign securities institution applying for a B-Share seat on the Shenzhen Stock Exchange (SZSE) must submit a long list of documents to the SZSE: (a) an application form signed by the an authorized representative of the foreign securities institution; (b) a copy of its Certificate of Qualification for Operation of Foreign Stocks issued by the CSRC; (c) a copy of the foreign securities institution's business license issued by its home jurisdiction; (d) a copy of its securities business license issued by the relevant authorities of its home jurisdiction; (e) its articles of association; (f) its financial statements for the last year audited by an accounting firm; (g) the resumes of the major directors, senior executives and professionals of the foreign institution; and (h) a brief introduction of the foreign securities institution.¹³² The SZSE is to take a decision on a completed application within fifteen days of receipt.¹³³ These requirements are similar to those for domestic securities companies applying to engage in B-Share business under the B-Share Tentative Provisions, except that a domestic applicant is required to submit audited financial statement for the previous two years as well as a general statement of its previous two years' securities trading.¹³⁴

Foreign securities institutions holding a B-Share seat may only engage in B-Share trading. The B-Share seat may not be used for other business without SZSE permission. B-Share seat holders are to keep records of their B-Share trading for not less than 20 years, and the SZSE is to have access, upon request, to such documents. In addition, B-Share seat holders are to notify the SZSE within five days of specific material events, such as an amendment to the foreign securities institution's formation documents.¹³⁵ While the B-Share seat may not be withdrawn, it may be transferred to

¹³² Shenzhen Securities Exchange Foreign Institutions B Share Seat Administration Rules, Arts 1-5.

¹³³ *Id.*, Art. 6. If approved, the documents of approval shall be submitted to the CSRC for recording, and the applying institution shall be notified. If declined, the applicant is to be informed of the reasons for rejection. Pursuant to Art. 13, an overseas institution which has obtained the special B-share brokerage number through signing B-share trading agent agreement with domestic securities institutions may apply for a B-Share seat on the SZSE by completing the specified application form for seat and providing the written documents of termination of the aforesaid agent agreement.

¹³⁴ B-Share Tentative Measures, Art. 11.

¹³⁵ Shenzhen Securities Exchange Foreign Institutions B Share Seat Administration Rules, Arts 7-12. In addition, a B-Share seat holder is to notify the SZSE within five days of (i) alteration of its registered capital or place of registration of the corporation; (ii) change in any of its major principals; (iii) its obtaining a substitute for the license for securities business or other qualification certificates issued by local authorities; (iv) its obtaining the new substitute for the Certificate of Qualification for Operation of Foreign Stocks or other qualification certificates issued by the CSRC; (v) any major financial crisis, bankruptcy liquidation, cancellation or merger; (vi) any serious business losses; (vii) its receiving punishments for violations of laws or rules from

another foreign securities institution with SZSE consent, although the B-Share Seat Rules do not specify the applicable procedures for such transfer. Foreign B-share seat holders are to appoint two persons who will be primary contacts between SZSE and the foreign securities institution. A foreign B-Share Seat holder is to submit the previous year's audit report to the SZSE within four months after the end of each fiscal year. Users of a B-Share seat remain subject to the SZSE's and Shanghai Stock Exchange's trading rules.

The B-Share seat fee for foreign securities institutions is HK\$600,000, along with an annual seat management fee of HK\$30,000. These fees are to be paid at the same time.¹³⁶ The foreign B-Share seat holder is to reimburse the SZSE for relevant telecommunication fees each quarter, as the SZSE pays such fees to the service provider in advance.

Disputes between the SZSE and foreign B-Share seat holders are to be governed by Chinese law and are to be settled through negotiation by both parties, or be submitted to the China International Economic & Trade Arbitration Commission for arbitration where the negotiation fails.¹³⁷

The SZSE may punish violations of relevant exchange rules by foreign B-Share seat holders through (a) a fine; (b) public criticism; (c) warning; (d) limitation of trading; (e) suspension of B-Share seat (the seat may not be transferred during the suspension); and (f) termination of the seat. Any party objecting to any punishment levied on it may, within fifteen days from receiving the notification of decision on punishment, apply to the SZSE for reconsideration of such punishment, although the punishment is not stayed during the period of reconsideration.

(ii) Special membership in China's stock exchanges

As stated in China's specific commitments on securities sector, upon the date of China's WTO accession, representative offices of foreign securities institutions would be allowed to become a Special Member of a Chinese stock exchange. Both the SZSE and the Shanghai Stock Exchange issued their versions of the Tentative Rules on Administration of Special Overseas Members on 25 July 2002 (hereinafter Special Member Rules) enabling representative offices of foreign securities institutions to

the authorities or industrial associations; (viii) any change in B-Share business contact persons or authorized clerks of B-Share seat; and (ix) other important matters.

¹³⁶ Id., Art. 14. If the B-Share seat is applied for in the second half of the year, that year's management fee will be reduced 50%. The annual management fee afterwards shall be paid before the January 30 of each year.

¹³⁷ Id., Art. 18.

become a Special Member of each exchange.¹³⁸ Each exchange's version of the Special Member Regulations is identical to the other.

The Special Member Rules amend and supplemental Notice of the Promulgation of the Measures on Management of Resident Representative Offices in China of Foreign Securities Institutions (hereinafter RO Notice) issued by the CSRC on 22 April 1999 and effective as of the same date. As stated in Article 2 of the RO Notice, a resident representative office is an agency established to engage in non-business operations within Chinese territory, as reviewed and approved by the CSRC. In chapter two, the RO Notice details the application and establishment procedures for a securities representative office; chapter three addresses the supervision and administration of such representative offices. The RO Notice does not specifically allow securities representative offices to hold any type of seat on a Chinese stock exchange. The Special Member Rules correct this oversight, consistent with China's WTO commitments by allowing the representative offices of foreign securities firms to apply, after one year of operations, to become a special member of a Chinese stock exchange. As provided in the Special Member Rules, Special Members must: (a) comply with relevant Chinese laws and regulations, the exchanges' articles of association, rules and other relevant regulations; (b) execute the exchanges' decisions; (c) accept the exchanges' annual and interim examination; (d) submit annual operation reports and report material changes; (e) coordinate and communicate with their parents on the operation and affairs concerning the exchanges; and (f) pay membership fees and relevant charges according to the exchanges' regulations.¹³⁹ Note that the Special Member Rules require that the parent of the applicant representative office must have international securities business experience, good reputation and achieved good operating results. A Special Member may attend the general members meeting of exchange members as a non-voting delegate, make proposals to the exchanges, and accept the services supplied by the exchanges.¹⁴⁰ Special members do not have the same rights retained by an "ordinary" member of the exchange. Specifically an "ordinary" member's rights to vote on exchange management issues and supervising exchange affairs. Despite these differences, since China only committed to allow representative offices to become Special Members of a stock exchange, China's efforts in this context appear to be

¹³⁸ Shanghai Stock Exchange Tentative Rules on Administration of Special Overseas Members, Art. 2; and Shenzhen Stock Exchange Tentative Rules on Administration of Special Overseas Members, Art. 2.

¹³⁹ Shanghai Stock Exchange Tentative Rules on Administration of Special Overseas Members, Art. 11; and Shenzhen Stock Exchange Tentative Rules on Administration of Special Overseas Members, Art. 11.

¹⁴⁰ Shanghai Stock Exchange Tentative Rules on Administration of Special Overseas Members, Art. 10; and Shenzhen Stock Exchange Tentative Rules on Administration of Special Overseas Members, Art. 10.

WTO-compliant, albeit implemented seven months later than as provided in its Schedule of Specific Commitments.

(iii) Fund management

In its Schedule of Specific Commitments, China committed to allow, upon accession, foreign investors to create a joint venture fund management company, with foreign interest limited to 33 percent of the venture's registered capital; the limit on foreign interest will increase to 49 percent of the venture's registered capital by the third anniversary of WTO accession, 11 December 2004. There are no provisions or commitments to allow the increase of foreign interest beyond 49 percent of the venture's registered capital. On 1 June 2002, the CSRC issued the Rules for Establishing Foreign-Invested Fund Management Companies (hereinafter FI-FMC Establishment Rules), effective as of 1 July 2002.¹⁴¹ The FI-FMC Establishment Rules create the first framework for foreign investment in China's investment funds sector and amend the Tentative Measures of Administration of Securities Investment Funds, issued by the Securities Commission of the State Council on 14 November 1997.¹⁴² On 12 July 2002, the CSRC clarified certain aspects of the FI-FMC Establishment Rules by stating that the Relevant Issues in the Examination and Approval Procedures for the Establishment of Fund Management Companies Circular issued on 7 January 2002, and the Several Issues Concerning Major Changes of Fund Management Companies Circular issued on 21 March 2002, respectively, were applicable to foreign-invested fund management companies.¹⁴³

The FI-FMC Establishment Rules broadly allow foreign-invested fund management to engage in the same services as a domestic fund management company, establishing and managing public investment funds. A FI-FMC, which must be structured as a limited liability company, may be established by application made by a new fund management company or by acquisition (through transfer or subscription) of shares in an existing fund management company by a foreign investor. There is a 33 percent cap on foreign ownership of a FI-FMC, increasing to 49 percent by 11 December 2004. As China made no commitment as to when, or if, it would permit foreign fund

¹⁴¹ On 20 December 2001, the CSRC published for public comment a set of draft rules relating to the establishment of FI-FMCs. In the accompanying notice, the CSRC indicated that the comment period would be 11 days and would conclude on 31 December, 2001. The CSRC did not promulgate the finalized FI-FMC Establishment Rules until 1 June 2002.

¹⁴² These Tentative Rules were augmented by the Notice on the Promulgation of Detailed Implementing Regulations for the Provisional Measures on Securities Investment Funds, which addressed several issues, including the content and form of fund deeds.

¹⁴³ See Statement by a CSRC Spokesperson on Issues Relevant to the Establishment of Fund Management Companies (Including Fund Management Companies with Foreign Equity Participation), *China Law & Practice*, October 2002, 16(8) 119-131.

management companies to hold more than a 49 percent equity interest in a FI-FMC, or to establish wholly owned fund management subsidiaries in China, the FI-FMC Establishment Rules are silent on those issues. Upon agreement of the parties, a foreign investor may be the controlling shareholder of the FI-FMC, with a plurality of shares, provided that the foreign investor meets mandated asset management and experience requirements, and complies with the foreign ownership limits stated above.¹⁴⁴ A foreign investor may hold shares in no more than two FI-FMCs and be controlling shareholder in only one.¹⁴⁵

The foreign party to a FI-FMC must be: (a) a financial institution established and validly existing under the laws of the country in which it is located and has not been subject to serious penalties from a securities regulator or judicial authority during the past three years; (b) the foreign party's home jurisdiction has entered into a memorandum of understanding with the CSRC regarding regulatory cooperation; (c) have paid up capital of not less than RMB 300 million (approximately US\$36 million) in freely convertible currency; and (d) comply with any other prudential conditions as specified by the CSRC.¹⁴⁶ The domestic Chinese party to a FI-FMC is to comply with standards specified in the FI-FMC Establishment Rules, such as being a trust and investment company or a securities company.¹⁴⁷ There are concerns that this requirement will limit the number of possible Chinese partners and leave more foreign investors chasing few potential Chinese partners. The FI-FMC itself must have paid-in capital of not less than RMB 10 million (approximately US\$1.2 million), and each fund must raise not less than RMB 200 million (approximately US\$24 million). The FI-FMC's chairman of the board, general manager, and deputy general manager are to possess the qualifications required and issued by the CSRC.

Registration and approval for a FI-FMC is a two-step process. Pursuant to Article 12 of the FI-FMC Establishment Rules, the CSRC is to approve or reject an application to form a FI-FMC within sixty days of receipt of the parties' application. If approved, the CSRC will issue an approval document.¹⁴⁸ Once approved, the FI-FMC applicant is permitted to prepare for the opening of business by the joint venture and, pursuant

¹⁴⁴ Id.

¹⁴⁵ Id.

¹⁴⁶ Rules for Establishing Foreign-Invested Fund Management Companies, Art. 6.

¹⁴⁷ Id., Art. 7.

