

WORLD TRADE ORGANIZATION

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Committee on Trade in Financial Services

REPORT OF THE MEETING HELD ON 19 SEPTEMBER 2005

Note by the Secretariat¹

1. The Committee on Trade in Financial Services held a meeting on 19 September 2005, under the Chairmanship of Mr. Guido Kemmerling (Germany). The agenda is contained in airgram WTO/AIR/2647.

A. ADOPTION OF THE ANNUAL REPORT TO THE COUNCIL FOR TRADE IN SERVICES

2. The Chairperson drew Members' attention to document S/FIN/W/47, containing a draft report of the Committee's activities in 2005.

3. With regard to paragraph 2 of the draft report, the representative of the United States suggested that the following sentence be added after the first sentence: "Some Members expressed concern that the three Members have not yet accepted the Fifth Protocol."

4. The representative of Brazil suggested that the following sentence be added to the final paragraph of the report: "Some Members expressed concern with the presentation of this communication at the Committee on Trade in Financial Services."

5. The Committee adopted the annual report with those amendments.

B. TRANSITIONAL REVIEW UNDER SECTION 18 OF THE PROTOCOL ON THE ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA

6. The Chairperson recalled that the Committee was mandated to conduct this review of the implementation by China of its commitments pursuant to section 18 of the Protocol on the Accession of the People's Republic of China. For this year's review, written communications had been received in advance from the following Members: the European Communities (S/FIN/W/44); the United States (S/FIN/W/45); Japan (S/FIN/W/46); Chinese Taipei (S/FIN/W/48); and Australia (S/FIN/W/49).

7. The representative of China said that the Chinese government had always attached great importance to the strict compliance with its commitments in the WTO. In the past year, the financial authorities had made enormous efforts to seriously implement China's commitments through the improvement of market access conditions for foreign-funded financial institutions, as well as through the enhancement of transparency and efficiency of their financial regulatory work.

8. Rules for Implementing the Regulation Governing Foreign-funded Financial Institutions in China, which took effect on 1 September 2004, had promoted the development of foreign-funded banks in China. With the establishment of an effective banking regulatory framework and the cultivation of a fair competition environment, the safe operation of the banking system would better safeguard the sustainable development of the economy.

¹ This document has been prepared under the Secretariat's own responsibility and without prejudice to the positions of Members and to their rights and obligations under the WTO.

9. In the past year, foreign service providers had been speeding up their steps to access the Chinese financial services market while China's commitments phased in. The number and market share of foreign financial institutions had increased dramatically.

10. In the case of the banking industry, following an earlier-than-committed opening of RMB business to foreign-funded banks in the cities of Shenyang and Xi'an last year, RMB business in Shantou and Ningbo would be opened in December this year strictly as committed. Thus, RMB business in 20 cities across China would be open to foreign-funded banks by then. By end July 2005, foreign banks had established 227 operational entities in China. In addition, 133 foreign-funded banks had been approved to operate RMB business up to now, including 73 banks approved to operate RMB business for non-foreign invested enterprises; 15 foreign banks were permitted to provide on-line banking services; 41 foreign-funded banks were permitted to carry out derivative products transactions; and 5 foreign bank branches were permitted to offer custodian services for securities investment by qualified foreign institutional investors (QFII) in China. Together with the increase of institutions, the business of foreign-funded banks was also developing rapidly. As of end July 2005, the total assets of foreign-funded banks in China had reached over US\$ 79.29 billion.

11. According to its commitments, China had phased out all geographical restrictions to foreign-funded insurers by the end of last year. Foreign-funded insurers may already carry out all kinds of life and non-life insurance business in China, besides those not included in the commitments. He added that as of the end of this year, no compulsory cession would be required anymore upon all lines of primary risks for non-life, personal accident, and health insurance businesses.

12. Since the last review, the development and opening of the insurance industry in China had continued in good terms. Institutional and business expansion of foreign-funded insurance companies had further accelerated. At the same time, the turnover of foreign-funded insurers was growing dramatically. According to the Chinese Insurance Regulatory Commission (CIRC), the growth rate of foreign-funded insurers was 4 to 5 times that of domestic insurers. In 2004, the premium of general insurance companies and life insurers increased by 52.1 per cent and 44.7 per cent, respectively, compared to the same period in 2003. In the same period, the insurance premiums of all insurers in China had increased by just 11.3 per cent.

13. China was also implementing its WTO commitments on the liberalization of securities services in a serious manner. The Chinese Government encouraged the establishment of joint venture securities companies and joint venture fund management companies through the business involvement of qualified foreign securities institutions. By end August 2005, the Chinese Securities Regulatory Commission (CSRC), had approved 4 foreign-funded securities companies and 19 foreign-invested fund management companies to be set up. Twenty-seven foreign institutions had obtained the qualification of QFII, and the permitted investment quota would gradually increase from US\$4 billion to US\$10 billion.

14. China had introduced a large number of liberalizing measures in the financial area, in response to the reform deepening reform and opening-up processes, and its commitments in the WTO. As a result, the number and market share of foreign financial institutions had grown dramatically, indicating that China was implementing its WTO commitments in a serious and positive manner. China was confident in the reform and further liberalization of its financial markets and in its ability to improve its regulatory framework.

15. After this introduction, the representative of China turned to the second part of his statement. He first addressed **horizontal issues** (questions on all three financial sub-sectors).

16. Regarding the questions raised on reinsurance, he asked Members to refer to his introductory statement. As to the calls for flexibility in further relaxing geographical restrictions for foreign banks,

the requirement on newly established branches to engage in RMB business, and the quotas on foreign exchange funding, he asked Members to refer to China's Services Schedule.

