

**COMPARATIVE VIEW ON THE MARKET ACCESS
SUPERVISION OVER FOREIGN BANKS IN
CHINA AND HONG KONG^{*}**

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ABSTRACT

In recent years, with the deepening of economic and financial integration in the world, more transnational banks intend to access China markets for doing business, and therefore the voices for opening China's domestic markets as well as improving foreign bank market access supervision are high. The thesis introduces mainland China's foreign bank market access supervision, including its supervisory regime, legislative pattern, legal requirements and the procedures of foreign bank market access, and then provides a comparative perspective with Hong Kong's foreign bank market access supervision. Based on such comparison between mainland China and Hong Kong, the thesis outlines four main issues of foreign bank market access supervision in mainland China, including its decentralized supervisory regime, disorganized supervisory legislative system, strict business access restrictions, and unreasonable access procedures, and proposes solutions in response to these issues by taking reference from Hong Kong's advanced experience.

Keywords: Foreign Bank, Market Access, Supervision

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บทคัดย่อ

ในช่วงหลาชีปีที่ผ่านมา มีการรวมกลุ่มทางศรษฐกิจและการเงินเกิดขึ้นมากมาก ส่งผลให้ธนาคารข้ามชาติ มีความต้องการที่จะเข้ามาทำธุรกิจในตลาดของจีนแผ่นดินใหญ่มากขึ้น(ไม่รวมไต้หวันซึ่งคงจะมาแล้ว)ส่งผลให้มีผู้สนใจเข้ามาร่วมลงทุนจำนวนมากในจีนแผ่นดินใหญ่ รวมถึงให้มีการปรับปรุงการกำกับดูแลการเข้าสู่ตลาดของธนาคารต่างประเทศ

วิทยานิพนธ์ฉบับนี้นำเสนอวิธีการกำกับดูแลการเข้าสู่ตลาดของธนาคารต่างประเทศในจีนแผ่นดินใหญ่ รวมถึงหลักการตรวจสอบ รูปแบบทางกฎหมายข้อกำหนดทางกฎหมาย และขั้นตอนการเข้าสู่ตลาดของธนาคารต่างประเทศ รวมถึงนำเสนอผลการศึกษาเบรียบพิบัติในการกำกับดูแลการเข้าสู่ตลาดของธนาคารต่างประเทศในอ่องกง โดยคำนึงถึงพื้นฐานของความแตกต่างของทั้งจีนแผ่นดินใหญ่และอ่องกง วิทยานิพนธ์นี้จะกล่าวถึงประเด็นสำคัญว่า ประการในการกำกับดูแลการเข้าสู่ตลาดของธนาคารต่างประเทศในจีนแผ่นดินใหญ่ รวมถึงหลักการการกระจายอำนาจในการตรวจสอบการกำกับดูแลทางกฎหมายที่ไม่เป็นระเบียบ ข้อจำกัดที่เข้มงวดและขั้นตอนที่ไม่เหมาะสมในการเข้าสู่ธุรกิจ และเสนอแนวทางในการแก้ไขปัญหาโดยข้อสังจารณ์เกี่ยวกับของอ่องกง

คำสำคัญ : ธนาคารต่างประเทศ, การเข้าสู่ตลาด, การกำกับดูแล

1. Introduction

In recent years, with the globalization of economy and trade, the integration and interdependence between financial institutions, financial instruments, and financial markets are also strengthening, which has brought not only an increase¹ in transnational banking institutions, cross-border transactions and international business, but also international financial turbulence, as well as a new wave of banking supervision reform.

Currently, on one side, there is a surge of transnational banks entering China's domestic financial market, while on the other, there is an outdated supervisory system hardly keeping step with this increase.

Foreign bank market access supervision refers to regulatory authorities appointed and authorized by laws, monitoring and implementing existing laws and regulations that govern foreign bank market access and also formulating relevant subordinated rules and policies to regulate how foreign banks access hosting country markets and set up an entity. Foreign bank market access supervision includes four key points: i) the hosting country's supervisory regime regarding this matter, ii) the legislative pattern, iii) the legal requirements, and iv) the application and approval procedure.

To this end, this article will introduce laws and practices regarding foreign bank market access supervision, focusing on mainland China's legislation and practice in this matter and comparing this with Hong Kong's experience, then discussing various problems of mainland China in this area before proposing constructive suggestions.