¹⁴⁸ The CSRC officially accepted the first application for a joint venture fund management company from Allianz AG and Guotai Junan Securities Co. Ltd on 31 July 2002. As of the end of February 2003, the CSRC had officially accepted eight applications and had granted only one operating license to China Merchants Fund Management Company, the joint venture established jointly by ING Investment Management, China Merchants Securities and certain other Chinese companies.

to Article 14 of the FI-FMC Establishment Rules, is to make a second application to the CSRC to commence business. The CSRC is to make a determination as to the FI-FMC's commencement of business operations within thirty days of receipt of the application to commence business. When the CSRC issued the FI-FMC Establishment Rules, the rules did not specify whether a FI-FMC must be approved by the Ministry of Commerce (MOFCOM), as is required of other foreign-invested enterprises. Further, the FI-FMC Establishment Rules did not address whether an approved FI-FMC could register with the State Administration of Industry and Commerce (SAIC) as a foreign-invested enterprise without MOFCOM approval, and whether it could enjoy preferential tax treatment as a FIE. On 18 November 2002, MOFCOM and the CSRC jointly issued the Questions Relevant to the Implementation of the Circular, specifying that FI-FMCs must be approved by MOFCOM (after CSRC approval) as a foreign invested enterprise before SAIC registration. CSRC approval also is required for the issuance of each fund by a FI-FMC.

Despite the issuance of the FI-FMC Establishment Rules, several practical issues limit the attractiveness of the FI-FMC structure to foreign investors.

- Pursuant to Article 33 of the Tentative Measures of Administration of Securities Investment Funds, the CSRC mandates an 80:20 portfolio split between corporate securities (stocks and corporate bonds) and government bonds.
- As the Remnimbis are not convertible on the capital account, fund managers are not free to invest in securities denominated in a foreign currency.
- China issued its first integrated, national investment funds law on 28 October 2003, which will be effective as of 1 June 2004. The CSRC is expected to issue implementing regulations and other interpretations of the Securities Investment Fund Law over the next few months, meaning that changes to the fund management industry could be in the offing.
- Under the Tentative Measures of Administration of Securities Investment Funds, all promoters of a fund management company are required to guarantee the truthfulness, accuracy and completeness of the fund prospectus and guarantee that it contains no false or misleading content.
- Section 8(1)(5) of the Guidance on Mandatory Provisions in the Articles of Association of Fund Management Companies specifies that the directors of a fund management company may not directly or indirectly trade stocks in China or elsewhere.

- CSRC's mandatory articles of association for fund management companies prohibit senior managers of the fund management company from working at any other for-profit enterprise.

Aside from these issues, several aspects of the FI-FMC Establishment Rules may contravene certain of China's WTO commitments:

- The FI-FMC Establishment Rules were not issued until 1 June 2002, and certain important practical issues were not clarified until 12 July 2002. China had committed to opening its fund management sector upon WTO accession, 11 December 2001.
- The FI-FMC Establishment Rules require that the foreign investor be organized in a jurisdiction that has entered into a memorandum of understanding (MOU) with the CSRC regarding cooperation in the regulation of the securities market, and has maintained an effective cooperative relationship with the CSRC. This restriction significantly narrows the pool of possible foreign entrants.
- As indicated above, the FI-FMC Establishment Rules place certain requirements on potential Chinese partners to a FI-FMC. Some commentators have suggested that such requirements are technical barriers to trade, violating WTO disciplines.
- The FI-FMC Establishment Rules specify that all FI-FMCs are to be structured as a limited liability company. Commentators have suggested that such direction may not be consistent with the national treatment principle where, as in the fund management context, more business vehicles are available to domestic entities than foreign entities.
- The FI-FMC Establishment Rules, when read with other relevant rules and regulations, seem to require the actual entity making the direct investment into China to satisfy all relevant requirements. This may prevent even significant intermediate operating companies within a corporate group from satisfying relevant CSRC requirements, and seems to unreasonably restrict access to this sector of China's economy.
- The FI-FMC Establishment Rules contain some significant ambiguities that implicate China's commitments to regulatory transparency and clarity. For example, foreign shareholders in a FI-FMC must not have been subject to any "material penalty" in the past three years. This term is not defined in the FI-FMC Establishment Rules or other relevant regulation. Other ambiguous provisions include the reference to "other relevant laws and regulations" made in the FI-FMC Establishment Rules. These ambiguities confer much power to the CSRC to

interpret the meanings of such terms. Abuse of such power would violate China's transparency-related commitments.

- The capital requirements for a FI-FMC are set at fixed levels regardless of the potential of a company's operations in China. In addition, the level of the current capital requirements seems to be too high.¹⁴⁹

(iv) Joint venture securities companies

On 1 June 2002, the CSRC promulgated the Rules for Establishing Foreign-invested Securities Companies, effective on 1 July 2002, setting forth the procedures for establishing and operating a joint venture securities company (JVSC). These Rules allow foreign investors to form and operate a joint venture securities company, provided that foreign interest in such venture does not exceed 33 percent of the venture's registered capital. China has made no commitments as to further liberalization of foreign ownership limit on joint venture securities companies. As envisioned in Article 3 of the Rules for Establishing Foreign-invested Securities Companies, "securities companies with foreign capital equity participation" include securities companies created by foreign investment into an existing Chinese securities company¹⁵⁰ or created as a new entity by joint promotion of Chinese and foreign parties.¹⁵¹ A JVSC is to be structured as a limited liability company and must have minimum registered capital of RMB 500 million,¹⁵² as provided in Article 121 of the Securities Law.

Pursuant to the Rules for Establishing Foreign-invested Securities Companies, the foreign party to a JVSC must: (a) be a licensed securities firm from a jurisdiction whose securities regulator has executed a MOU with the CSRC; (b) have 10 years' operational experiences;¹⁵³ (c) have been subject to no material disciplinary actions or

¹⁴⁹ See China's WTO Implementation: An Assessment of China's Second Year of WTO Membership, prepared by the U.S.-China Business Council and available at www.uschina.org

¹⁵⁰ Instead of establishing a securities joint venture with a Chinese securities company, a foreign investor may choose to acquire a stake in an existing Chinese securities company and to apply for the conversion of the domestic securities company into a foreign investment securities company. However, the limitations on equity ratio, the scope of business, the qualification requirements in respect of the shareholders and the requirement of at least one domestic shareholder holding no less than one third of the equity interest will continue to apply. If a foreign securities firm acquires a stake in a domestic securities firm, then the portion of the business of the domestic firm that a foreign investment securities company is not permitted to conduct must be disposed of before the conversion is permissible. See Bill Shouyun, *New Rules on JV Securities Companies: A Limited Opening of China's Securities Industry*, *China Law & Practice*, October 2002, 16(8).

¹⁵¹ When establishing a new company, the foreign investors must find Chinese partners that have enough cash or non-cash assets to make their capital contribution. Another problem a foreign investor may need to consider is how to resolve the competitive relationship between the Chinese partners and a JVSC. See *id.*

¹⁵² Rules for Establishing Foreign-invested Securities Companies, Art. 6.

¹⁵³ However, the Rules do not clarify whether the business history of the foreign shareholders' predecessors counts towards the ten-year requirement.

sanctions in the three years prior to its JVSC formation application; (d) have appropriate risk control that have satisfied the legal requirements of its home-jurisdiction securities regulator and effective internal control processes; (e) possess a good reputation and good business achievements; and (f) comply with any other CSRC required conditions. Foreign investors may not hold more than 33 percent of the JVSC's equity, and a single Chinese securities company is to hold at least 33 percent of the JVSC's equity.¹⁵⁴

If there is only one Chinese shareholder in a JVSC, Article 8 of the Rules for Establishing Foreign-invested Securities Companies requires that it must be a domestically funded securities company. If there is more than one Chinese shareholder in a joint venture securities company, the other Chinese shareholder need not be a domestically funded securities company, but must have the qualifications to be a shareholder in a securities company, as specified by the CSRC in the Securities House Procedures. Chinese securities companies must seek CSRC approval if its holdings exceed 5 percent of a JVSC's capital. A Chinese shareholder may not be qualified to hold 5 percent or more in a JVSC's capital if: (a) it has been subject to any sanction due to operating in any material violation of laws or regulations during the three years prior to the application; (b) its aggregate losses have reached 50 percent of its registered capital; (c) it is insolvent or unable to pay debts when they fall due; (d) the total amount of its debts have reached 50 percent of its net assets; or (e) there are other circumstances as prescribed by the CSRC.

The Rules for Establishing Foreign-invested Securities Companies require that the chairman of the board, general manager and deputy general manager(s) meet the qualification conditions for senior management personnel of a securities company specified by the CSRC, such as being a Chinese national. If the foreign shareholder appoints a foreign national to serve as the chairman, general manager or deputy general manager, it must obtain special CSRC approval.¹⁵⁵

Application and approval for JVSC establishment is a two-step process, as with a FI-FMC. The first step involves the filing of a specified application with the CSRC, signed by a representative jointly appointed by shareholders and CSRC review of the application by the CSRC. Once JVSC formation approval has been received, the JVSC must then file an application to the CSRC for the Permit for the Operation of Securities Business and the issuance of the Permit for the Operation of Securities

¹⁵⁴ Rules for Establishing Foreign-invested Securities Companies, Art. 10.

¹⁵⁵ *Id.*, Art. 11; and the Interim Rules on Administration of Qualification of Senior Officials in Securities Operation Institutions, Art. 5. The same situation exists with a foreign chairman, general manager or deputy manager in a joint venture fund management company. See Rules for Establishing Foreign-Invested Fund Management Companies, Art. 9.

Business. If the CSRC does not issue the Permit for Operation of Securities Business, the joint venture securities company may not engage in the securities business.

Under the Rules on Administration of Securities Companies, a comprehensive-type securities company may, among other things, engage in: (a) underwriting of securities; (b) dealing in securities as a broker and for its own account; (c) securities investment consulting (including financial consulting); (d) investment management; and (e) custody of securities. However, pursuant to Article 5 of the Rules for Establishing Foreign-invested Securities Companies, the scope of business of a JVSC is limited to: (a) underwriting of shares (including A shares and B shares) and bonds (including government bonds and corporate bonds); (b) dealing in foreign investment shares (B shares) as a broker;¹⁵⁶ (c) dealing in bonds (including government bonds and corporate bonds) as a broker and for its own account; and (d) other businesses approved by the CSRC.¹⁵⁷ Further, it does not appear that a JVSC may: (a) offer asset management services on behalf of its institutional or individual clients; (b) offer domestic private placement financing services, whether for public or private companies; or (c) engage in consulting or investment advising; (d) deal in A-Shares for its own account or as a broker; or (e) deal in B-Shares for its own account.¹⁵⁸

As with the Rules for Establishing Foreign-Invested Fund Management Companies, there is no mention in the Rules for Establishing Foreign-invested Securities Companies that the formation of a JVSC should obtain approval from the MOFCOM in addition to the CSRC's approval. However, as with an FI-FMC, the Questions Relevant to the Implementation of the Circular, specifies that a JVSC must be approved by the MOFCOM as a foreign invested enterprise before SAIC registration.

Several practical issues limit the attractiveness of a JVSC to foreign securities institutions:

¹⁵⁶ If a foreign investor acquires a stake in an existing domestic securities company that was originally licensed to provide A share brokerage business, such securities company must terminate its A share brokerage business and re-register with the SAIC after the investment is completed.

¹⁵⁷ On 29 April 2003 the CSRC banned collective entrusted investment management businesses by publishing the Issues Relevant to Securities Companies' Engaging in Collective Entrusted Investment Management Business Circular.

¹⁵⁸ On 18 December 2003, the CSRC issued the Client Asset Management Businesses of Securities Companies Trial Procedures, effective as of 1 February 2004. Pursuant to these Procedures, securities companies are to apply to the CSRC to engage in client asset management business defined as designated asset management for single clients, collective asset management for multiple clients and special asset management for clients with special needs. Only comprehensive-type securities companies may engage in client asset management business. Although these Procedures are silent as to a JVSC offering client asset management services, one may assume that the Procedures are drafted to seemingly include all comprehensive-type securities companies.

- The small size of China's securities market means that JVSC profit margins will be small. The CSRC's setting and regulating of fees place further pressure on profit margins.
- The required form of a JVSC is viewed by foreign securities institutions as being suboptimal.

In addition, several issues related to the Rules for Establishing Foreign-invested Securities Companies may violate China's WTO commitments:

- A JVSC's permissible business scope is narrower than that of a Chinese securities company. Further, a JVSC's permissible business scope does not include several lines of business common to securities companies in other jurisdictions. At the end of 2001, the CSRC issued a circular allowing domestic securities companies to engage in trust investment businesses; currently JVSCs may not engage in such line of business.
- As indicated in China's Schedule of Specific Commitments, a JVSC is to be permitted to "engage in ... trading of B and H shares as well as governmental and corporate debts". However, the Rules for Establishing Foreign-invested Securities Companies allow a JVSC to only engage in proprietary trading of government and corporate bonds.
- The prohibition on a JVSC trading in A-Shares seems inconsistent with the Interim Rules on Administration of Securities Investment of Qualified Foreign Institutional Investors in China (discussed below). A JVSC is a company incorporated under China's corporate laws, and is not viewed as a "foreign financial institution", so a JVSC cannot become a QFII.
- As with an FI-FMC, the Rules for Establishing Foreign-invested Securities Companies contain high capital requirements for the foreign party and specify the JVSC's form.
- The Rules for Establishing Foreign-invested Securities Companies have some ambiguous requirements, such as requiring the foreign investor to have "sound internal control" and "good reputation and operating results". These terms are undefined and give the CSRC wide discretion to allow or disallow certain foreign securities firms from entering the Chinese market.
- The Rules for Establishing Foreign-invested Securities Companies require that the foreign investor be organized in a jurisdiction that has entered into a memorandum of understanding (MOU) with the CSRC regarding cooperation in the regulation of the securities market, and has maintained an effective

cooperative relationship with the CSRC. This restriction significantly narrows the pool of possible foreign entrants.