17. He then turned to China's minimum capital requirement for financial services. He explained that at last year's TRM, his delegation had given made a clear and detailed explanation of the legal nature and rationale of China's transparent and prudential minimum capital requirement. He nevertheless took the opportunity to reiterate that China had the right, as any other Member, to regulate its financial services through measures based upon prudential principles. Member's right to introduce prudential measures, such as minimum capital requirements, was not against the GATS and should not be challenged. Thus, China's right to impose minimum capital requirements based upon prudential concerns should be respected by other Members.

18. Since December 2003, China had relaxed to some extent its working capital requirement for 40 branches of foreign-funded banks, taking into consideration the development of the banking sector. Although in his view there were no international standards for minimum capital requirements, as some Members had alluded to, and although in the past some developed Members had refused to discuss the topic of prudential measures in the WTO, he confirmed that China would continue to adjust and apply its minimum capital requirement in the future based strictly on prudential principles and regulatory needs, and also in a fair and transparent way. As regards the detailed minimum capital requirements and other market access or regulatory measures in the sub-sectors of banking, insurance and securities, he asked Members to refer to the relevant regulations adopted in China and the responses provided in this and previous TRM meetings.

19. He then turned to **banking services**. Concerning the progress made in introducing a risk-based management system, he said that the CBRC was currently studying the capital supervision and administration framework, and encouraging banks to enhance the inside venture management under the new framework. The CBRC had not yet issued a new programme for the implementation of the new capital agreement.

20. Taking into consideration the actual situation of China's banking industry, the CBRC had established a general strategy for the implementation of the new capital agreement on the basis of a "two-step" and "two-way" system. During the first step, commercial banks should strictly follow the measures on the capital adequacy of commercial banks to ensure that the minimum requirement of eight per cent was reached on 1 January 2007. In the meantime, the CBRC would accelerate supervision and inspection, and would encourage banks to promote transparency by disclosing information on time.

21. As a second step, the CBRC would encourage Chinese banks to promote venture management under the new framework, and to establish the inside evaluation system under the new framework as soon as possible. Once the banks could manage according to the new framework, the CBRC would implement the new agreement and measure the requirements on credit venture capital by using inside evaluation systems, and measure the requirement on operation venture capital by using a standard and basic index.

22. He further explained that the "two-way system" was the implementation of the new agreement on the Chinese banks with branches or subsidiaries abroad by using inside evaluation systems, and the measurement of requirements on the operation venture capital by using a standard or basic index. Other banks would still apply the current rules on capital supervision and administration. Before the implementation of the new capital agreement in China, the branches of foreign banks would be allowed to use the new agreement with the same time schedule and in the same manner as domestic banks if the foreign banks were under the new agreement. In addition, the CBRC would carry out the supervision and administration of these branches under the current framework.

23. The practice of capital supervision and administration showed that CBRC would not consider lowering the requirements on the minimum registered capital and capital adequacy with the introduction of the new capital agreement.

24. Turning to other questions, he said that in general there was no limitation on the share of foreign banks in financial institutions. According to the *Regulations on the Administration of Foreign-Invested Financial Institutions*, the *Detailed Implementing Rules for the Regulations on the Administration of Foreign-Invested Financial Institutions* and the *Measures on the Administration of Investment in Chinese Financial Institutions by Foreign Financial Institutions*, China permitted foreign banks to open foreign-owned banks, joint banks and branches in China; and to invest in Chinese banks. He explained that, according to Article 9 of the *Measures on the Administration of Investment in Chinese Financial Institutions by Foreign Financial Institutions*, if the total share of foreign banks in a non-listed Chinese Financial Institution reached 25 per cent or more, the Chinese financial institution would be administrated as a foreign financial Institution; and if the total share of foreign banks in a listed Chinese financial institution reached 25 per cent or more, the Chinese financial institution would still be administrated as a Chinese financial institution. All these regulations and practices were not in violation of the commitments in China's Services Schedule.

25. Replying to questions on minimum capital requirements for each branch, he said that in addition to his previous reply on minimum capital requirements, under relevant Chinese laws and regulations, branches of foreign-funded banks made their own decisions regarding their business scope, RMB business and, hence, the corresponding amount of working capital. At present, since even the business scope and the clients of branches of the same bank might differ, the risks the branches faced were not necessarily the same. Therefore, China required that the working capital requirement and the capital adequacy ratio be met for each branch of a foreign-funded bank rather than for its overall commercial presence in China. He added that after the transitional period, China would open up its overall banking sector. In the future, based on the principle of prudential supervision, China would consider how to apply the working capital requirement to the overall commercial presence of a foreign-funded bank in China in the spirit of consolidated supervision.

26. Turning to another question, he said that China required that 30 percent of the working capital of a foreign bank branch be maintained in the form of interest-bearing assets, including time deposits, in Chinese commercial banks or RMB government bonds. This requirement was imposed with a view to keeping a certain amount of funds to pay primary creditors in case of a foreign bank's failure. Due to the frequent capital inflow and outflow from foreign bank branches in China, Chinese authorities could not ensure effective supervision of the funds if they were placed with the foreign banks established in China. This was also in line with the practices of many countries that required a proportion of working capital to be maintained in the form of interest-bearing assets being deposited in other banks or used to purchase investment instruments with low risks such as government bonds.

27. Regarding **securities services**, the *Administrative Measures on the Management of Securities Investment Fund Management Companies*, promulgated by the CSRC, the Chinese Securities Regulatory Body, on 16 September 2004, had entered into force on 1 October 2004 replacing the *Rules on the Establishment of Fund Management Companies with Foreign Shareholding* that had been promulgated on 1 June 2002. According to Paragraph 2, Article 9, of the *Administrative Measures*, "an overseas shareholder of a joint venture fund management company shall have a minimum paid-up capital in convertible currency equal to RMB 300 million". Meanwhile, according to Article 13 of the *Securities Investment Fund Law* promulgated on 28 October 2003, the main shareholders of a fund management company were required to "have no less than RMB 300 million registered capital". He added that all those requirements were stipulated in laws and regulations, and China did not have any plan to modify these provisions. In China's view, these requirements were prudential measures for the regulation of the financial sector, consistent with the GATS, with paragraph 214 of the Working Party Report, and with China's commitments.

