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Committee on Trade in Financial Services

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COMMUNICATION FROM CANADA

Transitional Review Mechanism in connection with Paragraph 18 of the Protocol on the Accession of the People's Republic of China

The attached communication has been received from the delegation of Canada with the request that it be distributed to Members of the Committee on Trade in Financial Services.

I. PREAMBLE

1. Canada welcomes the significant progress made by China in striving to implement its WTO commitments for financial services. Approvals for new entrants to the banking, insurance and the securities industries have increased competition, while geographic restrictions have so far been lifted within the timeframes committed to by China. In addition, while licensing procedures remain burdensome, Canada understands that published timelines for approval are being respected for the most part. Finally, the release of new rules and regulations governing financial services has enhanced transparency for firms operating in China.

2. Building on Canada's submission for the TRM process in 2002 (S/FIN/W/20), the main focus of this inquiry is to seek clarification of the prudential reasoning behind certain regulations. In addition, Canada is interested in how certain specific measures are regarded to be consistent with China's commitments in its Schedule of Specific Commitments and/or the Working Party Report on China's Accession. The promotion of a transparent regulatory regime is very important to Canada, and a number of questions/comments address this issue accordingly. Further to China's intervention during the 2002 TRM exercise, Canada is also requesting further clarification on some issues regarding banking services and licensing procedures for financial services, as noted below.

3. In accordance with paragraph 18 of China's accession protocol, and in order to contribute to an informed discussion, Canada requests that China provide written responses and relevant information concerning these questions and comments before the next meeting of the Committee on Trade in Financial Services.

II. QUESTIONS AND COMMENTS

A. INSURANCE

4. To ensure that insurance firms can form clear expectations regarding their rights and obligations when operating in China, Canada would like to encourage CIRC to communicate with insurance firms in writing as much as possible, especially regarding interpretation of relevant rules and regulations.

5. Canada understands that domestic insurers can apply to be licensed at the city level or the provincial level, and a provincial license allows a firm to offer services to any city or area within the province. Can China please confirm this understanding? As well, while China's GATS Schedule of Specific Commitments states that foreign-invested insurance firms will face restrictions on geographic expansion for the first three years after accession, can China please confirm that after this three-year period (i.e. as of December 2004), foreign-invested insurance firms will also be allowed to apply for provincial licenses (consistent with China's National Treatment commitments)? If foreign-invested firms will not be allowed to apply for provincial licenses, can China please outline the process by which foreign-invested firms will be permitted to expand geographically?

6. Can China please outline the approval requirements and procedures for new life insurance products and provide information on any differences that may exist between actual approval times for foreign-invested firms and domestic firms? Is the approval procedure the same for foreign and local companies, including for industry consultations and/or hearings regarding new product filings? If not, can China please explain how this is consistent with its National Treatment obligations in its Schedule of Specific Commitments? In addition, can China please confirm that prior approval by CIRC is required for each new life insurance product, and that the product must be re-approved for sale in each separate city that a foreign-invested life insurance firm operates in? Is this also the case for both foreign and domestic firms? If CIRC requires re-approval for each city in which a life-insurance product is to be sold, can China please explain the prudential rationale behind requiring multiple approvals for the same product?

7. According to a notice issued by CIRC on 27 October 1999, "Circular on Re-Transmission of 'Reply of the People's Bank of China to Permit Experimented Agreement Deposits of Insurance Companies with Commercial Banks'" (No. 201), domestic firms are allowed to freely place contractual deposits (that can include special interest rates) with local banks. However, the 1999 notice also explicitly excludes foreign-invested insurance firms from this permission, and Canada's understanding is that foreign-invested firms must at present obtain special written permission from the regulator before they can negotiate contractual deposits with local banks. Can China please confirm whether this discriminatory rule is still in place, and if so, whether it is administered at present by the PBOC or the CBRC? As well, should this rule still exist, can China please explain how it plans to reform it to ensure National Treatment for foreign-invested insurance firms?