(v) Qualified foreign institutional investor vehicle

On 5 November 2002 the CSRC and the PBOC jointly issued the Interim Rules on Administration of Securities Investment of Qualified Foreign Institutional Investors in China (QFII Interim Rules) effective as of 1 December 2002. The QFII Interim Rules allow certain foreign institutional investors to apply to become Qualified Foreign Institutional Investors (QFIIs). The QFII Interim Rules create the first framework for foreign investors to access China's A-share and bond markets and to repatriate profits and principal, with some restrictions. QFIIs are to be companies, not individuals, and are subject to the revised *Catalogue Guiding Foreign Investment in Industry*. China's WTO accession documents do not mention QFIIs, and the adoption of the QFII Interim Rules—could be viewed as an expansion of China's WTO-driven securities market access liberalization. As such, this section of the report only provides a brief overview of the mechanics of the QFII Interim Rules.

QFIIs may be a fund management institution, an insurance company, a securities company or another type of asset management institution or (as yet undefined) "other" institution. Potential QFIIs are to be financially stable, enjoy good credit, and satisfy the asset size test and other CSRC requirements. In the QFII context, the asset size test depends on the type of institution seeking a license: (a) for fund management institutions, to have engaged in fund business for not less than five years and to have managed assets of not less than US\$10 billion in the most recent fiscal year; (b) for insurance companies, to have engaged in insurance business for not less than 30 years, to have paid-in capital of not less than US\$1 billion and to have managed securities assets of not less than US\$10 billion in the most recent fiscal year; (c) for securities companies, to have engaged in securities business for not less than 30 years, to have paid-in capital of not less than US\$1 billion and to have managed securities assets of not less than US\$10 billion in the most recent fiscal year; (d) for commercial banks, to have total assets listed within the world's top 100 and to have managed securities assets of not less than US\$10 billion during the most recent fiscal year. The CSRC may adjust the above-mentioned conditions for asset value, etc. depending on the development of the securities market. In order to attract medium- and long-term investment, qualified institutions that manage close-end Chinese funds or pension, insurance or mutual funds with a good investment record in other markets will be given priority consideration.

QFIIs must have appropriate risk control and monitoring standards, staff licensed in the QFII's home jurisdiction, and a sound corporate governance structure. QFIIs are

to comply with any further requirements issued by the CSRC, and are required to have an account at a commercial bank within China. Such commercial bank is to be the custodian of QFII assets. Certain branches of foreign commercial banks with more than three years of operating experience in China may be custodians of QFII assets. A securities company within China is to execute the QFII's securities trading. Since a QFII cannot carry out trading activities in its own right, and hence it cannot control execution risks such as the timing of trades and communication of orders.

A financial institution desiring to become a QFII must submit a standard application form and a specified list of documents to the CSRC. The form imposes joint and several liability on the board of directors for deliberate misrepresentations on the form. The CSRC must approve or reject a QFII application within 15 working days of receipt. Upon approval, the CSRC notifies the applicant and issues a securities business investment permit. Upon receipt of the permit, the applicant has to apply, through its Chinese custodian, for SAFE approval for its intended investment level. The SAFE has 15 working days to act on such application. Upon SAFE approval, the QFII applicant will be issued of a notification about its investment limit and a foreign exchange registration certificate. Upon receipt of the foreign exchange certificate, the QFII may open a special purpose RMB account with its custodian. This account will fund purchases and other related costs as well as holding proceeds. QFIIs are to be fully invested, in the amount approved by the SAFE, within 90 days of receipt of the CSRC approval certificate.

QFIIs may invest in RMB-denominated financial instruments including A-shares, treasury bonds, convertible and corporate bonds, and any other instrument approved by the CSRC. However, Shanghai Stock Exchange QFII Investing in Domestic Securities Market Securities Trading Implementing Rules and Shenzhen Stock Exchange QFII Investing in Domestic Securities Market Securities Trading Implementing Rules promulgated on and effective from 1 December 2002 indicate that QFIIs are not permitted for the moment to participate in treasury bond repurchases and enterprise bond trading due to "technical reasons"¹⁵⁹ The Implementing Rules do not specify what the technical difficulties are, nor do they provide any timetable within which such technical difficulties are to be solved.

QFIIs may only remit proceeds offshore pursuant to relevant guidelines. QFIIs may only apply to the SAFE to purchase foreign exchange one year after their principal is fully paid. Thereafter each remittance is capped at 20 percent of the total principal

¹⁵⁹ QFII Interim Rules, Art. 20.

and must be made three-month intervals. The recipient of the offshore remittance of principal or of profits must be the QFII itself.

Complementing the QFII Interim Rules, the SAFE issued Administration of Foreign Exchange for Securities Investments in the PRC by QFIIs Interim Rules effective 1 December 2002. The minimum QFII investment is to be US\$50 million with a US\$800 million cap. A single QFII cannot hold more than 10 percent of the aggregate A-shares in a single listed company. The aggregate limit of all QFIIs' investment in a single listed company may not exceed 20 percent of the total A-shares. If QFII holdings exceed such limits, the stock exchange is to issue a sell down notice. Pursuant to that notice, QFIIs are to sell A-shares in a quantity to comply with the aforementioned limits. QFIIs have five trading days to comply with the sell-down notice, with excess shares sold on a last in first out basis.

The PBOC issued the Notification on Relevant Issued of the Application of the Business of Custody of Securities Investment of Qualified Foreign Institutional Investors in China (hereinafter PBOC QFII Notification). The notification sets forth the requirements and procedures for commercial banks to undertake a custodian business for domestic securities investments by qualified foreign institutional investors. Furthermore, the notification divides application banks into domestic and foreign-funded categories.

The PBOC's head office oversees all applications filed by domestic banks. The notification requires domestic banks to file an application for carrying out such business, a feasibility study report, and other specified documents. Only one of a foreign-invested bank's branches may engage in custodial services. If the foreign-invested bank is a wholly-foreign-owned enterprise or a joint venture, only the head office may engage in custodial services. Foreign-invested banks are to submit their application and related materials in triplicate to the local PBOC branch. If the relevant application is signed by a signatory authorized by its head bank and who happens to be the chairperson of the board or the president, a power of attorney is not required. If the signatory does not hold such a position, a power of attorney is necessary and must be notarized as specified in the PBOC QFII notification. Upon PBOC approval, applicants must apply to the CSRC for the custodianship under the QFII Interim Rules.

2. Compliance with transparency obligations

Theoretically, the simplest way to find all laws, regulations, administrative rules and other measures related to China's WTO obligations is to look to the lists provided by China's government to the WTO. In accordance with paragraph V(a) of Annex 1A to the China

Accession Protocol (Information to be Provided by China in the Context of the Transitional Review Mechanism), China should regularly provide updated lists of all laws, regulations, administrative guidelines and other measures affecting the trade in services to the WTO, including the date of publication and the date of entry into force. China did provide such a list to the WTO during the first transitional review.¹⁶⁰ This list, however, did not satisfy the WTO requirement because it included only a portion of the laws, regulations, or other measures affecting trade in services, especially in financial sectors. The following table is from the official list provided by China.¹⁶¹

Table 13

	Services sector or sub-sector	Relevant laws, regulations and/or administrative measures and date of publication or effective date
28	7. Financial services A. Insurance Services	Regulations on Administration of Foreign-Funded Insurance Companies 12/12/2001.
29	B. Banking Services	Regulations on Administration of Foreign-Funded Financial Institutions 20/12/2001. Detailed Rules for Implementing the Regulations on Administration of Foreign-Funded Financial Institutions 1/2/2003. Rules on Administration of Representative Offices of Foreign-Funded Financial Institutions in China 13/6/2002. Proclamation by the PBOC on the Related Issues of Foreign-Funded Financial Institutions' Market Access 9/12/2001.
30	Motor Vehicle Financing by Non-Bank Financial Institutions	The regulation is at the final stage of formulation and a draft has been published on the official website of the PBOC (www.pbc.gov.cn) for public comments.
31	Securities	Rules for Establishing Foreign-Invested Securities Companies 1/6/2002. Rules for Establishing Foreign-Invested Fund Management Companies 1/6/2002.

Compared with the tables developed herein by the authors, the lists made by China's government are too simple and omit a few important laws (e.g. the Law on Commercial Banks and the Securities House Procedures) and a number of rules, especially notifications with actual binding force. One of the characteristics of the lists notified by China is that they mainly cover market access of foreign financial service suppliers, ignoring provisions on business operation, or on market exit. The transparency obligation runs through every aspect of trade in financial services, thus relevant laws, regulations, rules or other measures to be made public should not be those concerned market access alone. Even with respect to laws

¹⁶⁰ See Communication from the People's Republic of China, "Notification under Section 18 of China's Protocol of Accession to the Council for Trade in Services", S/C/W/218, 22 October 2002.

¹⁶¹ In order to make the titles (English translation) of the laws, regulations, or other measures consistent in this report, there are some minor changes in the English version titles, but the minor changes are not misleading or confusing.

that address market access, numerous binding laws, regulations, rules or other measures have not been notified by China to the WTO. This issue was raised by some WTO Members during the first transitional review in the WTO. For example, the EU paid much attention to China's transparency, especially in the insurance sector.¹⁶² In the banking sector, Japan was of the view that "Chinese authorities issue licenses to foreign banks by non-transparent rules and procedures ..."¹⁶³

Another issue related to transparency is the issue of translations. China has committed that it will make available to WTO Members translations into one or more of the official languages of the WTO "all laws, regulations and other measures" affecting, inter alia, trade in services, in no case later than 90 days after they were implemented or enforced.¹⁶⁴ However, so far, China has provided only a small portion of such translations and always lags behind the time limit.¹⁶⁵ In February 2003, the State Council issued a notification on translations of administrative regulations.¹⁶⁶ According to this notification, the administrative department that drafted the administrative regulation, or a leading administrative department in case of more than two departments involved in drafting, is responsible for translation of such regulation. The Legal Office of the State Council (Guowuyuan Fazhiban) is liable for reviewing and approving official English translations, with general responsibility for translation quality.¹⁶⁷ The work of translation, reviewing and approving must be completed within 90 days from the date of promulgation of a regulation.¹⁶⁸ It must be noted that this notification merely covers administrative regulations. Neither laws that are subject to the purview of the NPC, nor rules formulated by administrative departments (e.g. regulatory commissions) are addressed in the document. Therefore, the translation and notification of laws and rules, which provide for the majority of binding legal documents in China, is still a prominent problem.

¹⁶² See Communication from the European Communities and their Member States, S/FIN/W/18, 23 September 2002, p. 1.

¹⁶³ See Communication from Japan, S/FIN/W/21, 1 October 2002, p. 9.

¹⁶⁴ See para. 334 of China's Working Party Report.

¹⁶⁵ For those related to financial services, see Notification Pursuant to Article III:3 of the GATS, S/C/N/215, 24 December 2002; S/C/N/221, 24 December 2002; S/C/N/222, 24 December 2002; S/C/N/223, 24 December 2002. S/C/N/224, 24 December 2002; S/C/N/225, 24 December 2002.

¹⁶⁶ *Guowuyuan Bangongting Guanyu Zuohao Xingzheng Fagui Yingwen Zhengshi Yiben Fanyi Shending Gongzuo de Tongzhi* (Notification on the Work of Reviewing and approving official English translations of Administrative Regulations), issued by the General Office of the State Council on 24 February 2003, Guobanfa [2003] No.10.

¹⁶⁷ See id, para. 1.

¹⁶⁸ See id., para. 3.

3. Economic needs tests

In its Schedule, China undertakes not to impose any measure that requires making an economic needs test in the process of approving licensing applications for foreign-funded banks.¹⁶⁹ Thus, the economic needs test in the Law on Commercial Banks 1995 was repealed by the Law on Commercial Banks 2003.¹⁷⁰ However, the economic needs tests still exist in some financial rules.