28. As one of the measures to fulfill China's WTO commitments, the CSRC had promulgated the *Rules on the Establishment of Securities Companies with Foreign Shareholding* on 1 June 2002 to set forth the rules for the establishment and operation of joint-venture securities companies. According to those rules and other relevant laws and regulations, 4 joint-venture securities companies had been licensed by the CSRC as of August 2005, with a total capital investment of over RMB 1 billion Yuan. In line with China's WTO commitments, the business scope of those joint-ventures was the following: (i) underwriting of stocks (including A, B and H shares) and bonds (including government and corporate bonds); (ii) brokerage business in B and H shares; (iii) brokerage and proprietary trading of bonds (including government and corporate bonds); and (iv) other business approved by the CSRC.

29. Up to now, China's WTO commitments in relation to the securities industry had been fully fulfilled. Currently, joint-venture securities firms could engage only in the businesses stipulated in his response. As securities companies in China were in the process of rectification, China would, subject to the progress and outcome of the rectification, study the possibility of broadening the joint-venture securities firms' business scope.

30. In the case of **insurance services**, foreign-funded non-life insurers were currently allowed to operate in the form of branches and subsidiaries in China; the detailed requirements were provided in the relevant regulations and according to China's commitments.

31. The branches of an insurance company were permitted to establish sub-branches within the business territory of the branches. This was also true for non-life insurers. The conditions and procedures for the establishment of branches, as well as other initial establishment requirements, were included in the *Regulations on the Administration of Insurance Companies*, the *Regulation on the Administration of Foreign-Invested Insurance Companies* and its Implementing Rules by CIRC, to which Members might refer to. Answers to questions on additional capital requirements for additional branch establishments could also be found in those three regulations. China believed these requirements were based on prudential considerations and were not against the GATS. He added that the CIRC carried out approval and examination procedures of those businesses on the basis of national treatment and following the principle of prudence.

32. The representative of China said he was not sure that the questions on the amendment of the Insurance Law were directly linked to China's commitments. However, he confirmed that the amendment process was open and transparent. The CIRC had collected comments from interested parties, including foreign insurance companies. The amendment was still under way and he hoped he could update Members of further developments in the future.

33. In the case of group life coverage, issues related to business scope were administered strictly in accordance with the commitments at the WTO. He requested Members to refer to the relevant regulations and commitments.

34. Replying to the questions on the conditions for insurance companies' assets to be invested abroad, he requested Members to refer to the *Provisional Measures on the Administration of the Overseas Utilization of Insurance Foreign Exchange Fund* and its detailed implementing rules. As to the establishment of insurance assets management companies, he asked Members to refer to the *Interim Regulations for Insurance Assets Management Companies*, as well as to the provisional measures and detailed implementing rules. He reiterated that China's requirements for insurers to invest foreign exchange funds as well as those for the establishment of insurance asset management companies, complied with the principles of prudential regulation and supervision, and national treatment.

35. Finally, on the questions regarding the **pension sector**, the representative of China said that the enterprise annuities market was still at its preliminary stage and the enterprise annuity itself was also a new concept in China. At present, the defined contribution plan under trust basis was permitted

in China and the relevant regulations were the *Provisional Measures on Enterprise Annuities* and the *Provisional Measures on the Enterprise Annuities Fund Management*. He added that the process for application and approval of enterprise annuities fund management was provided in the *Provisional Measures on the Qualification Accreditation for Enterprise Annuities Fund Management Institutions*.

36. The representative of Canada drew Members' attention to a written communication that his country had just been submitted for circulation to Members. Due to the lateness of this submission, he requested that responses be provided at the next meeting. He nevertheless highlighted the main elements of Canada's submission. A point that had been raised by some Members previously - the ability of foreign-invested insurance joint ventures to expand on an equal footing with domestic firms - concerned an important commitment that China was to implement by end 2004. However, approvals for new branches and sales offices of foreign invested insurance joint ventures continued to lag compared to the speed at which domestic insurance firms were permitted to expand. Foreign banks continued to face limits on access to foreign currency funds from abroad, artificially capping their lending portfolios. Canada hoped that this system would be revised to allow greater flexibility for foreign banks to expand their lending business in China.

37. He also referred to Article 30 of the CBRC Administrative Regulations on Foreign Invested Financial Institutions which required that the value of a foreign bank's foreign currency deposits received did not exceed 70 per cent of the value of its foreign currency assets within China. In essence, a foreign bank could only fund up to 70 per cent of its foreign currency loans with funds deposited in China, and at least 30 per cent of its loan funding must be from abroad. This requirement limited the ability of foreign banks to lend foreign currency without bringing it in from abroad. He asked whether the CBRC had established a timeframe for reviewing and eventually eliminating the 70 per cent rule given that it seemed to run counter to the purpose of the foreign exchange borrowing quotas administered by the State Administration of Foreign Exchange (SAFE) and the National Development and Reform Commission (NDRC).

38. The representative of the European Communities took note of China's explanation of its capital requirements, but called for a significant reduction of these requirements, which were still very high by international standards and in comparison with other countries. He also expressed the European Communities' concerns about China's regime for the regulation of suppliers of financial information and data processing services. Additionally, while taking note of the explanation provided by China on the 20 and 25 per cent caps on foreign equity in banking institutions, the European Communities remained concerned about this issue and urged China to be more flexible and loosen such restrictions.