¹ As of the end of 2015, 209 representative offices have been set up by 181 foreign banks from 45 countries and regions, 94 branches have been set up by 77 foreign banks from 26 countries and regions, and 37 wholly foreign-funded banks and 2 Chinese-foreign equity joint venture banks have been established by foreign banks from 14 countries and regions. The institutions of these foreign banks cover 27 provinces and 50 cities in China, an increase of 30 cities compared with 2003. Regarding performance, as of the end of 2015, the total assets of foreign bank profit-institutions in China reached 2.15 trillion RMB, up 23.60% year on year; deposit balance reached 1.32 trillion RMB, up 25.27% year on year; and loan balance reached 978.5 billion RMB, up 7.10% year on year. It turns out that foreign banks are still playing an aggressive role in China. (Annual Report 2015. China Banking Regulatory Commission. China Financial Press. 2016. 5)

2. China Laws and Practice of Foreign Bank Market Access Supervision

2.1 China Banking Supervisory Regime

There are three main regulators supervising China's banking industry and foreign bank market access: the China Banking Regulatory Commission ("CBRC"), the People's Bank of China ("PBOC"), and the State Administration of Foreign Exchange ("SAFE").

CBRC is the main authority responsible for supervision over banking institutions and operations.² It has the power to conduct the examination and approval for all banking financial institutions including foreign bank establishment, modifications, termination, and business scope³, as well as to adopt the admittance qualifications of management, directors and senior executives of all the banking financial institutions including foreign banks⁴.

PBOC is the central bank of China, having the power to formulate and implement monetary policies, supervise the inter-bank market, maintain the operation of payments and settlements system, and direct and dispose of anti-money-laundering.⁵ Foreign banks are required to get approval and support from PBOC in order to access its central payment and settlement system, open a clearing account, pass the anti-money-laundering requirements, and deliver the deposit reserves, among other activities.

SAFE undertakes the foreign exchange administration functions in China.⁶ Since one of the main businesses of foreign banks is to provide financial services to transnational enterprises, plus with frequent cross-border capital flows between foreign banks and their overseas parent banks, foreign banks will also be involved

² Article 2 and 3, Banking Supervision Law of the People's Republic of China. Standing Committee of National People's Congress, 2006 Amendment.

³ Article 16, Banking Supervision Law of the People's Republic of China. Standing Committee of National People's Congress, 2006 Amendment.

⁴ Article 20, Banking Supervision Law of the People's Republic of China. Standing Committee of National People's Congress, 2006 Amendment.

⁵ For more detailed information, please refer to article 4, Peoples' Bank of China Law. National People's Congress, 2003 Amendment.

⁶ For more detailed information, please refer to the official website of SAFE: <http://www.safe.gov.cn/>.

in SAFE's supervision. In addition, to access several specific foreign exchange businesses, it is necessary to acquire SAFE's approval.

2.2 China Banking Supervisory Legislation

Laws governing domestic banks and foreign banks in China can be separated into two systems: i) general laws governing both domestic banks and foreign banks, and ii) laws governing foreign banks only. Formulated in 1995 and amended in 2015, the *Law of the People's Republic of China on Commercial Banks* is the leading general law regulating the entire banking industry in China. In theory, it covers both domestic banks and foreign banks; however, it indicates an exception for regulating foreign banks, "unless otherwise there are provisions by laws and administrative regulations, these provisions shall prevail"⁷. Thus, later a series of regulations and rules were promulgated and became the special rules regulating foreign banks in China, establishing a separate supervision legislative system for foreign banks and their market access.

Regarding foreign bank market access supervision, currently, there are dozens of laws and regulations governing this matter, across both the general banking supervision legislative system and the foreign banking supervision legislative system, such as the Regulation of the People's Republic of China on the Administration of Foreign-funded Banks, the Implementation Rules for the Regulations of the People's Republic of China on the Administration of Foreign-funded Banks, the Implementation Measures of the China Banking Regulatory Commission for the Administrative Licensing Items concerning Foreign-Funded Banks, and the Measures for the Administration of the Office-holding Qualifications of the Directors (Council Members) and Senior Managers of Banking Financial Institutions.

2.3 Legal Requirements on Foreign Bank Market Access in China

The legal requirements on foreign banks market access in China can be summarized into 3 aspects: i) requirements for entity set-up, ii) requirements for business access, and iii) requirements for senior executive appointments.

⁷ Article 92, Law of the People's Republic of China on Commercial Banks, Standing Committee of the National People's Congress, 2015 Amendment.