For example, according to the Rules on Administration of Establishment of Operation Networks in the Same City by Commercial Banks,¹⁷¹ one of the principles in approving operation networks is that such establishment of networks must be appropriate to the development level and operational situation of the local banking business, and satisfy the banking service demands of local communities. This is a typical economic needs test, which is in violation of China's WTO commitments. This requirement applies not only to domestic banks, but also to foreign-funded banks.¹⁷²

As another example, according to the Interim Rules on Intermediary Business of Commercial Banks, to engage in an intermediary business commercial banks must satisfy "the objective demands of financial market development."¹⁷³

Compared with banking laws, insurance laws are more consistent with the WTO commitment regarding economic needs tests. Article 15 (1) of the Rules on Administration of Insurance Companies stipulated that one of the conditions to apply for the establishment of a branch of an insurance company was to be beneficial to the development of the local insurance market. This typical economic needs test rule inconsistent with China's WTO commitments was repealed in 2002.¹⁷⁴ The Insurance Law amended in October 2002, however, reserved a similar article, reflecting the difficulty and sluggishness of amending the law in the NPC.¹⁷⁵

¹⁶⁹ One of China's WTO commitments is that, "criteria for authorization to deal in China's financial services sector are solely prudential (i.e., contain no economic needs test or quantitative limits on licenses." "Upon accession, licenses will be issued with no economic needs test or quantitative limits on licenses." See China Schedule.

¹⁷⁰ Para. 2 of Art. 12 of the Law on Commercial Banks 1995 provided that the PBOC must consider economic development needs and banking competition status when examining an application of establishment of a commercial bank. The existing para. 2 of Art. 12 of the Law on Commercial Banks 2003 states: "other prudential conditions shall also be met for the establishment of a commercial bank."

¹⁷¹ See PBOC Order [2002] No.3, art.4.

¹⁷² See PBOC Order [2002] No.3, art.2.

¹⁷³ See PBOC Order [2001] No.5, art.5.

¹⁷⁴ See *Guanyu Xiugai Baoxian Gongsi Guanli Guiding de Jueding* (Decision on Amendment of the Rules on Administration of Insurance Companies) by CIRC on 15 March 2002, CIRC Order [2002] No.3.

¹⁷⁵ Para. 2 of art. 72 of the Insurance Law reads: "The Insurance Regulatory Agency, when examining establishment of insurance companies, should consider the needs of development and fair competition of insurance industry."

The effect of changing the rule is seriously diminished while the relevant law remains unchanged.

4. Quantitative limits

The securities investment trust business of qualified foreign institutional investors is a new business in China. It seems that both domestic banks and foreign-funded banks can engage in such business, but in fact, there is a quantitative limit on foreign-funded banks. According to the Notification on Relevant Issues of the Application of the Business of Trust of Securities Investment of Qualified Foreign Institutional Investors in China, only one branch of a foreign bank can deal with such business in China; other branches (in other cities) of the same foreign bank cannot deal with such business, and wholly-foreign-owned banks or joint equity banks can engage in such business only through their head offices.¹⁷⁶ There is no similar quantitative limit for domestic banks. This quantitative limit is certainly inconsistent with China's WTO commitments and in violation of the national treatment obligation under the GATS/WTO. Furthermore, the approval procedures for such business are stricter for foreign-funded banks than for domestic banks, which also may be inconsistent with national treatment obligations.

Article 6 of the Rules on Administration of Insurance Companies stipulated that one of the principles of setting up insurance companies was reasonable geographic arrangement and fair competition. Article 17 of the Rules stated that the CIRC shall take into account of the geographic arrangements and quantities of existent branches before approving an application to set up a branch of an insurance company. All of the above articles (amounting to quantitative limits) were repealed by the CIRC after China's entry to the WTO.¹⁷⁷

The newly issued Measures on Administration of Auto Financing Company has a potential quantitative limit on foreign auto financing service suppliers, which may be challenged in the WTO dispute settlement framework.¹⁷⁸ Article 14 of the measures stipulates: "an auto financing company shall not set up any branch or subsidiary." It appears that this limitation applies equally to domestic and foreign investors; however, considering there already exist many subsidiaries of domestic investors in China's territories, it is easy for them to establish separate auto financing companies in different areas. Thus, to some extent, the result of Article 14, a formally identical treatment, has, in effect, changed the competitive conditions between foreign and domestic auto financing investors, which is potentially inconsistent with paragraph 2 of GATS Article XVII, i.e., a de facto discrimination.

¹⁷⁶ *Yinfa* [2002] No.371, art.3.

¹⁷⁷ See CIRC Order [2002] No.3.

¹⁷⁸ See CBRC Order [2003] No.4. The rules entered into effect from 3 October 2003.

C. Comparison of China's WTO commitments and new financial laws two years post-accession

One method to estimate whether China's financial service laws are consistent with China's WTO commitments is through comparison. China's WTO commitments respecting banking for the first two years are briefly shown in the following table.

Table 14: China's specific commitments in banking services (two years post-WTO)

	2001-2002 (first year)	2002-2003 (second year)
Geographic Coverage	1. Upon accession: Shanghai, Shenzhen, Tianjin and Dalian 2. Within one year: Guangzhou, Zhuhai, Qingdao, Nanjing and Wuhan	Jinan, Fuzhou, Chengdu and Chongqing.
Clients	For foreign currency business, no restriction.	For local currency business, to Chinese enterprises.
Financial Leasing	Foreign financial leasing corporations will be permitted to provide financial leasing service at the same time as domestic corporations (Additional commitment).	Same as the first year.
Motor Vehicle Financing	No limitation on commercial presence of foreign motor vehicle financing services.	Same as the first year.
Economic needs test	No economic needs test.	Same as the first year

The following table summarizes Chinese implementation of the above commitments.

Table 15: China laws and rules relating to China's specific commitments

	2001-2002 (first year)	2002-2003 (second year)
Geographic Coverage	Proclamation by the PBOC on the Related Issues of Foreign-Funded Financial Institutions' Market Access, PBOC Proclamation [2001] No.1 (Paragraph 2). From 11 December 2001, to allow foreign-funded financial institutions in Shanghai and Shenzhen to operate RMB business, and to allow foreign-funded financial institutions in Tianjin and Dalian to apply for RMB business.	Proclamation on Further Opening RMB Business for Foreign-Funded Financial Institutions, CBRC [2003] No.2. From 1 December 2003, to allow foreign-funded financial institutions in Jinan, Fuzhou, Chengdu and Chongqing to apply for RMB business. Other foreign-funded financial institutions having been approved to do RMB business could expand geographic coverage to the above four cities.

	2001-2002 (first year)	2002-2003 (second year)
Clients	<p>Proclamation by the PBOC on the Related Issues of Foreign-Funded Financial Institutions' Market Access, PBOC Proclamation [2001] No.1. (Paragraph 1).</p> <p>From 11 December 2001, to eliminate the limitation on clients of foreign currency service, to provide the service to all units and individuals in the territory of China, on the condition of increasing working capital or capital.</p>	<p>Proclamation on Further Opening RMB Business for Foreign-Funded Financial Institutions, CBRC [2003] No.2.</p> <p>From 1 December 2003, upon CBRC approval, foreign-funded financial institutions could provide RMB business to Chinese enterprises in areas opening to RMB business.</p>
Financial Leasing	<p>Proclamation by the PBOC on the Related Issues of Foreign-Funded Financial Institutions' Market Access, PBOC Proclamation [2001] No.1. (Paragraph 4).</p> <p>From 11 December 2001, foreign investors could apply for establishing wholly-foreign-owned or joint-equity financial leasing companies according to Rules on Administration of Financial Leasing Companies.</p>	Same as the first year.
Motor Vehicle Financing	<p>Proclamation by the PBOC on the Related Issues of Foreign-Funded Financial Institutions' Market Access, PBOC Proclamation [2001] No.1. (Paragraph 3).</p> <p>From 11 December 2001, foreign-funded non-banking financial institutions could apply for wholly-foreign-owned or joint-equity motor vehicle financing companies according to an upcoming rule to be issued by the PBOC. (However, the PBOC did not issue the rule in 2001, 2002)</p>	<p>Administrative Rules Governing Auto Financing Company, CBRC Order [2003] No.4.</p> <p>From 3 October 2003, foreign non-banking investors could apply to establish auto financing companies.</p>
Economic needs test	There was no economic needs test in the Regulation 2001, so economic needs test did not exist in the establishment of foreign-funded financial institutions.	The Law on Commercial Banks 2003 deleted the economic needs test article in the Law on Commercial Banks 1995.

In addition to legal changes, China has also, in many cases, executed its WTO commitments in practice. For example, in relation to banking, to the end of October 2003, 62 foreign banks from 19 countries had established 191 operating institutions in China, among which 84 were approved to engage in RMB business. Furthermore, foreign-funded banking institutions had set up 211 representative offices in China. Total assets of foreign-funded banks in China amounted to US\$46.6 billion, 1.4 percent of China's total banking assets.¹⁷⁹ From China's WTO entry to the end of October 2003, China approved 28 foreign banking representative offices, 12 branches of foreign banks, and 6 sub-branches of foreign-funded banks.¹⁸⁰ In relation to motor vehicle financing, the CBRC has approved the applications for establishment of Shanghai GM, Toyota (China) and Volkswagen (China) auto financing companies by the end of December 2003.¹⁸¹ As

¹⁷⁹ The chairman of the CBRC, Liu Mingkang, in a news conference held by the News Office of the State Council on 1 December 2003, <http://www.cbrc.gov.cn/yaowen/detail.asp?id=207>

¹⁸⁰ Id.

¹⁸¹ <http://www.chinanews.com.cn/n/2003-12-30/26/386425.html>

to insurance services, in 2002, the CIRC approved 6 foreign insurance companies to access the Chinese insurance market, and 16 foreign-funded insurance operating institutions.¹⁸² In the first half of 2003, the CIRC approved 2 foreign insurance companies to access the Chinese insurance market, and added Chengdu and Chongqing as cities open to foreign insurance business.¹⁸³ From 11 December 2003, foreign-funded non-life insurance companies could engage in all non-life insurance business except statutory insurance business, and added Fuzhou, Xiamen, Ningbo, Shenyang and Wuhan as cities open to foreign insurance business.¹⁸⁴

IV. WTO transitional review of China's financial laws, rules and other measures

In order to monitor China's compliance with the WTO agreements, the WTO designed the Transitional Review Mechanism (hereinafter referred to as the TRM) for China.¹⁸⁵ The TRM is unique: "Nothing similar could be found in any other WTO Agreements, in GATT or WTO history."¹⁸⁶ Based on this mechanism, the General Council and those subsidiary bodies of the WTO shall review the implementation by China of the WTO agreements and the provisions of the China Accession Protocol.¹⁸⁷ The review takes place from accession each year for eight consecutive years.¹⁸⁸ Compared with Trade Policy Review Mechanism (hereinafter referred to as the TPRM) applicable to other WTO Members, the TRM is relatively strict.¹⁸⁹ Through the TRM, other WTO Members can monitor and urge China to make its laws, regulations, rules and relevant measures consistent with the WTO agreements. For China, the TRM is both a burden and an opportunity. In each year's review

¹⁸² See the speech of the Chairman of the CIRC, Wu Dingfu, at 2003 national insurance conference, http://www.circ.gov.cn/notes/list_detail.asp?Auto_ID=181

¹⁸³ See the speech of the Chairman of the CIRC, Wu Dingfu, at a insurance working seminar on 9 July 2003, http://www.circ.gov.cn/notes/list_detail.asp?Auto_ID=194

¹⁸⁴ See Proclamation of Performing Relevant WTO Commitments, CIRC Proclamation [2003] No.59.

¹⁸⁵ China Accession Protocol, Part I, section 18.

¹⁸⁶ See a Chinese representative's speech in the meeting of Committee on Trade in Financial Services of the WTO on 22 July 2002, S/FIN/M/36, para.56.

¹⁸⁷ There are in total 16 WTO subsidiary bodies to be involved in the review mechanism, including: Council for Trade in Goods, Council for Trade-Related Aspects of Intellectual Property Rights, *Council for Trade in Services*, Committees on Balance-of-Payments Restrictions, Committee on Market Access (covering also ITA), Committee on Agriculture, Committee on Sanitary and Phytosanitary Measures, Committee on Technical Barriers to Trade, Committee on Subsidies and Countervailing Measures, Committee on Anti-Dumping Measures, Committee on Customs Valuation, Committee on Rules of Origin, Committee on Import Licensing, Committee on Trade-Related Investment Measures, Committee on Safeguards, *Committee on Trade in Financial Services*. (emphasis added).

¹⁸⁸ It is possible to extend to ten years, depending on the decision by the General Council. See China's Accession Protocol, Part I, Section 18:4.