39. The representative of the United States said that the transitional review mechanism continued to be very useful, particularly in areas like financial services where China was still phasing in its commitments. The TRM allowed Members to seek clarifications regarding policies and practices, and thus promoted a fundamental concept of transparency. The TRM also provided a forum for Members to convey their expectations regarding the implementation by China of its accession commitments. In turn, the TRM allowed China to explain its policies and practices and prevent misunderstandings that could lead to trade frictions.

40. The questions raised by the United States in its communication covered insurance, banking, securities, pensions and financial information services. In the area of insurance, the United States welcomed the actions taken by China in the last year in removing geographic restrictions and most business scope restrictions as of 11 September 2004. He also welcomed the regulations and rules issued to facilitate the implementation of commitments. China's insurance commitments held great promise for foreign insurers. Nearly 40 foreign insurers, many of them American, were now operating in China. Foreign insurers had less than 3 per cent of market share in China, but they were gaining ground. Increased competition should benefit consumers. In its questions on insurance, the United States focused, first, on the ability of foreign insurers to extend their business geographically

through branch and sub-branch expansion. The questions also focused on capital requirements and the status of various planned measures, such as the draft Insurance Law. However, with regard to many questions in the insurance area, the response that the United States seemed to receive was that it should look at China's commitments and at the regulations that China had issued. The written questions had been submitted precisely because the United States had already checked those sources and still had issues on which further clarification was sought.

41. In section 1, subparagraphs (a), (b), and (d) of its submission, the United States asked for confirmation of its understanding of certain issues. In question 1(c), the United States noted that foreign insurers were being granted branch approvals consecutively, while domestic insurers seemed to receive concurrent approvals for their applications. That differential treatment raised concerns for the United States. With regard to foreign insurers interested in providing group licence coverage, the United States wanted to know when the Chinese Regulatory Authority was planning to provide implementing guidelines. In his view, this question had not been answered.

42. Questions 5 and 6 dealt with the limitations on the insurers' ability to invest their foreign exchange funds in overseas funds or equities, which, as mentioned by China in last year's TRM, applied to both domestic and foreign insurers. The question was how China justified the disproportionate impact of this requirement, given that the level of assets necessary to qualify could be realistically met only by domestic insurers. Similarly, while the interim regulations for insurance asset management companies applied to both domestic and foreign insurers, there was a disproportionate impact given that insurers must have held licences for more than 8 years prior to applying. He added that the United States had a useful bilateral dialogue with China on insurance issues, and would try to follow up on many of these questions, as well as on other questions, in the framework of that dialogue.

43. In the banking area, the United States had two areas of inquiry. One referred to capital requirements and had been reiterated by other Members; and the other referred to China's Accession Protocol commitments regarding Chinese foreign joint banks. In his view, according to China's regulations, foreign investor ownership could not exceed 25 per cent, whereas in China's services schedule there was no limitation on the percentage of foreign ownership. He wondered how this could be justified in light of China's services schedule. He said that he did not obtain an answer to that question. As regards securities services, the questions focused on capital requirements and the nature of the services that the Chinese regulatory authorities had allowed foreign enterprises to engage in.

44. In the area of pensions, the United States was seeking clarifications regarding the licensing process for companies intending to offer pension annuity services. He did not register an answer to those questions either. He also said that the Ministry of Labour and Social Security (MOLSS) had reportedly stopped accepting applications for enterprise pension funds, and the United States would like to know when applications would start being accepted again, and whether or not the authority was interested in instituting a rolling application process.

45. The last set of questions raised by the United States in its submission dealt with the provision of financial information services. There were concerns in this area because Xinhua acted both as the regulator and the major competitor of foreign financial information service providers in China; while in its Accession Protocol China had committed to create an independent regulator.

46. The representative of Australia also recognised that the review was a valuable mechanism for the transparent implementation of China's financial services commitments. Australia acknowledged the considerable progress made by China in implementing its WTO commitments in the financial services sector and in its economic reform programme in general. The competitive stimulus and enhanced efficiency that had accompanied the liberalization of China's financial sector would prove to be an important contribution to future growth in the sector and the economy in general.

47. Australia noted the answers included in China's statement. However, he sought further clarification since he was unable to detect responses to a number of Australia's questions, which were in fact very similar to some of the questions submitted by other Members. In banking, Australia looked forward to answers to its specific questions on the limitations imposed on foreign banks' access to off-shore borrowing, and on the limitations on foreign equity ownership. In insurance, he asked whether an indication could be given as to when implementing measures would be issued by the China Insurance Regulatory Commission to provide specific guidelines and approval criteria for foreign insurers interested in providing group life, health, pension and annuity services so as to give effect to China's commitments regarding those services.

48. The representative of Chinese Taipei noted that some of his delegation's questions had also been addressed in the explanations provided by the Chinese delegation. Chinese Taipei recognised China's efforts to improve its business environment in its implementation of WTO commitments over the past few years with the aim of further integrating into the global economy. Chinese Taipei looked forward to China's continuous efforts to further deregulate its market access for financial services.

49. The representative of Switzerland said that one major problem faced by Swiss banks was the remaining barrier imposed by capital requirements for foreign bank entry into the Chinese market. He was well aware that this topic had already been raised by the Chinese delegation in their introductory remarks. Switzerland would be very grateful if China could in future provide more information on plans to further liberalize capital requirements for foreign bank entities. Switzerland supported the statements by the European Communities and the United States regarding the limitations on foreign participation in financial institutions. In his view, allowing a 25 percent participation was not sufficient. Switzerland was interested in knowing if there were any plans to raise these limits in the future in order to allow majority or even 100 per cent foreign participation.

50. The representative of Japan said that as recently forecasted by the OECD, China was likely to be the world's biggest exporter and the fourth largest economy by 2010. He encouraged China to continue its efforts to liberalize the economy, and in particular the financial sector. He reiterated that, regulatory transparency and consistency in implementing regulations were as important as individual liberalization measures.