2.3.1 Requirements for Entity Set-up

According to China laws, foreign banks must fulfill a series of conditions required by laws covering capital adequacy, profitability, experience, reputation, risk control, and internal management, and apply for CBRC's examination and approval, in order to set up any new entities in China. Those requirements on institution access mainly focus on two aspects: i) requirements on the overseas parent bank or foreign shareholder, and ii) requirements on the to-be established institution itself.⁸

2.3.2 Requirements for Business Access

In China, a foreign bank's business access can be divided into two aspects, i) general business access, and ii) additional business access. A newly established foreign-invested bank must obtain a financial permit issued by CBRC, which will state several general businesses that the new entity can engage in, covering 12 to 13 items depending on whether the new entity is a foreign bank branch or a foreign bank subsidiary.⁹ After formal establishment, this newly established foreign-invested bank may apply to CBRC for additional business permits on a case by case basis, such as RMB business, debt or capital instruments issuance, derivatives business, credit card business, and overseas wealth management services for clients.¹⁰

However, China sets several critical restrictions and prohibitions on foreign bank business access, such as: i) a newly established foreign bank is prohibited from engaging in Chinese Yuan business in its first year after

⁸ For details of those requirements, please see Implementation Measures of the China Banking Regulatory Commission for the Administrative Licensing Items concerning Foreign-Funded Banks, Order No. 4 [2015] of the China Banking Regulatory Commission, 2015 Amendment.

⁹ If the new entity is a foreign bank branch, its business scope may include 12 items. If the new entity is a foreign bank subsidiary, then its business scope may include 13 items. For details of the business scope, please see Article 31 and 29, Regulation of the People's Republic of China on the Administration of Foreign-funded Banks, State Council, 2014 Amendment.

¹⁰ Chapter 5, Implementation Measures of the China Banking Regulatory Commission for the Administrative Licensing Items concerning Foreign-Funded Banks, Order No. 4 [2015] of the China Banking Regulatory Commission, 2015 Amendment.

establishment, ii) a foreign bank branch is prohibited from providing any Yuan business to Chinese citizens except for accepting fixed-term deposits in an amount of no less than one million Yuan, and iii) foreign-invested banks and domestic banks are under different treatments regarding the business application and approval process (e.g. foreign-invested banks are required to obtain more approvals and permits for engaging in certain business areas such as Yuan business permit).

2.3.3 Requirements for Senior Executive Appointments

The appointment of a senior executive of a to-be established foreign bank institution, such as director, senior management personnel, or chief representative, is under the strict supervision of CBRC. Senior executives cannot assume their positions before being approved by CBRC. There are a number of conditions for senior executive appointments set by laws.¹¹

2.4 Procedure of Foreign Bank Market Access in China

The market access procedure for foreign banks in China can be divided into two main phases: i) the establishment preparation access phase, and ii) the business commencement access phase. During these different phases, the to-be established entity and its overseas parent bank or foreign shareholder must fulfill different requirements and submit a number of application documents to CBRC respectively, while CBRC will then conduct its supervision based on the performance of the to-be established institution and its overseas parent bank or foreign shareholder as well as their submitted documents, and make a decision of approval or denial of the application for establishment preparation access or business commencement access.¹²

¹¹ For details of those requirements, please see the Measures for the Administration of the Office-holding Qualifications of the Directors (Council Members) and Senior Managers of Banking Financial Institutions.

¹² For details of those requirements, please see Implementation Measures of the China Banking Regulatory Commission for the Administrative Licensing Items concerning Foreign-Funded Banks, Order No.4 [2015] of the China Banking Regulatory Commission, 2015 Amendment.

3. Hong Kong Laws and Practice of Foreign Bank Market Access Supervision

In order to provide a more specific comparative view, the article will give a brief introduction to Hong Kong laws and practice regarding foreign bank market access by focusing on four main sectors: the supervisory regime, the legislative pattern, the legal requirements of business access, and the application and approval procedure.

First, Hong Kong implements a centralized supervision regime for its banking sector which is different from mainland China. Hong Kong Monetary Authority (“HKMA”) is the sole regulatory authority undertaking the duties of a central bank, supervising all banking institutions, as well as managing Hong Kong’s Exchange Fund.¹³ In other words, all banking institutions, including foreign banks and their market access are subject to HKMA’s sole supervision.

Second, Hong Kong’s legislation on banking supervision is highly organized. Unlike mainland China, to regulate such a huge and detailed project as market access of the banking industry, Hong Kong legislators and regulators use only one ordinance, plus one guideline, to cover all legal principles and regulatory requirements, namely, Hong Kong Banking Ordinance and Guide to Authorization. Such a highly organized and centralized banking legislative pattern provides great facilitation to apply and supervise market access of the banking industry in Hong Kong, which is a sharp contrast to the banking legislative pattern in mainland China.

Third, Hong Kong places no barrier to overseas banks operating locally in the territory, whether the transactions are conducted in Hong Kong dollars or other currencies.¹⁴ In other words, in Hong Kong, foreign banks are entitled to the same treatment as local banks without any restrictions.

