China | China opens financial sector to more foreign ownership

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China has taken a major step toward the long-awaited opening of its financial market. On last Friday, unveiled at a government briefing during the US President Trump's first visit to China, Vice Finance Minister Zhu Guangyao said China will remove foreign ownership limits on banks while allowing overseas firms to take majority stakes in local securities ventures, fund managers and life insurance companies. This move indicates that China will give global financial companies more access to the financial sector of the world's second-largest economy.

In particular, the key points of the speech could be summarized as follows:

- Foreign firms will be allowed to own stakes of up to 51% in securities ventures; and China will drop foreign ownership limits for securities companies three years after the new rules are effective.
- China will lift the foreign ownership cap to 51% for life insurance companies after three years and remove the limit after five years.
- Limits on ownership of fund management companies will be raised to 51%, and will be removed in three years.
- China will also eliminate the 20% ceiling on ownership of a Chinese commercial bank or asset management companies by a single foreign investor and the 25% cap on total foreign ownership of such companies.

It is a milestone move for China on its way to financial liberalization

On the way of financial liberalization, China has already made some steps in opening its equity and bond markets to foreign investors, such as the recently launched Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect and Bond Connect etc. In addition, the authorities also accomplished the interest rate liberalization and are on the way to internationalize the currency and to further promote inbound and outbound investment.

However, international banks and securities firms have long been frustrated by ownership caps that made them as marginal players in China's financial sector. Actually, China has used joint venture requirements and ownership caps in a broad range of industries to protect domestic companies from competition with foreign firms and to induce sharing of foreign technology and management expertise with local partners.

Some caveats are noteworthy to cautiously welcome the new policy

First, how important a role foreign financial firms can play remains uncertain. Some scholar predicted that overseas companies will probably focus on increasing their presence in insurance companies, securities and fund management industries, which have significant room for them to participate. However, the bank lending business, which is dominated by the four largest state-owned banks, will attract less interest for them because these banks have longstanding relationships with giant state-owned companies while foreigners lack a competitive edge.

Second, it will take time for Zhu Guangyao's commitments to be translated into actual policy by respective regulatory agencies for banking, securities and insurance, as well as the central bank. Although the big direction is here, we believe that the process will be slow.

Third, while opening the financial sector to more foreign ownership, Chinese authorities might further strengthen the macro prudential policies and financial regulations in order to circumvent some potential shocks that foreign financial companies might bring to the domestic financial market.

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