51. The representative of China thanked Members for the follow up questions. He was surprised, however, by the questions regarding minimum capital requirements since China had given a complete explanation. He added that he would be willing to discuss the issue of international standards with interested Members after this meeting. China was not the only country imposing minimum capital requirements. Noting that some Members welcomed the bilateral dialogues with China on insurance services, he considered it advisable to deepen these dialogues because the topic was very technical to be discussed in detail at this occasion. Regarding the questions raised by Australia, the representative of China said that since these had been received at a late stage in the process, it was impossible to refer back to experts in capital, most of whom were concentrating on the preparations for the December Ministerial Meeting in Hong Kong, China. He added that he had no further replies to provide at that time.

52. By way of conclusion, the Chairperson invited the Committee to take note of all the statements made. Secondly, he requested the Secretariat to prepare a report, to be presented to the Council for Trade in Services. It would be a factual report, stating basically that:

- (a) pursuant to section 18 of the Protocol on the Accession of the People's Republic of China, the Committee had conducted a review of the implementation by China of the WTO Agreement and of related provisions of the said Protocol, in the meeting held on 19 September 2005;

- (b) written communications had been received from five Members, namely the European Communities, the United States, Japan, Chinese Taipei, and Australia; and
- (c) the details of the discussion, including all the interventions made at the meeting, would be found in the meeting report, to be issued as document S/FIN/M/50.

53. The representative of Canada requested that a reference to his country's communication be included in the report.

54. The representative of China said, for the sake of the record, that the hard copy of Australia's questions had actually been received in the morning of the day of the meeting; this explained why China had no time to prepare replies. The same applied to the questions from Canada.

55. The Chairperson suggested that this be reflected in an appropriate manner in the report. The Committee so decided.

C. ACCEPTANCE OF THE FIFTH PROTOCOL TO THE GENERAL AGREEMENT ON TRADE IN SERVICES EMBODYING THE RESULTS OF THE FINANCIAL SERVICES NEGOTIATIONS

56. The Chairperson recalled that three WTO Members had yet to accept the Fifth Protocol: Brazil, Jamaica, and the Philippines. He invited these Members to provide information on the status of their domestic processes.

57. The representative of Brazil said that the ratification of the Protocol was following due legislative process and it was impossible to indicate at this stage when that could be finalized.

58. The representative of the Philippines said that the situation had not changed since the last report made to the Committee, and it was not possible to indicate a definite timeframe for the acceptance of the Protocol.

59. The representative of the United States expressed her country's concern that the three Members had yet to accept the Protocol. She expressed the hope that more positive news could be heard at the next meeting.

60. The representative of Japan expressed his disappointment that these three Members had yet to ratify the Protocol. He encouraged them to make substantial progress by the next Ministerial Conference in Hong Kong, China.

61. The representative of the European Communities encouraged the three Members to provide more detailed information on the status of the acceptance procedures as soon as possible.

62. The representative of Norway regretted that the item had still to be included in the agenda. He encouraged the three Members to make progress before the Ministerial Conference.

63. The Chairperson said that no new information had been received on the status of domestic procedures in these Members, since a concrete date for their acceptance of the Protocol could not be envisaged. Some delegations had expressed their concern about this matter. He encouraged the three Members concerned to accelerate the internal procedures for the acceptance of the Protocol and to keep the Committee informed of any progress.

64. The Committee took note of the statements made and decided to revert to this agenda item at the next meeting.

D. TECHNICAL ISSUES

65. The Chairperson recalled that as he had indicated at the end of the discussion on organization of future work at the previous meeting, the Committee would address again the communication from Brazil on electronic commerce and financial services (JOB(05)/103) in order to allow Members to make further comments if necessary. He also recalled that he had endeavoured to hold informal consultations on two suggestions made at the last meeting, namely to request the Secretariat to update a previous note on the distinction between modes 1 and 2, and to invite representatives from the Basel Committee on Banking Supervision and other relevant international bodies to the Committee to share information regarding their work in this area. In the meantime, the Secretariat had circulated an informal note containing relevant submissions and meeting reports (Job(05)/155). The outcome of the consultations was the following: firstly, most Members did not consider it necessary to have an updated note by the Secretariat at this stage. Some of them would rather review previous discussions on this issue to see whether there might be a need for further information. Secondly, there was no consensus at this stage to invite representatives from the international standard setting organizations.

66. The representative of Brazil expressed his concern about the difficulties some Members had with inviting the Basel Committee on Banking Supervision and other relevant organizations to share their expertise in the regulatory field. This input would be important for both financial regulators and negotiators. He reiterated his delegation's interest in inviting those international organizations. He requested the Chairperson to pursue his consultations on this matter, and encouraged the Members that had expressed difficulties to clearly indicate their concerns, instead of simply vetoing the proposal.

67. The representative of Hong Kong, China said that the communication raised two issues. On the one hand, the regulatory concerns and challenges posed by cross-border trade in financial services. In that regard, he supported the idea of inviting some of the international standard setting bodies to share their experience and work in this field. He reminded Members that those bodies had already come to the WTO, and a separate session had been organized with them. That could be an example to follow. He asked whether the Secretariat could provide further information in that regard. The other issue raised by Brazil's communication was the distinction between modes 1 and 2. In that regard, he considered that the informal note by the Secretariat was a useful tool to review previous discussions, which had not lead to any specific conclusion. Rather, the summary of opinions expressed was attached to the scheduling guidelines (S/L/92). He wondered to what extent this issue - the distinction between modes 1 and 2 - had created difficulties for individual Members to make commitments in financial services or, possibly other sectors. There had been suggestions as to how this issue could be practically resolved and wondered to what extent Members would be able to move beyond what had been already been reflected in the previous summary of discussions. The preference of Hong Kong, China was to have greater clarity and certainty than what was provided by the summaries of previous discussions attached to the scheduling guidelines. He was also wary of the risk of spending too much time on a discussion that might not lead to a better solution. Given that the distinction between modes 1 and 2 was relevant for all services sectors, he also wondered to what extent this issue should be taken up solely in this Committee. Discussions which concerned the implementation of the GATS itself, should perhaps be held in a broader forum, such as the Council for Trade in Services. He clarified that he was not making a suggestion, but just wanted to raise issues for Members to reflect upon when considering the communication from Brazil.