¹⁸⁹ Under TPRM, the ordinary frequency of reviews are every two years, four years, mostly six years, or even longer for least-developed-country Members, based on the impact of individual Members on the functioning of the multilateral trading system. See Trade Policy Review Mechanism, Annex 3 of the WTO Agreement, para C(ii).

process, China has to face challenges from other WTO Members, answer various difficult questions regarding its domestic laws and/or policies, and defend itself against potential “intrusions” of some WTO Members. From the perspective of time, for China, the TRM is a quick method of learning the rules of the game under the WTO.

In view of the importance of the TRM, the General Office of the State Council of the PRC (*Zhonghua Renmin Gongheguo Guowuyuan Bangongting*) issued to local governments at provincial level, central governmental departments and commissions, a special instruction on how to deal with this matter.¹⁹⁰ In this instruction, the General Office mentioned the main reason for the significance of the TRM, which is that the TRM, as well as notification and enquiry matters, has a direct impact on China’s reputation in the WTO.¹⁹¹ In spite of the efforts of the Chinese government, during the first round of transitional review, the EU and certain other WTO Members still felt that, “[m]ost new legislation [of China] affecting trade in services contains an excessive number of unclear or ambiguous provisions.”¹⁹²

A. Issues raised in the TRM meetings to date

The following sections summarize the various financial services issues raised in the TRM meetings to date.

1. Banking and other financial issues

The table below highlights key banking issues which have been raised.

¹⁹⁰ Guowuyuan Bangongting Guanyu Zuohao Woguo Jiaru Shijie Maoyi Zuzhi Youguan Maoyi Zhengce Tongbao Zixun he Shenyi Gongzuo de Tongzhi (The Instruction on How to Facilitate the Matter of Notification, Enquiry and Review of Trade Policy Relating to the China Accession to the WTO), Guobanfa (2002) No. 50. (Issued by the General Office of the State Council on 29 September 2002).

¹⁹¹ See *id.*, para.1. The Instruction on How to Facilitate the Job of Notification, Enquiry and Review of Trade Policy Relating to China’s Accession to the WTO. Guobanfa (2002) No. 50. (Issued by the General Office of the State Council on 29 September 2002).

¹⁹² Communication from the European Communities and Their Member States: TRM China-Trade in Services, S/C/W/211, 23 September 2002. It should be noted that these negative opinions could not prevent the general pass of TRM for China. To some extent, they are like warnings.

Table 16: Banking law issues raised in TRM meetings

	2002	2003	Relevant rules	Complainants
1	Minimum working capital requirements for branches of foreign banks are high.	Minimum working capital requirements for branches of foreign banks are high. Minimum capital requirements for foreign-funded banks are high.	Regulation 2001, DRI 2002 (Art.31-36)	EU (in both 2002 and 2003), Canada (2002) Chinese Taipei (2002) Canada (2003)
2	Motor Vehicle Financing (no regulation yet).	No direct branching from abroad, high minimum capital requirement, no right to set up internal branches or subsidiaries, no deposit-taking from local car manufactures.	Administrative Rules Governing Auto Financing Company (Art.5, 7,14,18,etc)	US (2002), Japan (2002) EU (2003)
3	Translation Delay.			US (2002)
4	Approval of local Currency business for foreign bank branches (branch-by-branch basis).	Approval of local Currency business for foreign bank branches (branch-by-branch basis).	Regulation 2001 (Art.20) and DRI 2002 (Art.38)	Canada (in both 2002 and 2003)
5	One year interval between approval of a branch and submission of another branch	One new branch per year	DRI 2002 (Art.14)	EU (in both 2002 and 2003)), Canada (in both 2002 and 2003)
6	One year interval between refusal of an application of setting up an operating institution in a city and resubmission in the same city.		DRI 2002 (Art.20)	Japan (2002)
7	Foreign currency deposits received in China not to exceed 70% of foreign currency assets in China.	Foreign currency deposits received in China not to exceed 70% of foreign currency assets in China.	Regulation 2001 (Art.30)	Canada (in both 2002 and 2003)
8	40% limit on interbank loans.	40% limit on interbank loans.	Draft	Canada (in both 2002 and 2003), Japan (in both 2002 and 2003)
9		30% working capital of foreign branches must be deposited at Chinese-funded banks.	Regulation 2001 (Art.24), DRI 2002 (Art.65)	EU (2003)

2. Insurance issues

The table below highlights key insurance issues which have been raised.

Table 17: Insurance law issues in TRM meetings

	2002	2003	Relevant rules	Complainants
1	<p>Transparency issue: the Regulation on foreign-funded insurance institutions contains vague provisions. Internal branching issue.</p> <p>When to issue implementing rules of the Regulation?</p> <p>The scope of “relevant rules”.</p>	CIRC to communicate with insurance firms in writing.	The Regulation (Art.5,6,14,etc)	EU, US, Chinese Taipei, Canada (2003)
2	Multi-tiered application process, invitation to apply from the CIRC.		The Regulation (Art.8-12)	US
3	Minimum registered capital requirements are very high.	<p>Concerns on capital requirements for national and regional licenses.</p> <p>Minimum registered capital requirements are very high.</p>	<p>The Regulation (Art.7)</p> <p>Drafts of revised Rules on Administration of Insurance Companies (Art.6, 12)</p>	EU, US, Japan (2003), Canada (2003)
4	Chinese language requirement for foreign senior management personnel.	Chinese language requirement for foreign senior management personnel.	Rules on Administration of Insurance Companies (Art.15)	US, Canada (2003)
5	The necessity of renewing an insurance business license.		The Regulation (Art.25)	Chinese Taipei
6		Prohibition of associate enterprises transactions relating to reinsurance.	The Regulation (Art.20.1)	Japan
7	Separation of life insurance and non-life insurance.		The Regulation (Art.16)	Chinese Taipei

3. Securities issues

The table below highlights key securities issues which have been raised.

Table 18: Securities law issues in TRM meetings

	2002	2003	Relevant rules	Complainants
1	Why not permit Chinese mutual fund companies to be lead partner in a new Sino-foreign mutual fund joint venture company?		Interim Rules on the Administration of Securities Investment Funds (Art.24.1)	Canada
2	Necessity of the requirement of MOU between the CSRC and a home securities regulator.		Rules for Establishing Foreign-invested Securities Companies (Art.7.1); Rules for Establishing Foreign-Invested Fund Management Companies (Art.6.2)	Chinese Taipei
3	Requirement of 10 years operating experience.		Rules for Establishing Foreign-invested Securities Companies (Art.7.2)	Chinese Taipei
4		Limitation on the choice of domestic partners.	Rules for Establishing Foreign-Invested Fund Management Companies (Art.7); Rules for Establishing Foreign-invested Securities Companies (Art.8.2)	EU
5		Business scope limited to manage assets of retail investors, not institutional investors.	Rules for Establishing Foreign-Invested Fund Management Companies	EU

B. China's Responses

China did not provide written responses to the above questions raised by various WTO Members, and all China's replies are from China's oral statements at TRM meetings.¹⁹³ In those meetings, China stated that it had been making every possible effort to carry out its WTO commitments with regard to financial services since accession to the WTO.¹⁹⁴

First, with respect to banking services, China argued that the current capital requirements are consistent with Chinese financial development level, and for the purpose of protecting the interests of domestic depositors and the safety and soundness of China's financial system.¹⁹⁵

¹⁹³ In China's opinion, China has no legal obligation to provide written answers for TRM purpose under section 18 of the China Accession Protocol. See para.46 of S/FIN/M/37.

¹⁹⁴ S/FIN/M/37, para.16.

¹⁹⁵ Id, para.21.2 (a).

Regarding banking branching restrictions and approval procedures, China stated that those are prudential requirements. Regarding the intervals between applications, China also argued that these are for prudential purposes.¹⁹⁶

Second, as to insurance services, China stated that “relevant rules” had all been made public and easily accessible for foreign insurance companies. China argued that the “multi-tiered application” only occurred if application material was considered incomplete or failing to meet requirements.¹⁹⁷ Further, China stated that the insurance capital requirements reflect the specific situation of China’s insurance industry and apply equally to domestic insurance institutions, and so do not violate WTO national treatment obligations. Moreover, China indicated that the reason of separating life insurance and non-life insurance markets is prudential in nature.¹⁹⁸

Third, in relation to securities services, China stated that the reason prohibiting a Chinese fund management company to be a lead partner is to avoid illegal transfers of interests between old Chinese fund management companies and newly set-up companies.¹⁹⁹

C. Conclusion

On the whole, most WTO Members have given China positive comments for its performance of WTO commitments, especially developing countries, such as India, Pakistan and Cuba.²⁰⁰ Even the US government also admitted that a number of positive developments had occurred, e.g., China reduced capital requirements in certain financial services sectors, and opened up the auto financing sector.²⁰¹ However, the TRM process is not sufficiently clear to meet each WTO Member’s expectations. For example, US officials expressed disappointment over the result of the first transitional review because it failed to produce a final report or recommendation, while Chinese officials expected a more limited review.²⁰² Before further negotiation to clarify the procedures of the TRM, it is difficult to estimate the implications of the TRM on China’s WTO compliance.

¹⁹⁶ Id, para.60.

¹⁹⁷ Id, para.21.1 (a).

¹⁹⁸ Id, para.53.

¹⁹⁹ Id, para.61.

²⁰⁰ Id, para.30, 35, 64.

²⁰¹ USTR, 2003 Report to Congress on China’s WTO Compliance, at p.4.

²⁰² See GAO Report to Congressional Committees, *First-Year U.S. Efforts to Monitor China’s Compliance*, GAO-03-461, March 2003, p.3, p. 27.

CHAPTER FOUR

CHINA'S FINANCIAL SERVICES LAWS AND INTERNATIONAL FINANCIAL REGULATORY STANDARDS

I. The WTO prudential carve-out

As mentioned above, the WTO legal framework on financial services addresses the interaction between financial services liberalization commitments and the role of prudential regulation. This section discusses the key elements of this framework and its meaning.

A. Paragraph 2 of the Annex on Financial Services

Paragraph 2 (a) of Annex on Financial Services states as follows:

Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.

The first sentence of paragraph 2(a) is the so-called prudential carve-out which entitles a Member to take prudential regulatory measures related to financial services trade.²⁰³ The second sentence is a trade-off of the first sentence, providing that such measures (prudential measures provided by the first sentence) shall not be used as means of avoiding the Member's commitments or obligations under the GATS agreement. The GATS text and other provisions of the Annex on Financial Services do not resolve the question of relationship between the first sentence and the second sentence, i.e. to what extent does the second sentence narrow down the scope of power provided by the first sentence? For example, in a Member's Schedule of Specific Commitments, if the column of limitations on market access and national treatment is "none" (full commitments), can a Member take a limitation measure on market access or national treatment in the name of the prudential carve-out? If the answer is no, then what is the meaning of prudential carve-out? For instance, Colombia takes the view that paragraph 2 of Annex on Financial Services and Article VI of the GATS (domestic regulation) allows Members to take both prudential and non-prudential measures to ensure the stability and integrity of the financial system.²⁰⁴ Malaysia insists that there be "no flexibility to introduce any changes to the so-called

²⁰³ See WTO Secretariat, *Guide to the Uruguay Round Agreements* 176 (Kluwer Law International 1999).

²⁰⁴ Communication from Colombia, S/CSS/W/96, 9 July 2001.

prudential carve-out”.²⁰⁵ Even Japan, a typical developed country, also thinks that Members should be cautious when discussing limitations respecting the right of each Member to take prudential measures.²⁰⁶ However, the EU and its Member States emphasize that prudential measures should not be used “as a means of avoiding GATS market access and national treatment commitments.”²⁰⁷

B. The scope of the WTO prudential carve-out

The essence of the second sentence is that prudential measures shall not be used as a means of “avoiding the Member’s commitments or obligations under the Agreement”. This sentence implies that prudential measures should not aim intentionally to avoid a Member’s commitments and obligations, one of which is the national treatment obligation under GATS Article XVII. Logically, it means that the prudential carve-out should not be used to derogate from the national treatment obligation, but this conclusion seems to be in contradiction to the first sentence which describes the scope of the prudential carve-out with the wording “[n]otwithstanding any other provisions of the Agreement”. In a word, the scope of the prudential carve-out is unclear.²⁰⁸

The scope of the prudential carve-out depends on the distance between prudential measures and GATS obligations: the longer the distance, the broader the scope of the carve-out, and vice versa. To identify the scope of the prudential carve-out is, in essence, to identify the distance of GATS obligations and prudential measures, or to strike a balance between the two. Paragraph 2(a) does not define the concept of prudential carve-out, or clearly identify the distance between the carve-out and GATS obligations, so there is much room for Members to maneuver. So far, no international prudential standards with binding force exist. For example, the effects of principles issued by the Basel Committee on Banking Supervision, International Association of Insurance Supervisors (IAIS), International Organization of Securities Commissions (IOSCO), etc. are all voluntary in nature.²⁰⁹

C. The WTO and international financial regulatory standards

Some argue that there should be a direct relationship between international financial regulatory standards and financial services liberalization via the prudential carve-out.