8. Canada notes that minimum capital requirements for insurance companies remain very high by international standards, and requests that China continue to review its capital requirements to ensure efficiency and an entry regime that is not overly burdensome for foreign insurance firms.

9. Can China please provide an overview of the recent changes to reserving requirements for life insurance products? As well, can China please outline the policy basis supporting the introduction of stricter reserving requirements at this time? Further, is it the case that domestic firms, including those that must honour high guaranteed-rate insurance policies sold in the 1990s (and which threaten the soundness of their capital bases when current interest rates are very low), are in some cases being given leeway with respect to complying with the new reserve requirements for in-force policies? Canada is concerned that foreign-invested life insurance firms (which do not have these expensive guaranteed-rate policies on their books) now face a higher cost of doing business and reduced profitability because the new reserve requirements are effective immediately for their in-force and new policies. Is China considering any further revisions to its life insurance reserving regulations to promote the continued stability of domestic life insurers while not adversely affecting those foreign-invested firms that have entered the market more recently and have maintained healthy balance sheets? Has China ensured that it is complying with its National Treatment commitments with respect to the design and implementation of these new reserve requirements?

10. Article 15 of “Provisions of the Insurance Company Administrative Measures” [promulgated by CIRC, March 1, 2000] states that an insurance company establishing a branch office “shall have senior management personnel for the branch office who meet the qualifications of their posts specified by CIRC”. In practice, one of these “qualifications” is that senior management personnel must be able to speak Chinese. Can China please outline the criteria used to assess this qualification? As well, what managerial positions are typically bound by this qualification?

B. BANKING

11. During the 2002 TRM exercise China commented in general terms on registered capital requirements for branches of foreign-invested banks. However, it did not explain the prudential rationale behind assessing these requirements on a branch-by-branch basis, including the 8% capital adequacy requirement for each individual branch. Canada’s concern relates to capital adequacy ratios for individual branches and Article 38 of the “Detailed Implementing Rules for the Administrative Regulations on Foreign-Invested Financial Institutions” [promulgated by the PBOC], which requires that for a given branch to be eligible to receive initial approval to provide local currency services or to receive approval to increase the scope of such services, this branch must have been in operation for more than three years and have been profitable for the two consecutive years prior to application. Canada reiterates that these requirements, especially when imposed at the individual branch level, present a significant impediment to the expansion of local currency services by foreign-invested banks. Would China please explain why it disagrees with the view that applying prudential requirements to the aggregate Chinese operations of foreign-invested banks may be more efficient than addressing prudential concerns on a branch-by-branch basis?

12. Canada would once again like to take this opportunity to raise its concerns regarding the CBRC’s unusually high minimum capital requirements for banks. While Canada recognizes and appreciates the differentiation that is incorporated into the capital rules (i.e. different levels of required capital depending on the *scope* of business), it remains the case that the lack of flexibility in the capital requirement guidelines regarding the *size* of banking operations can adversely affect smaller banks, banks seeking to specialize, or banks seeking to be active in smaller markets. As a result, these requirements can have a significant negative impact on competition. Is the CBRC planning to introduce more flexibility into its capital rules to help smaller firms compete on a more even footing? If so, over what timeframe will these changes be implemented?

13. Article 14 of the “Detailed Implementing Rules for the Administrative Regulations on Foreign-Invested Financial Institutions” stipulates that foreign banks must wait one year between receiving approval for a given branch and submission to the CBRC of an application to open another branch. Canada noted in the 2002 TRM exercise that this appears to be inconsistent with China’s commitment in its Schedule of Specific Commitments to only retain prudential restrictions in its licensing regime for banking. While China remarked last year that opening new branches could place “unhealthy pressure on the soundness of operations and risk management” [S/FIN/M37, Paragraph 21, 2.d)], could China please indicate whether it has experienced any occurrences of this in relation to internationally active banks that often set up numerous branches at the same time in other national markets? As well, are domestic banks in China bound by this same restriction?