68. The representative of the United States said her country would have serious concerns about pursuing this debate any further. As stated by the representative from Hong Kong, China, Members had already traversed this issue before, and the Secretariat had presented a Note to help Members in their thinking. The debate had not prevented Members from making commitments on these two modes of supply. Since it was for individual Members to place items on the agenda and for others to react, the presumption should not be created that Members had reached a consensus decision to enter into a debate over the Brazilian paper or the subject contained therein. Although the United States

had questions on the substantive issues raised in the paper, it did not intend to pursue them at the moment. She had no problem with a narrow consultation by the Chairperson to see what was causing discomfort to some delegations regarding the invitation of international setting bodies or further exploration of the suggestion made by Hong Kong, China to find another format for such meetings. That did not mean, however, that she could support another format, but was simply seeking further clarification from Brazil as to the exact scope of the consultation proposed.

69. The Chairperson confirmed that no decision had been taken as to how to proceed with this issue. Members were just debating about Brazil's submission.

70. Responding to the query raised by Hong Kong, China, a representative of the Secretariat said that in October 2001, upon the request of this Committee, a seminar was held with the three standard setting organizations, to inform Members of their activities. The preceding consultations took into account the concerns of some Members, and the desire at the time was to separate such an event from the official work of the Committee. It was therefore organized as a seminar, which was moderated by a representative of the Secretariat and not by the Chairperson of the Committee. That provided comfort to those Members who wanted to draw a distinction between an information-seeking event, such as a seminar, and the official proceedings of the Committee.

71. The representative of Brazil said that it was not his intention to oblige any Member to react to the issues raised in the communication. The idea was to share Brazil's concern as to how to distinguish between the two modes of supply when making new commitments. Brazil thought that a multilateral debate on that issue would be to the benefit of all developing country Members. This could be a good example of a multilateral approach being used to complement the request-offer process, as stated in the negotiating guidelines and procedures. He did not agree with the position advocated by Hong Kong, China that if a conclusive debate could not be reached, then an issue should not be taken up. Brazil was not seeking a conclusive agreement on whether modes 1 and 2 overlapped, but was interested in exploring different views. Regarding the query raised by the United States, he confirmed that Brazil was seeking a narrow consultation in relation to a potential invitation to international standard setting bodies to come to the Committee itself or to a more informal seminar at a time when regulators were in town. He added that Brazil was open to any option.

72. The representative of Hong Kong, China supported the idea of further consultations regarding the invitation of international standard setting bodies. He clarified that Hong Kong, China attached importance to the issue and, as revealed by previous discussions, had been pressing for greater clarity on the distinction between modes 1 and 2. The point he had raised was rather whether further discussions would add value to what Members already had on the table, i.e. records of previous meetings, as well as summaries incorporated in the scheduling guidelines. Both the Note by the Secretariat and the summary of informal discussions that had been attached to the scheduling guidelines alluded to a number of options to clarify the scope of modes 1 and 2. The question was whether and to what extent Members would be able to move beyond what had already been discussed. Delegations should not spend their time on repeating previous discussions. If Members were able to move closer to a common understanding on this issue, the second question was whether they might find the appropriate vehicle to reflect that understanding. These were practical issues that Hong Kong, China rose for Members to reflect upon.

73. On the substance of the issue, a couple of suggested solutions deserved further attention. The first one was to ensure that commitments on modes 1 and 2 be of the same level. Another idea, which had not been really taken up in the discussion thus far, was to draw a distinction on the basis of where the service was being delivered. That would imply looking also at the place where the consumer was physically present, since services would be tangibly consumed by the consumer on the spot due to the nature of services. To the extent that these ideas could help clarify the distinction between modes 1 and 2, Hong Kong, China would be willing to pursue discussions in the Committee or in other appropriate forum.

74. The representative of China supported the idea of having another seminar similar to the one held in October 2001.

75. The Chairperson said that the suggestion was made to pursue informal consultations on the suitable format for the invitation of international standard setting organizations. In that regard, he proposed to have bilateral consultations with interested Members first, in order to get a sense of the different views. If he saw a chance to develop a consensus among the most interested delegations, then he would consider to have a broader consultation with a view to bring this issue again into the Committee. The Committee so agreed.

76. The Committee took note of the statements made, agreed to the suggestion made by the Chairperson, and decided to revert to this agenda item at the next meeting.

E. RECENT DEVELOPMENTS IN FINANCIAL SERVICES TRADE

77. The Chairperson said that, as indicated in the airgram, a representative of the China Banking Regulatory Commission would make a presentation on the regulation and supervision of China's banking sector. The presentation would be made by Mr. Deng Hongguo, Deputy Director-General of the Banking Supervision Department.