²⁰⁵ See Report of the Meeting Held on 3-6 December 2001, p. 60. S/CSS/M/13, 26 February 2002.

²⁰⁶ See Report of the Meeting Held on 3-6 December 2001, p. 57. S/CSS/M/13, 26 February 2002.

²⁰⁷ See Communication from the EC and their Member States: GATS 2000, Financial Services, S/CSS/W/39, para.21, 22 November 2000.

²⁰⁸ Kalypto Nicolaidis & Joel P. Trachtman, From Policed Regulation to Managed Recognition in GATS, in *GATS 2000: New Directions in Services Trade Liberalization* 241, 255 (Pierre Sauve & Robert M. Stern, editors, Brookings Institution Press 2000).

²⁰⁹ See the website of the Financial Stability Forum (FSF) at www.fsforum.org for discussion of international financial standards.

GATS Article VII:5 states as follows:

Wherever appropriate, recognition should be based on multilaterally agreed criteria. In appropriate cases, Members shall work in cooperation with relevant intergovernmental and non-governmental organizations towards the establishment and adoption of common international standards and criteria for recognition and common international standards for the practice of relevant services trades and professions. (emphases added)

It must be noted that the role of international standards in the above provision should not be exaggerated to be as important as international standards directly applicable to the service trade. GATS Article VII:5 only provides Members shall make efforts “towards the establishment and adoption of common international standards and criteria”. Therefore, international standards, if any, cannot be directly applied to trade in services under the legal framework of the GATS. There must be a process of “establishment and adoption”, which means it is necessary to have multilateral negotiations on the application of international standards in the GATS. Even if GATS VII:5 generally applies to the Annex on Financial Services, there is no legal position of international standards in determining whether a measure is prudential or not.

Some may invoke GATS VI:5(b) as supporting the legal authority of international standards in service trade. It reads: “In determining whether a Member is in conformity with the obligation under paragraph 5 (a), account shall be taken of international standards of relevant international organizations applied by that Member.”²¹⁰ This paragraph indeed emphasizes the role of international standards in domestic regulation related to service trade and it seems also to be a general obligation because it is in Part II of the GATS (“General Obligations and Disciplines”).

Overall, therefore, there is no clear legal basis for relating international financial standards and the WTO agreements.

D. Is there a need to define the prudential carve-out?

So far, many Members think that there is no need to define the prudential carve-out contained in the Annex on Financial Services.²¹¹ For instance, the Philippines has stated that the language in paragraph 2(a) of the Annex on Financial Services was “quite clear”, and the wide discretion granted to Members was “intentional”.²¹² Thailand also expressed that there was no problem with the definition of prudential measures contained in the Annex on Financial Services.²¹³ Malaysia

²¹⁰ The footnote of this paragraph states that “relevant international organizations” refers to international bodies whose membership is open to the relevant bodies of at least all Members of the WTO.

²¹¹ See S/FIN/W/16, para.4, 3 November 2000.

²¹² Report of the Meeting Held on 13 July 2000, Note by the Secretariat, para.32, S/FIN/M/27, 23 August 2000.

²¹³ See Report of the Meeting Held on 13 July 2000, Note by the Secretariat, para.35, S/FIN/M/27, 23 August 2000.

thought that the prudential carve-out is a “fine balance reached in the Uruguay Round”,²¹⁴ and even objected to the initiation raised by Japan to gather information on prudential regulation from international financial organizations because “the exercise would impinge on the right of national governments to take prudential measures independently, as provided for in the Financial Services Annex.”²¹⁵ Mexico supported Malaysia’s view.²¹⁶

On the contrary, Australia suggested developing a definition of prudential regulation or a common understanding of that term.²¹⁷ Japan stated that there was ambiguity as to the definition of prudential regulation, so suggested collecting information on prudential regulation from the international financial organizations. However the Japanese representative admitted that it was “difficult and unrealistic” to achieve a definition of prudential regulation.²¹⁸ The EU also felt it “difficult or not realistic” to define what prudential regulation was under the prudential carve-out, but it supported Japan’s proposal to collect information from international financial organizations.²¹⁹ Canada supported Japan’s proposal provided that such exercise did not touch on the prudential carve-out in any way.²²⁰

The third view, expressed by both the US and India, is whether there is a need to define the prudential carve-out. According to this cautious view, there is no compelling evidence the prudential carve-out has been abused, or used as disguised protection, so it is premature to consider the definition of prudential carve-out.²²¹

The result is that, at present, the exact scope of the prudential carve-out and its relation (if any) to international financial standards remains unclear and subject to on-going discussion.

II. China’s financial services laws and international financial regulatory standards

Within the above context, it is clear that the meaning of the prudential carve-out is quite significant in China’s on-going financial services liberalization process. This section discusses a number of key

²¹⁴ Report of the Meeting Held on 25 May 2000, Note by the Secretariat, para.25, S/FIN/26, 29 June 2000. See also Report of the Meeting Held on 13 April 2000, Note by the Secretariat, para.22, S/FIN/M/25, 8 May 2000.

²¹⁵ Report of the Meeting Held on 29 November 2000, Note by the Secretariat, para.22, S/FIN/M/29, 14 March 2001.

²¹⁶ *Id.*, S/FIN/M/29, para.23.

²¹⁷ Report of the Meeting Held on 25 May 2000, Note by the Secretariat, para.21, S/FIN/M/26, 29 June 2000.

²¹⁸ Report of the Meeting Held on 25 May 2000, Note by the Secretariat, para.22, S/FIN/M/26, 29 June 2000.

²¹⁹ Report of the Meeting Held on 13 July 2000, Note by the Secretariat, para.27, S/FIN/M/27, 23 August 2000.

²²⁰ Report of the Meeting Held on 2 April 2001, Note by the Secretariat, para.22, S/FIN/M/30, 8 May 2001.

²²¹ Report of the Meeting Held on 25 May 2000, Note by the Secretariat, para.29, 30, S/FIN/M/26, 29 June 2000.

areas of interest, including capital adequacy, connected lending and large exposures, and provisioning and loan classification.

A. Capital adequacy

The 1988 Basel Capital Accord sets the minimum capital adequacy ratio at 8 percent for internationally active banks. Capital for the purpose of capital adequacy and large exposure controls is defined as the sum of registered capital, capital surplus, earning surplus, unallocated profits, general provisions, revaluation reserves, and long-term subordinated bonds with a maturity of five years or more with the investment in unconsolidated firms deducted.

However, in addition to the general 8 percent capital adequacy ratio requirement for foreign-funded financial institutions, Article 28 of the Regulation 2001 issued by the State Council after China's entry to the WTO states as follows:

The ratio of the share of RMB assets in its capital to the share of RMB assets in its risk assets shall not be less than 8 percent for any wholly-foreign-funded bank, joint-equity bank, wholly foreign-funded finance company or joint-equity finance company.

For a foreign bank branch, the ratio of the share of RMB assets in the total amount of its operating capital plus reserves to the share of RMB assets in its risk assets shall not be less than 8 percent.

The PBOC shall, in accordance with the relevant provisions, adjust the ratios set forth in the preceding two paragraphs step by step.

This special 8 percent ratio for RMB assets, in fact, adds a new capital requirement for wholly-foreign-funded banks and joint-equity banks because they must simultaneously satisfy a general 8 percent ratio for all assets and a separate 8 percent ratio for RMB assets. As a result, wholly-foreign-funded banks or joint-equity banks cannot make up the inadequacy of RMB capital through provision of additional foreign currency capital. More importantly, there is no counterpart requirement for Chinese domestic banks to keep a separate 8 percent ratio for foreign currency assets, implying that Chinese domestic banks may offset the inadequacy of foreign currency assets by increasing their RMB assets. Is such kind of measure prudential or compatible with paragraph 2 of the Annex on financial services? At least in the views of drafters of the Regulations, such special requirement for RMB assets is to reduce the risks of RMB assets of foreign-funded financial institutions,²²² but if such special requirement is a prudential measure, why does the last paragraph of Article 28 of the Regulation 2001 provide that such ratios shall be adjusted step by step, which is interpreted by the drafters that the 8 percent ratio for RMB assets

²²² *Guowuyuan Fazhi Bangongshi Caizheng Jinrong Fazhisi* (Finance Department of Legal Affairs Office, the State Council, edited), *52 Zhonghua Renmin Gongheguo Waizi Jinrong Jigou Guanli tiaoli Wenda* (Questions and Answers of the Regulations on Administration of Foreign-Funded Financial Institutions of PRC) (CITIC Publishing House, 2002).

should be eliminated gradually before December 2006, five years after entry to the WTO?²²³ One of China's commitments in financial sector is to eliminate "non-prudential measures" within five years after entry to the WTO, and there is no time limit to eliminate prudential measures under the Annex on Financial Services. In fact, if a measure is reasonable enough to be prudential, it should not be eliminated by WTO rules as a mandatory obligation on Members; otherwise paragraph 2 of the Annex on Financial Services would be meaningless.

Capital adequacy requirements are embodied not only in the capital adequacy ratio, but also in the capital amount itself. Principle 8 of the Insurance Core Principles issued by International Association of Insurance Supervisors (IAIS) in October 2000 states that an insurance company should maintain minimum levels of capital or levels of deposit. This minimum requirement applies to all insurance companies (both domestic and foreign insurance companies) and therefore seems to be consistent with the GATS national treatment obligation. However, the insurance supervisor has the authority to "require an insurance company to hold capital at a higher level than the required minimum margin where circumstances exist to justify such an action".²²⁴ This flexible view held by the IAIS opens the door for a Member to establish different capital requirement for domestic and foreign insurance companies. The IAIS does not give the detailed "circumstances to justify such an action", but most probably, the circumstances are related to maintaining the integrity and stability of a Member's financial system, as well as to the protection of policy holders, which is in the scope of paragraph 2 of the Annex on Financial Services.

B. Operating capital requirements for foreign bank branches

Another highly argued point relating to the banking sector in the transitional review meetings held by the WTO in 2002 is on the amount of capital requirements for branches of foreign banks in China. According to the DRI 2002 issued by the banking supervisor of the time, the PBOC,²²⁵ in order to establish a branch of a foreign bank, it is necessary to satisfy not only the general capital requirement of RMB 100 million,²²⁶ but also the capital requirements from RMB 100 million to RMB 600 million based on the scope of its RMB and foreign currency business.²²⁷

²²³ Id.

²²⁴ See IAIS *Core Principles Methodology*, Principle 8 (10).

²²⁵ The CBRC took over most regulatory powers from the PBOC, and the banking regulatory rules issued by the PBOC are still applicable unless revised by the CBRC.

²²⁶ See para. 2 of art. 5 of the Regulations on Administration of Foreign Financial Institutions, effective on 1 February 2002.

²²⁷ See Arts 31-36 of the Detailed Rules for Implementing the Regulations on Administration of Foreign Financial Institutions, effective on 1 February 2002.

Table 19

Business & customer type	Operating capital of a branch	Registered capital of a subsidiary & JV bank
Foreign currency business for foreign enterprises and partial foreign currency for non-foreign enterprises	RMB 100 million	RMB 300 million
All foreign currency business for all types of customers	RMB 200 million	RMB 400 million
Foreign & domestic currency business for foreign enterprises and partial foreign & domestic currency business for non-foreign enterprises	RMB 200 million (100 m. in RMB, 200 m. in foreign currency)	RMB 400 million (100 m. in RMB, 300 m. in foreign currency)
All foreign currency business for all types of customers, RMB business for foreign enterprises, and partial RMB business for non-foreign enterprise	RMB 300 million (100 m. in RMB, 200 m. in foreign currency)	RMB 500 million (100 m. in RMB, 400 m. in foreign currency)
All foreign currency business for all types of customers, all RMB business for foreign enterprises	RMB 400 million (200 m. in RMB, 200 m. in foreign currency)	RMB 600 million (200 m. in RMB, 400 m. in foreign currency)
All foreign & domestic currency business for all types of customers	RMB 600 million (400 m. in RMB, 200 m. in foreign currency)	RMB 1 billion (600 m. in RMB, 400 m. in foreign currency)

Note: foreign enterprises include foreign natural persons.