14. In Canada’s submission for the TRM process in 2002 (S/FIN/W/20), Canada noted that Article 30 of the “Administrative Regulations on Foreign-Invested Financial Institutions” requires that the value of a foreign bank’s foreign currency deposits received within China shall not exceed 70% of the value of its foreign currency assets within China. Further, Canada stated that this requirement limits the ability of foreign banks to lend foreign currency without borrowing from Chinese banks or bringing in foreign currency from abroad. In its response last year (S/FIN/M37, Paragraph 57), China did not outline the prudential rationale for this requirement, nor explain how this requirement is consistent with China’s Market Access commitments under Article XVI of the GATS. However,

China did note that this requirement had been relaxed from a previous 40% limit, and that the 70% limit “would be further relaxed during the five year transitional period.” Can China please explain the prudential rationale for the present 70% limit, and provide details of its plans to relax this restriction?

15. In late 2002, the PBOC issued Draft Notice No. 28 containing regulations that would cap the amount of RMB that banks can borrow on the interbank market to fund their lending business at 40% of their RMB deposits. Can China please confirm whether it is still considering introducing these regulations and whether it is considering any amendments pursuant to the comments it has received? While China claimed during the 2002 TRM exercise that these rules would meet a National Treatment test [S/FIN/M37, Paragraph 21, 2.c)], this cap could put foreign banks at an extreme disadvantage – especially those who are not planning to establish large RMB deposit bases – because it will artificially limit the amount of lending they can do. Keeping in mind that National Treatment is assessed not only on whether treatment is similar, but also whether this treatment affords equal competitive opportunities (as described in Article XVII.3 of the GATS) could China please explain in more detail how the draft regulations are consistent with its National Treatment obligations in its Schedule of Specific Commitments? As well, in relation to the above-mentioned likely effect of limiting lending by foreign banks, could China please explain how artificially limiting interbank loans is consistent with its GATS Market Access obligations?

C. GENERAL

16. Canada has previously noted that China's licensing requirements for foreign participation in the banking, insurance, and fund management sectors all have complex multi-stage approval processes for establishment of new locations. These often involve an initial approval for a preparatory office, and then another approval to commence operations. These processes can be very costly and time consuming for firms and may contradict the spirit of Paragraph 308 of the Working Party Report, namely that "China's licensing procedures and conditions would not act as trade barriers to market access and would not be more trade restrictive than necessary." In its intervention during the 2002 TRM exercise [S/FIN/M37, Paragraph 21, 1.a)], China addressed Members' complaints about a “multi-tiered application” process, but only made reference to cases where applications are incomplete or fail to meet CIRC requirements. Canada would like to reiterate that its concerns lie with the multi-stage application processes outlined here and contained in the "Administrative Regulations on Foreign-Invested Financial Institutions", the "Administrative Regulations on Foreign-Invested Insurance Companies", and the "Administrative Regulations on Foreign Participation in the Establishment of Investment Funds". Can China please comment on the prudential rationale for applying multi-stage branch-licensing procedures (i.e. requiring the establishment of a preparatory office and often imposing a several month waiting period before a final inspection, after which the firm may be permitted to commence operations) on firms that have already successfully established their business in China? As well, can China please explain how complex approval procedures for successive branches or locations of a foreign-invested financial institution are consistent with its Market Access commitments and Paragraph 308 the WTO Working Party Report on China's Accession?

17. While regulatory transparency has improved markedly since China's accession to the WTO and Chinese regulatory authorities have demonstrated a genuine interest in receiving input from financial institutions and other WTO Member governments, Canada would like to note that the periods provided for public comment on the July 31, 2003 draft “Implementing Rules for the Regulations of the People's Republic of China on Administration of Foreign-Funded Insurance Companies”, and the August 18, 2003 draft “Administrative Regulations of the People's Republic of China on Insurance Companies” [issued by the CIRC] were very short by international standards and did not afford enough time for a considered response, especially given the need to allow time for translation of relevant documents. Canada encourages the Chinese regulatory authorities to provide

as much time as possible for public comment and to consider adopting a common standard across the CBRC, CIRC and CSRC for public consultation periods on draft rules and regulations.