Fourth, compared with China, Hong Kong presents two characters regarding the application and approval procedure: i) Hong Kong sets a pre-communication and coordination process between the to-be established banking institutions and HKMA, which can improve the effectiveness for completing the application as well as

¹³ For more detailed information, please refer to the official website of HKMA: www.hkma.gov.hk/eng/

¹⁴ The Three-tier Banking System, an introduction to Hong Kong’s banking system, see the official website of HKMA <http://www.hkma.gov.hk/eng/key-functions/banking-stability/banking-policy-and-supervision/three-tier-banking-system.shtml>

shortening the time that HKMA deals with the application.¹⁵ ii) Hong Kong provides a hearing and appeal process for the to-be established banking institutions in the event of being rejected by HKMA.¹⁶

4. The Issues and Proposed Solutions of Foreign Banks Market Access Supervision in China

4.1 The decentralized supervisory regime with multi-supervisory regulators has numerous negative effects.

First, China separates supervisory power thus resulting in low supervisory effectiveness. A foreign bank must be subject to separate supervision and seek approval from CBRC, PBOC, and SAFE. Second, a decentralized supervisory regime may cause conflicts of orders made by different regulators. Although each regulator has its own scope of duty, these scopes do not stand in sharp contrast and sometimes may result in conflicts, thus creating confusion for foreign banks. Third, supervisory power may also cause political fights for supervisory power.

Based on Hong Kong's experience in this area, the article proposes two solutions for this issue. First, China should consider integrating the current multi-regulators into one general regulatory entity, to take charge of banking supervision, undertake central bank functions, and manage the state foreign exchange. Second, China should set up a one-stop center to coordinate foreign banks within different departments of the regulator.

4.2 The dual legislative pattern for domestic banks and foreign banks with scattered laws and regulations may cause significant inconveniences.

In one aspect, a foreign bank must comply with general laws and regulations which govern the entire banking industry and also comply with laws which are formulated to regulate foreign bank market access supervision separately, which is complicated and sometimes results in loopholes. In another aspect, in the process of foreign bank market access application and supervision, both foreign banks and regulators must collect all relevant provisions from massive and scattered laws and

¹⁵ Section 8.2-8.4, Guide to Authorization

¹⁶ Section 8.17-8.19, Guide to Authorization.

regulations to deal with different circumstances in the application and supervision processes, which is a serious obstacle and slows effectiveness.

Taking reference from Hong Kong's advanced legislative pattern, the article suggests that China should reform the current legislative pattern and simplify the laws. First, China should carry out an overall clean-up of all current laws and regulations governing foreign bank market access, to cut down unnecessary, overlapped and out-of-date provisions, and gather all the scattered and numerous provisions together and compile these into one single code. Second, China should apply legal application procedures to both domestic and foreign banks similarly, so that a foreign bank no longer needs to comply with different legal systems, both general banking laws and foreign banking regulations, at the same time when proceeding with the market access process.

4.3 Several critical restrictions and prohibitions to foreign bank business access serve as obstacles to foreign banks to operate and expand business in China

As mentioned above, there are numerous critical restrictions to foreign bank business access, such as Chinese Yuan business restriction, retail business restriction, and different treatments between domestic banks and foreign banks, while Hong Kong sets no restrictions or prohibitions for foreign banks to operate business, whether conducted by Hong Kong dollars or other currencies. Foreign banks are entitled to the same treatment as local banks in Hong Kong.

To this end, China should cancel the restriction for foreign-invested banks engaging in Yuan business, cancel the restriction for foreign bank branches engaging in retail business, and facilitate the foreign bank market access process by providing the same treatment to foreign banks as to domestic banks, which will not negatively impact the domestic banking industry, but on the contrary, may push domestic banks to develop by introducing competition.

4.4 The unreasonable procedure for foreign bank market access does not favor the protection of foreign bank benefits

First, China regulators conduct supervision and grant approvals under a low-transparency situation, and foreign banks have difficulty making any estimations regarding their applications. Second, market access approval in China is divided into two phases, preliminary approval and formal approval, and each foreign bank

must respectively submit the two applications and obtain two approvals one by one, which reduces effectivity. Third, the current procedure for foreign bank market access has no hearing or appeal process for the final decision. If the foreign bank's application is denied by the regulator, the access process will be terminated immediately.

Based on Hong Kong's practice in this area, the article suggests that China: i) improve its foreign bank market access process by introducing Hong Kong's pre-communication and coordination mechanism, ii) combine two phases of application and approval into one phase in order to shorten the time for access and to improve supervisory effectivity, and iii) set up a hearing and appeal procedure, so as to protect the foreign banks' legitimate benefits and also help prevent any mistakes made by the regulator taken together these suggestions which will make China's foreign bank market access process more just and reliable.

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