78. The representative of China, Mr Deng Hongguo, said that his presentation would focus on the development of reform, opening up and supervision of the Chinese banking sector. He started by providing an overview of the sector. Since China had initiated reform and opening-up more than 20 years ago, its banking sector had been growing rapidly. As of end 2004, the assets of the banking institutions totaled RMB 31.6 trillion (equivalent to about US\$3.8 trillion), 116 times higher than the level at the end of 1980. At present, the banking sector accounted for about 90 per cent of total financial assets in China. At the end of 2004, the banking system consisted of some 35,000 banking institutions, including 4 state-owned commercial banks (SOCBs), 3 policy banks, 12 joint-stock commercial banks (JSCBs), 4 asset management companies (AMCs), 112 city commercial banks, 211 foreign bank branches and subsidiaries, 223 foreign bank representative offices, 681 urban credit cooperatives, 33,135 rural credit cooperatives (RCCs), some non-banking financial institutions (e.g., trust and investment companies, finance companies, financial leasing companies, auto financing companies), and numerous postal saving institutions.

79. China's banking sector was facing many challenges. First, the proportion of non-performing loans (NPL) of Chinese local banks needed to be further reduced. The average NPL ratio of the 4 State-owned commercial banks and the 12 Joint-Stock commercial banks was as high as 25 per cent a few years ago. Great efforts had been made in recent years to address the problem. Four asset management companies had been established in 1999 to deal with RMB 1.3 trillion worth of NPLs from the 4 State-owned commercial banks. Local banks had also taken various measures to recover their NPLs and write off losses. However, as of end 2004, the NPLs of the 4 State-owned commercial banks and the 12 Joint-Stock commercial banks stood as high as RMB 1.7 trillion. The average NPL ratio had dropped to 13.2 per cent, still 8 percentage points higher than the average level of the world top 100 banks.

80. Secondly, local banks were in an urgent need to improve their corporate governance and operational mechanisms. There were deficiencies in areas such as decision-making, internal controls and risk management, incentives, innovation capacities, and human resources. They had low returns on assets (ROA) and returns on Equity (ROE), indicating their poor profitability. All this put local banks at a disadvantage against world advanced banks, and exposed them to even greater pressure in an increasingly competitive environment.

81. Since its establishment in April 2003, the CBRC had put priority on the reform of SOCBs and the RCCs. He wanted to focus on the reform of the 4 SOCBs. They had long been serving as a fund

supplier for the country's economy, although they had lost market share in the last twenty years. As of end 2004, total assets of SOCBs reached RMB 16.9 trillion. Given their important role in China's banking sector, the 4 SOCBs needed to restore competitiveness by further deepening reform and restructuring. The Chinese government had thus decided at the end of 2003, to select the Bank of China and China Construction Bank as partners for the new round of reform, and injected US\$45 billion to improve their capital base.

82. The reform consisted of three phases: financial restructuring to deal with NPLs; reform in corporate governance; and going public in capital markets. So far, the reform had achieved staged success. After two banks had completed their financial restructuring, their asset quality had been notably improved and their balance sheet had been substantially strengthened. At the end of 2003, the average NPL ratio of the 4 SOCBs had stood at 20 per cent as measured under the five-category loan classification system, and their average Capital Adequacy Ratio (CAR) had been as low as 4.61 per cent; whereas at the end of 2004, the NPL ratios of the BOC and the CCB dropped to 5.7 per cent and 3.8 per cent respectively, and their CARs had risen to 9.7 per cent and 11.97 per cent, respectively.

83. China's banking sector had been opened since 1979. After its accession to the WTO, China had been proceeding with the further open-up in accordance with WTO principles and China's WTO commitments. The main policies were as follows: no restrictions in terms of geographic coverage and clients for foreign currency business; 18 cities, including Shanghai, Shenzhen, Beijing, and Chongqing, as well as services for Chinese enterprises, had been opened for local currency business; and motor vehicle financing by foreign non-banking institutions had also been allowed.

84. As of end July 2005, 68 foreign banks from 19 countries and regions had established 227 operational institutions, 50 more than that at the end of 2001 when China had joined the WTO. Meanwhile, 174 foreign banks from 41 countries and regions had established 238 representative offices. The assets of foreign banks in China amounted to US\$79.3 billion, 54 per cent more than at the end of 2001, with an 18 per cent annual growth rate, and their RMB assets had risen to RMB 150 billion, 1.5 times that of the end of 2001, with annual growth of 43 per cent. Outstanding loans by foreign banks totalled US\$41.34 billion. Foreign banks' NPL ratio stood at a low level of 1.05 per cent. The business scope of foreign banks had also been expanded. So far, 133 foreign banks had been authorized to conduct RMB business, 73 of which had been permitted to provide RMB services for Chinese enterprises. Fifteen foreign banks had been authorized to engage in Internet banking business in China, 41 in derivatives activities, and 5 in Qualified Foreign Institutional Investors (QFII) custodian service. Altogether, foreign banks were now able to offer over one hundred types of products and services in China, more than 3 times more than that of local banks.

85. Rapid development of foreign banks also revealed certain problems. In respect of their operations and management, some foreign banks were using less prudential assets classification system, some branches saw the decrease of their actual operational capital and potential liquidity risks, and the average ROA of the foreign banks in China stayed at 0.41 per cent while that of the world top 100 banks is one per cent. In addition, the management and staff training of some foreign banks failed to keep pace with their business development. Some banks even conducted non-prudential operations that led to the loss of consumers in fierce competition. All this brought about new challenges to banking supervision.

86. He finally turned to issues related to banking supervision in China. In April 2003, the Chinese government had initiated a major reform of its financial supervision regime, under which the CBRC had been established, putting in place a supervisory framework where banking, securities and insurance services were subject to three separate regulators. He focused on four main issues. First, clear supervisory concepts had been set out. Upon its establishment, the CBRC had introduced 4 new supervisory concepts: consolidated supervision of each banking institution; strengthening of internal

controls in banking institutions; enhancing supervisory transparency; and staying focused on risk-based supervision.