The EU argued that “those amounts are extremely high and do not take into account the possible guarantee of the mother company ...”²²⁸ Taiwan, as a separate customs territory, is also concerned about this issue.²²⁹ China’s representative defended this as follows. First, “[t]he current operational capital requirement in China had to accommodate the current Chinese financial development level, including the banking industry and its supervisory capacity.”²³⁰ Second, “China believed that it was difficult for the regulatory authority of the host country to monitor and control the global operation risks of parent banks, even though they were committed to undertaking the liability of their branches.”²³¹ Third, “for the purpose of *protecting the interests of domestic depositors and the safety and soundness of the financial system*, China had to treat branches of foreign banks as legal entities so as to separate risks of branches from those of their parent banks.”²³² (emphasis added)

With regard to the first defense, “financial development level” seems to be a valid rationale; however, after a careful reading of the GATS text, the legal foundation of this reason is probably not stable. Among 29 articles of the GATS, only Article XIX:2 refers to “level of development”,

²²⁸ Communication from the European Communities and their Member States, S/FIN/W/18, 23 September 2002.

²²⁹ See Communication from the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, S/FIN/W/22, 11 October 2002.

²³⁰ Report of the Meeting Held on 21 October 2002, S/FIN/M/37, 24 October 2002, p.4.

²³¹ *Id.*, at 5.

²³² *Id.*

stating that the process of liberalization shall consider the level of development of individual Members. But Article XIX:2 is not a rule or principle governing the whole body of the GATS, but only a guideline or rule specifically for “negotiation of specific commitments” because that is the title of Article XIX. This is further supported by the Guidelines and Procedures for the Negotiations on Trade in Services, of which paragraph 3 reiterates GATS Article XIX:2.²³³ Therefore, the defense based on “financial development level” should have no direct effect. Further, lack of sufficient “regulatory capacity” should not be considered a sufficient rationale because it is the Chinese government’s duty (as well as in its own self-interest) to have an effective system of banking supervision, which should possess “adequate resources”.²³⁴ According to GATS Article VI (Domestic Regulation), each Member shall “ensure” relevant measures to be administered in a reasonable, objective and impartial manner. If there is no “regulatory capacity”, how can China “ensure” the administration of relevant measures in a way consistent with GATS? Finally, “financial development level” and “regulatory capacity” should have been considered when China negotiated with other WTO Members before entry to the WTO. China, however, has not made such reservations in the China Accession Protocol.

As to the second reason, there may be prudential reasons to require foreign banks to establish subsidiaries rather than branches (e.g. issues respecting assets available in insolvency and other issues of depositor protection and systemic stability). In fact, this is exactly one of the rationales underlying the Basel Accord itself. However, such reasoning would simply require both foreign and domestic banks to operate under similar capital requirements rather than adding additional burdens to foreign banks.

The real problem results from the third defense raised by China, i.e. for the protection of domestic depositors and safety and soundness of the financial system, which is a copy of the prudential carve-out embodied in paragraph 2 of the Annex on Financial Services. Since China invoked the prudential carve-out as a defense, it is evident that, in China’s opinion, such measure is a prudential measure, rather than a non-prudential measure; accordingly, China could not apply the 5 year grace period to this requirement.²³⁵ However, it must be noted that, at least in the case of RMB business, China sets only two qualifications for foreign financial institutions, i.e. “three years business operation in China” and “being profitable for two consecutive years prior to the application”.²³⁶ This is particularly strengthened by the additional expression “otherwise,

²³³ See para. 3 of the Guidelines and Procedures for the Negotiations on Trade in Services, adopted by the Special Session of the Council for Trade in Services on 28 March 2001, S/L/93, 29 March 2001.

²³⁴ See Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision*, Principle 1.

²³⁵ According to China’s Schedule, “within five years after accession, any existing non-prudential measures restricting ownership, operation, and juridical form of foreign financial institutions, including on internal branching and licenses, shall be eliminated.” See China Schedule, section 7:B.

²³⁶ See China Schedule.

none”.²³⁷ Since China’s commitments have excluded the existence of other qualifications for foreign institutions to engage in RMB business, it definitely raises the question whether China is seeking to avoid its commitments under excuse of the prudential carve-out, i.e. whether China is abusing the role of the prudential carve-out.

In fact, China’s banking regulations and rules have clearly identified the detailed categories of prudential measures for setting up branches of foreign banks. Article 7 of Regulations on Administration of Foreign-funded Financial Institutions provides six requirements, in addition to the registered capital requirement in Article 5 of the Regulations:

- Applicant being a financial institution
- Representative office in China for two years’
- Total assets not be less than US\$10 billion
- A sound supervisory system in the home country
- Home country regulator’s approval
- *Other prudential requirements by PBOC*

In article 7 of the Detailed Rules for Implementing Regulations on Administration of Foreign-Funded Financial Institutions, the PBOC listed six more prudential measures:

- Reasonable corporate governance structure
- Sound risk management system
- Sound internal control system
- Effective management information system
- Good operation, no material violative record
- Effective anti-money laundry measures

Among the above 11 prudential measures, none could be used as a defense of the additional capital requirements for establishment of foreign bank branches in China. It is worth noting that the Chinese representative in the WTO did not invoke China’s domestic laws, i.e. the above prudential rules, as a defense in the transitional review meetings, so the rule applicable to China’s problem is still the WTO rule, i.e. the prudential carve-out. The question is: Are China’s financial measures consistent with the prudential carve-out in the Annex on Financial Services? Can the additional capital requirements for foreign bank branches be justified by prudential regulation? If, according to Malaysia’s view, it is the independent right of national governments to take

²³⁷ See China Schedule.

prudential measures,²³⁸ then China's above measures are "prudential" because China says they are for prudential purposes. This conclusion, in fact, totally nullifies the second sentence of paragraph 2(a) of the Annex on Financial Services. The disputes on whether there is a need for a clear definition on prudential carve-out show the existence of ambiguity in the concept. From the perspective of China's example, paragraph 2(a) itself cannot provide a clear yardstick to determine consistency with the prudential carve-out rule.

China has noted the issue of high capital requirements for foreign-funded banks. On 1 December 2003, the Chairman of the CBRC announced that the CBRC decided the following changes to the capital requirements, which will be incorporated in the upcoming amendment of the DRI 2002:²³⁹

(1) the minimum operating capital of a foreign bank branch engaging in all foreign and domestic currency business for all types of customers is reduced from RMB 600 million to RMB 500 million; (2) the minimum operating capital of a foreign bank branch engaging in all foreign currency business for all types of customers and all RMB business for foreign enterprises is reduced from RMB 400 million to RMB 300 million; (3) the minimum registered capital requirements for a wholly-foreign-owned bank and a Sino-foreign joint equity bank are predigested from six levels (RMB 1 billion, 600 million, 500 million, 400 million, 400 million and 300 million) to three levels (RMB 300 million, 200 million and 100 million).

C. Connected lending and large exposures

In many countries special attention has been paid to connected lending within the framework of large exposure controls. Connected lending, which means the extension of credit to a bank's affiliates, insiders (i.e. directors, officers, employees and their families and friends) and/or bank shareholders, can lead to non-objective determinations of the creditworthiness of the borrower, to conflicts of interest, and in certain circumstances to dangerous leveraging within a group of companies and corruptive practices. Following this reasoning, the Regulation 2001 imposes limits on connected lending, subject to the same limit (25 percent of capital). "Connected enterprise" is redefined to mean that an enterprise has ability to directly or indirectly control or co-control or exert important influence on the other enterprise, or that two enterprises or more are under control by another enterprise. By contrast, the Regulation 1994 defines "connected enterprise" as two enterprises interrelated by means of one enterprise holding more than 20 percent shares of the other or by more than 20 percent shares of both enterprises being held by the same shareholder.

The problem with large exposure control is that the Regulation 2001 only limits exposures to enterprises. In other words, exposures to any other single borrowers except enterprises may be allowed to exceed the 25 percent lending limit. By contrast, under the Law on Commercial Banks

²³⁸ See Report of the Meeting Held on 29 November 2000, Note by Secretariat, para.22, S/FIN/M/29, 14 March 2001.

²³⁹ <http://www.cbrc.gov.cn/lingdaojianghua/detail.asp?id=65>

2003, a commercial bank is not allowed to lend to a single borrower an amount of more than 10 percent of the bank's capital.²⁴⁰

In many countries large exposure regulations provide a number of exemptions from the large exposure limits depending on types of borrowers and types of transactions. It seems too restrictive that the Regulations 2001 brings all exposures under the large exposure controls. We propose that short-term exposures denominated in local currency, exposures to central governments and central banks of specified countries and exposures secured on cash or specified government securities should be exempted from the large exposure limits.

Further, the Regulations 2001 and the DRI 2002 do not establish the mechanism for reporting large exposures which involves both regular and exceptional reporting systems, and threshold reporting limits. The regular reporting system requires foreign banks to report all large exposures at the reporting frequency laid down by the law. If in an exceptional case exposures exceed the limits, foreign banks must report this to the banking regulator without delay. Threshold reporting limits (e.g. 10 percent of capital) merit to be introduced. The banking regulator can then devote particular attention to those exposures above the threshold and approaching the limits and may require foreign banks to take preventive action before the exposure becomes excessively risky. Last but not least, whether or not the banking regulator transfers responsibility to home supervisors, the banking regulator should require parent banks to submit consolidated reports on large exposures on a regular basis.

Country and sectoral exposures are usually treated separately within the general framework of the policy on large exposures. Since precise definitions and judgments on sectors and country risk degrees are difficult and depend much on the expertise of the bank and the size and stability of the sector or country concerned, it appears inappropriate for supervisors to lay down official ceilings on the appropriate level of exposure to particular sectors or countries. Banks are expected to set their own internal limits on country and sectoral exposures while supervisors play a monitoring role.

D. Provisioning and loan classification

Foreign banks (and banks generally) should set aside appropriate provisions. In December 2001, the PBOC issued the Guiding Principles for Loan Risk Classifications. Under these Guiding Principles, loans are classified, based on their risk levels, into five categories: standard, mentioned, sub-standard, doubtful and loss, with last three categories being non-performing loans. In April 2002, the PBOC issued the Guidelines on Provisioning for Bank Loan Losses that also apply to foreign banks in China. According to these Guidelines, provisions can be divided into special general provisions, specific provisions and special provisions. General provisions are

²⁴⁰ See Art. 39 (4) of the Law on Commercial Banks 2003.

created against possible but unidentified losses, the amount of which is set aside based on a fixed percentage of the balance of the total loans. Specific provisions are created against specific losses, the amount of which is set aside based on the loss level of each loan after loans are risk-classified according to the Guiding Principles for Loan Risk Classifications. Special provisions are created against certain countries, regions, or sectors, or certain types of loan risk.

Under these Guidelines, a bank should set aside its general provisions quarterly, the year-end balance of which shall not be less than 1 percent of the year-end balance of loans. General provisions qualify for inclusion in supplementary capital according to the 1988 Basel Capital Accord.

A bank may set side its specific provisions on a quarterly basis referring to the following percentages: provisions for mentioned loans are set aside at 2 percent, sub-standard loans at 25 percent with a floating range of 20 percent, doubtful loans at 50 percent with a floating range of 20 percent, loss loans at 100 percent. The quarterly percentage for special provisions is left to the discretion of banks according to special risks, possibility and historical experience of loan loss of different types of loans (e.g. different countries, sectors).

There are other rules of a prudential nature under China's foreign financial institution rules. For example, any foreign bank which has set up two branches or more should designate one of them as the main reporting branch responsible for consolidated statements of all branches of the foreign bank involved. Furthermore, 30 percent of a branch's operating funds for foreign exchange business should take the form of foreign exchange fixed-term deposit with a maturity of 6 months or more as interest accrued assets while 30 percent of its operating funds for RMB business of RMB government bonds or RMB fixed-term deposit with a maturity of 6 months or more as interest accrued assets.

CHAPTER FIVE

LIBERALIZATION OF TRADE IN FINANCIAL SERVICES UNDER CEPA

According to GATT Article XXIV and GATS Article V, regional trade agreements can be exceptions of MFN treatment. Article V of GATS provides that “[t]his Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement ...” This clause is generally interpreted as an exception to the MFN treatment under Article II of GATS.²⁴¹

In order to promote the joint economic prosperity and development of Mainland China and Hong Kong SAR, the Mainland and Hong Kong Closer Economic Partnership Arrangement (hereinafter referred to as the CEPA) was signed and took effect on 29 June 2003. In addition to the Mainland and Hong Kong CEPA, there is a similar CEPA between the mainland and Macau, which was signed and took effect on 17 October 2003.²⁴² In this report, CEPA refers to the Mainland-Hong Kong CEPA. The CEPA, in essence, is a free trade agreement (FTA), which is an exception to MFN treatment.²⁴³ According to the CEPA, from 1 January 2004, the Mainland would apply a zero tariff rate to the import of some goods of Hong Kong origin.²⁴⁴ No later than 1 January 2006, the Mainland will apply a zero tariff rate to the import of all goods of Hong Kong origin.²⁴⁵

Service trade is also covered in the CEPA.²⁴⁶ The core of the CEPA service trade is Mainland China’s Schedule of Specific Commitments on Opening Service Trade to Hong Kong, as Annex 4 to the CEPA, in which the financial service sector is listed.