87. Second, banking legislation had been improved. The *Law of the People's Republic of China on Banking Regulation and Supervision* entered into effect on 1 February 2004. It embodied, to a large extent, the concepts of the *Core Principles for Effective Banking Supervision* issued by Basel Committee. Moreover, the legal framework was trying to apply the principle of national treatment. For example, the *Regulation Governing Capital Adequacy of Commercial Banks*, the *Provisional Administrative Rules Governing Derivatives Activities of Financial Institutions*, the *Provisional Rules on the Pricing of Services by Commercial Banks* and the *Administrative Rules Governing the Auto Financing Company* all granted the same treatment to local and foreign banks in China. Finally, the legal framework was built up for prudential and risk-focused supervision with a view to encouraging innovations and setting professional licensing requirements and supervisory controls. In this respect, the CBRC issued a range of rules and regulations to address credit risks, market risks, capital adequacy management and new businesses of commercial banks, through which the supervisory measures are further improved.

88. Third, international cooperation had been enhanced. The CBRC had been established cross-border supervisory cooperation mechanisms with overseas counterparts. So far, the CBRC had signed Memorandums of Understanding with the banking supervisory authorities of the US, UK, Korea, Singapore, Canada and others. Regular meetings with Canadian and Japanese authorities had been arranged. Moreover, the CBRC had set up a Council of International Advisers, composed of internationally-known banking specialists who have provided a great deal of good advice, ideas and recommendations. The CBRC also conducted a self-assessment on the compliance of the Chinese banking supervisory and regulatory regimes and practices against Basle Core Principles for Effective Banking Supervision. Based on assessment findings, it had formulated an action plan for further improvement.

89. Despite the achievements made, the authorities were fully aware of the gap between the CBRC and its counterparts in developed countries in terms of supervisory level, capacity, concepts as well as supervisory mechanisms, measures and skills. First, many international best practices and standards in banking supervision had not been introduced to China until several years ago. Examples were: five-category loan classification in 1998, application of loan loss provisioning in 2002, and prudential capital adequacy ration (CAR) management in 2005. Secondly, supervisory measures on new financial instruments and products, such as internet banking business and derivatives, still lagged behind the fast market developments. Third, China also faced the challenges posed by Basel II.

90. Summing up, he said that China had made substantial commitments in the WTO. China's accession had brought challenges and pressures to the banking sector and banking supervision. This was mainly because the sector still lagged behind developed countries' banking sectors in terms of maturity, competitiveness and regulatory framework. Such gaps could hardly be narrowed in the short run. China had been carrying out its WTO obligations in strict compliance. It was imperative for local banks to enhance their competitiveness through further reform. Otherwise, the already existing gap with foreign competitors would be widened and the development of China's banking sector as a whole be slowed down.

91. The Chinese banking sector was becoming more market-oriented and internationalized. China would continue to honor its WTO commitments and attach equal importance to banking supervision and banking development. Keeping an eye on supervision, opening-up and innovation with advanced concepts, mechanisms and measures, the CBRC would continuously strengthen banking supervision, guard against and mitigate risks, so as to ensure the safe and sound operation of China's banking sector.

92. The representative of Pakistan noted that while there were no geographic restrictions for foreign currency business, only 18 cities had been opened so far for business in local currency. She asked what the experience had been and whether China was thinking about extending this to other cities in China.

93. The representative of the European Communities said that the presentation had clarified the challenges that China was facing in opening up its banking sector. He added that China and the European Union had also established a regulatory dialogue, which was still in the initial stages, but could hopefully be very productive for both parties.

94. The representative of the United States sought further clarification regarding the timing of the three stages of the reform process: financial restructuring, corporate governance reform, and going public in capital markets.

95. The Chairperson noted that the OECD had recently published a report on China, and one chapter of which had been devoted to reform in the financial sector. One suggestion made by the OECD was that China change its rules concerning managing boards in banks, and allow more foreigners to take part in those boards.

96. The representative of China, Mr Deng Hongguo, said that the financial sector had been opened step-by-step, the banking sector since 1979. At that time, foreign banks offered their services to foreign-invested enterprises. Foreign currency business had used to be the major part of their business for more than 20 years, until local currency business had been opened to foreign banks. According to its WTO commitments, China would ease its geographic limitations step-by-step. So far, 18 cities had been opened for foreign banks to conduct local currency business. Two of those cities – Shenyang and Xi'an – had been opened two years before the commitment. By the end of next year, all geographic limitations on local currency business would be eliminated according to the commitments.

97. He added that there was no concrete timetable for the reform process. Three of the SOCBs were in the process of reform, two of them had just finished the process of financial restructuring, and the fourth one, the Industrial and Commercial bank of China, had just entered the phase of financial restructuring. He also said that foreign banks were allowed to invest in existing Chinese banks, and foreigners could also be part of the senior management of local banks. For example, the CEO of Shenzhen Development Bank was an American citizen.

98. He finally turned to some of the questions raised at the TRM on China's working capital requirements. He said that there was no universal standard available so far. In some of the less developed countries, the working capital was much higher than in China. The same was true for some OECD countries. While most European countries had lower capital requirements than China, that was not the case for other countries. In deciding on the level of capital requirements, the major problem to consider was the risk faced by foreign banks, which depended mainly on their business scope. For example, some developed countries did not allow foreign banks to conduct retail business, but China did. That meant that China, as a big developing country with less developed financial markets, was more open in some areas than some developed countries. When comparing capital levels in different countries, the business scope and the risk faced by foreign banks had to be taken into consideration. As of end 2003, China had reduced and simplified the criteria for capital levels. He added that China would review the need for future adjustments in the light of developments in the banking market and the risks faced by foreign banks.

99. The Committee took note of the statements made and decided to revert to this agenda item at the next meeting.

F. DATE OF THE NEXT MEETING

100. The Chairperson suggested that the Committee hold its next meeting during the next cluster of services meetings. The exact date would be announced in due course.

101. The Committee so agreed.