I. Insurance and insurance-related services

The scope of insurance services covered in China’s CEPA Schedule is the same as that in China’s WTO Schedule, i.e. life, health and pension/annuities insurance, non-life insurance, reinsurance and services auxiliary to insurance. As to specific commitments, China has accorded more favorable treatment to Hong Kong financial service suppliers.

First, China has relaxed market access conditions for Hong Kong insurance companies to enter the Mainland market. In China’s WTO Schedule, an investor must satisfy the following conditions: (1) it must be a foreign insurance company with more than 30 years of establishment experience in a WTO member; (2) it must have a representative office for two consecutive years in China; (3) it shall have total assets of more than US\$5 billion at the end of the year prior to application. However, in China’s

²⁴¹ Rai Bhala & Kevin Kennedy, *World Trade Law* (1998), p.166.

²⁴² There is nearly no difference between the two CEPAs.

²⁴³ See GATT Art. XXIV and GATS Art. V.

²⁴⁴ See CEPA Art. 5.2.

²⁴⁵ See CEPA Art. 5.3.

²⁴⁶ See Chapter 4 of the CEPA.

CEPA Schedule, several Hong Kong insurance companies can form an insurance group to apply for entry to the Mainland insurance market and the total assets of the group can be calculated to satisfy the asset requirement of US\$5 billion, and it is unnecessary for each insurance company in the insurance group to have 30 years operation experience and two years representative offices in China. If only one of insurance company in the group meets the requirements of 30 years of operation experience and two years of representative offices, then it is deemed that the group meets these requirements.

Second, Hong Kong insurance companies can purchase shares of Mainland insurance companies, albeit with a ceiling of 24.9 percent.

Third, if a Chinese citizen who is also a Hong Kong resident obtains the qualification of a Chinese actuary, he can engage in business in the Mainland without prior approval.

Fourth, a Hong Kong resident can engage in relevant insurance business after obtaining a Chinese insurance business license and being employed by a Mainland insurance institution.

II. Banking and other financial services

According to the CEPA Schedule, the categories of banking services are equivalent to those in China's WTO Schedule.²⁴⁷ The fact that China did not include more categories of banking services in its regional trade agreements indirectly shows that the scope of banking services in China's WTO commitments is sufficiently broad for the purposes of China's leadership.

As to specific market access and national treatment commitments, China provides more favored treatment to Hong Kong (or Macau) banking service suppliers under the CEPA.²⁴⁸ First, the minimum total assets requirement for a Hong Kong (or Macau) bank to establish a branch or juridical person in Mainland China is reduced to US\$6 billion. Second, there is no precondition for a Hong Kong (or Macau) bank to set up a representative office before establishing a joint equity bank or joint equity finance company. Third, the conditions for a branch of a Hong Kong (or Macau) bank located in Mainland China to apply for RMB operations include: (1) two years business operation in China, unlike the requirement of three years business operation in China's WTO Schedule; and (2) comprehensive consideration of whole branches operation in order to determine whether it satisfies the profitable qualification, unlike individual consideration of a single branch operation in China's WTO Schedule.

²⁴⁷ See Table 1 of Annex 4 of the Mainland and Hong Kong CEPA. According to a footnote in the CEPA, the "mainland" refers to the entire customs territory of China. See WT/REG162/1, 20 January 2004.

²⁴⁸ The existing schedule of specific commitments under current CEPA is unilateral. There are only service commitments made by Mainland China to Hong Kong. According to the arrangement, Mainland China and Hong Kong will negotiate service commitments to be made by Hong Kong to Mainland China, which will be contained in Table 2 of Annex 4 of the Mainland and Hong Kong CEPA. See Specific Commitments on Opening Service Trade Area, Annex 4 of the Mainland and Hong Kong CEPA.

From the perspective of structure, the service schedule in the CEPA is so simple that it is not made in order of the four modes of supply used in GATS. Instead, all specific commitments on banking are in the column of market access, and only in relation to mode three, i.e. commercial presence. Throughout the CEPA, no article is specifically about national treatment or non-discrimination obligations, even with respect to trade-related investment, which is obviously different from most FTAs. For example, NAFTA has a national treatment clause dealing with trade in services,²⁴⁹ and a specific national treatment clause in respect to financial services trade.²⁵⁰ In the US-Singapore FTA, there are some national treatment articles.²⁵¹ The CEPA provides for some very specific national treatment commitments. For example, with respect to accounting, auditing and bookkeeping services (CPC862), China has undertaken the specific obligation to treat “Hong Kong accountants who have already qualified as Chinese Certified Public Accountants (CPAs) and practiced in the Mainland (including partnership) ... on par with Chinese CPAs in respect of the requirement for annual residency in the Mainland”. Given the fact of no national treatment provision pertaining to financial services exists in CEPA, when supplying services relating to Mainland China, these service suppliers enjoy national treatment based on GATS/WTO, not on CEPA. This means that disputes on national treatment between Mainland China and Hong Kong (or Macau) will be only subject to the WTO dispute settlement system, not to any CEPA dispute settlement arrangement.²⁵² In order to address the weakness of a lack of a national treatment article in CEPA, especially to place national treatment disputes between Mainland China and Hong Kong (or Macau) within the CEPA dispute settlement system, it may be desirable to include a national treatment article in the CEPA.

III. Securities services

According to China’s CEPA Schedule, China allows Hong Kong Exchange and Settlement Ltd. (HKEx) to set up a representative office in Beijing. China also simplified relevant procedures for Hong Kong professionals to apply for China’s securities and future qualifications. They only need to take a legal knowledge examination, rather than a professional knowledge examination.

IV. Comments

Generally speaking, the more favored treatment granted to Hong Kong and Macau provide for meaningful advantages for their service providers. For example, the CEPA significantly lowers total

²⁴⁹ See NAFTA Art. 1202.

²⁵⁰ See NAFTA Art. 1405.

²⁵¹ See US-Singapore FTA, Art. 2.1 (national treatment for trade in goods), Art. 8.3 (national treatment for trade in services), Art. 10.2 (national treatment for financial investment), Art. 10.5 (national treatment for financial services), Art. 15.4 (national treatment for investment).

²⁵² According to Art. 19:3 of the two CEPAs, a joint guiding commission is the dispute settlement body under the CEPAs.

asset requirement from US\$20 billion to US\$6 billion.²⁵³ Under China's WTO commitments, only four HKSAR banks, i.e. HSBC, Hang Seng Bank, Bank of East Asia and DBS bank, meet the threshold (minimum US\$20 billion).²⁵⁴ This number increases to ten when the total asset requirement is lowered to US\$6 billion. Thus, in addition to the four banks mentioned above, Nan Yang Commercial Bank, Shanghai Commercial Bank, CITIC Ka Wah Bank, Wing Hang Bank, ICBC Asia, Dah Sing Financial Group and Wing Lung Bank also meet the new standard.²⁵⁵

However, "service supplier" in the CEPA is much stricter than that in the GATS. On the one hand, according to GATS Article XXVIII (g), "service supplier" means any person that supplies a service. "Person" means either a natural person or a juridical person.²⁵⁶ Since "natural persons" are generally not allowed to supply "banking services" (for prudential reasons), "juridical person" is the focus for analysis. GATS Article XXVIII (m)(i) stipulates that "juridical person of another Member" means a juridical person which is constituted or otherwise organized under the law of that other Member, and is engaged in substantive business operations in the territory of that Member or any other Member.²⁵⁷ No minimum operation time is required for being a "service supplier".

On the other hand, according to CEPA Annex 5 "Definition of 'Service Supplier' and related Rules", the standards applying to a Hong Kong service supplier providing service by way of a juridical person include: (1) establishment or registration based on Hong Kong SAR Corporation Regulations or other regulations, with a valid business registration certificate or license; and (2) being engaged in substantive business operations in Hong Kong. These standards are consistent with GATS Article XXVIII (m)(i). Nevertheless, the tests to determine engagement in substantive business operation in Hong Kong include a minimum requirement of three years of registration and operation in Hong Kong.²⁵⁸ To be a Hong Kong service supplier in banking and other financial services, i.e. a Hong Kong bank or finance company, the minimum requirement is five years of operation after obtaining a license.²⁵⁹ This requirement of the CEPA is stricter than those in the GATS.

²⁵³ See the table for banking above.

²⁵⁴ The total assets of these four bank are as follows (in US\$m): HSBC: 763,565; Hang Seng Bank: 60,846; Bank of East Asia: 23,108; DBS Bank: 20,708. Original data are from annual reports of the respective banks, cited in *CEPA: A Tentative Analysis of Its Impact on Hong Kong* (Hong Kong: Trade Development Council, July 2003), <http://www.tdctrade.com/econforum/tdc/tdc030701.htm>

²⁵⁵ The total assets of Nan Yang Commercial Bank, Shanghai Commercial Bank, CITIC Ka Wah Bank, Wing Hang Bank, ICBC Asia, Dah Sing Financial Group and Wing Lung Bank are respectively US\$11,199 m, US\$9,394 m, US\$9,344 m, US\$7,910 m, US\$7,982 m, US\$7,799 m, and US\$7,322 m. Original data are from annual reports of the respective banks, cited in id.

²⁵⁶ See GATS Art. XXVIII(j).

²⁵⁷ In the case of the supply of a service through commercial presence, owned or controlled by (1) natural persons of that Member; or (2) juridical persons of that other Member. See GATS Art. XXVIII (m)(ii).

²⁵⁸ See Art. 3(1) of CEPA Annex 5 "Definition of 'Service Supplier' and related Rules".

²⁵⁹ Id., Art. 3(1) of CEPA Annex 5 "Definition of 'Service Supplier' and related Rules".

Compared with the CEPA, the Framework Agreement on Comprehensive Economic Cooperation Between the Association of South East Asian Nations (ASEAN) and the People's Republic of China (hereinafter referred to as the ACFTA) is much simpler in the area of trade in services. ACFTA Article 4 "Trade in services" merely stipulates that the parties agree to negotiate the liberalization of trade in services and lists the aims of such negotiations. Like the CEPA, in the ACFTA, there is no national treatment obligation for either trade in goods or trade in services between China and ASEAN countries.²⁶⁰

²⁶⁰ It could be argued that ACFTA Art. 4 (a) is in relation to national treatment, but it only points out one of the aims of service negotiation is to "progressive elimination of substantially all discrimination between or among the Parties and/or prohibition of new or more discriminatory measures with respect to trade in services between the Parties ...". Prior to the end of ACFTA service negotiations, the national treatment obligation has not been covered by the existing ACFTA.

CONCLUSION

Since entering the WTO at the end of 2001, China has made outstanding progress in opening up financial services trade and gradually eliminated restrictions on financial market access and national treatment. Foreign-funded banks are permitted to engage in RMB business in 13 cities (Shanghai, Shenzhen, Tianjin, Dalian, Guangzhou, Zhuhai, Qingdao, Nanjing, Wuhan, Jinan, Fuzhou, Chengdu and Chongqing). The fundamental laws and rules reflecting WTO commitments relating to financial sectors have been formulated, among which are three important regulations and rules, i.e., the Regulation on Administration of Foreign-Funded Financial Institutions (banking), the Regulation on Administration of Foreign-funded Insurance Companies (insurance) and the Rules for Establishing Foreign-invested Securities Companies (securities). Although it is probable that China will formulate more financial regulations and rules, such as the Detailed Rules for Implementing the Regulation on Administration of Foreign-funded Insurance Companies (a draft was published by the CIRC on 31 July 2003 for comment), and revise the Detailed Rules for Implementing the Regulation on Administration of Foreign-Funded Financial Institutions in accordance with the banking regulatory power transfer from the PBOC to the CBRC, the new foreign-funded financial law framework has been established within the first two years post-accession.

From these newly published financial laws, regulations and rules, one can find two tendencies. The first tendency is that China's financial regulation system is moving forward along a path of prudential regulation in the process of performing its WTO commitments and obligations. The second tendency is that more and more laws, regulations and rules in China apply to both foreign and domestic financial institutions, with equal treatment. The experience of the past two years shows that China is seriously and positively implementing its WTO financial commitments. There exist some issues, such as high capital requirements, and it is possible that some issues will continue to exist for a long time; however, one of the advantages of the WTO is that it provides a multilateral mechanism to resolve those problems, through consultations, the TRM (or final TPRM for China) and the Dispute Settlement Mechanism. In fact, China's accession to the WTO has not caused a "flood" of litigation as predicted by some commentators. However, the real challenge for China's financial services sector will occur after the end of the five year transitional period, i.e. from December 2006. Therefore, China's financial laws, regulations and rules must be well prepared and adjusted for real WTO challenges in the near future.