China

Financial Stability Report 2017

Financial Stability Analysis Group of the People's Bank of China

China Financial Publishing House

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① This English edition is an unofficial translation of the *China Financial Stability Report 2017*, which was published in July 2017. In case of any discrepancies, the Chinese version shall govern.

Executive Summary

In 2016, the world economy recovered slowly. Advanced economies faced multiple political and economic challenges. The growth of emerging market economies stabilized but they were under structural adjustment pressures. The Chinese government continued to follow the overall principle of seeking progress while maintaining stability. Performance of the Chinese economy featured moderating but stabilizing growth and has taken a turn for the better. Reform of the financial sector deepened and the financial markets functioned properly. Overall speaking, the financial institutions were sound. Fresh progress was made in financial infrastructure development. The macroprudential policy framework was improved continuously. In general, the 13th Five-Year Plan has posted a good start in its first year.

The financial sector developed steadily. The assets and liabilities of the banking sector continued to expand with greater support to economic restructuring and upgrading, and financial services to the weak sectors improved. The reform of development financial institutions, policy banks and large commercial banks was furthered. Pressure eased on the asset quality of the banking sector and the overall credit risk was under control. The market participants of the securities and futures markets achieved sound development, market regulation was enhanced, and fundamental institutional arrangements were improved. The insurance sector expanded rapidly, featuring growth of both assets and premium revenue. The insurance sector's reform was deepened and the sector provided better services to the society.

The financial markets functioned in a sound manner. The financial markets expanded and participants were further diversified. Market institutional arrangements continued to improve and opening-up made notable progress. The money market reported record volume of turnover, the market interest rates were more flexible and moved more consistent with fundamentals of the economy and market trend, and the interest rates generally edged up. The foreign exchange market traded briskly, and more currencies were traded directly against RMB. The volume of bond spot trading posted a large increase y-o-y and the yield curve moved up. The stock market stabilized after the turmoil in the beginning of the year, yet the trading was obviously less brisk. The trading volume of futures grew rapidly. The prices of commodity futures surged while the prices of financial futures were relatively stable.

The building of financial infrastructure made new progress. The payment, clearing and settlement systems were further improved, and a number of important regulations were released. The financial laws, regulations and rules were further improved to uphold national and public security, and to streamline administration and delegate powers. The accounting standard system was improved, to better plan for reform and development and to strengthen the system of government accounting standards. The credit information sector developed further and the social credit system building made new progress. Coverage of the credit information system was expanded. The quality of anti-money laundering (AML) work was enhanced, and the FATF's fourth round of mutual evaluations proceeded steadily. The work in financial consumer protection produced good results and the quality of financial services improved.

The macroprudential policy framework was improved. The Joint Ministerial Conference on Financial Regulatory Coordination worked to promote ever-closer coordination in regulatory policies, measures and actions, strengthening synergy and effectiveness of financial regulation. Monitoring and assessment of systemic risks were strengthened, and the resolution regime of G-SIFIs was improved. The MPA system worked effectively, and the macroprudential policy framework for foreign exchange flows and cross-border capital flows was improved. The counter cyclical adjustment of the real estate market was strengthened, and the effect of differentiated credit policies, i.e. city-specific credit policies, was unfolding.

The Chinese economy has continued its stable and sound growth. Growth, albeit moderated, remained stable within a reasonable range and the performance has taken a turn for the better. The quality and efficiency of growth has improved, and the economic structure continued to optimize. New breakthroughs were made in reform and opening up. Yet, domestic and global economic situations and financial markets remain complex and present many imbalances and problems. From an international perspective, the world economy is still recovering slowly, and sentiments like protectionism, de-globalization and populism have gained momentum. With the environment getting more complex, unstable and uncertain, black swan events may occur more frequently. From a domestic perspective, the basis is not solid to support stable performance of the real economy and financial system, and downward pressure remains strong. The performance among regions and sectors has continued to diverge, and challenges and risks are not to be underestimated. Higher leverage ratio of the non-financial enterprises, rising volume and ratio of NPLs of commercial banks, potential risks in the implicit borrowing of some local governments, the coexistence of elevated housing prices in hot-spot cities and the large housing inventories in some third- and fourth-tier cities, and the lack of order in financial product innovation pose risks that need to be monitored.

Despite the cyclical and scale factors that contribute to the imbalances and problems in the Chinese economy, the root causes are the major structural imbalances that have obstructed the circular of economic activities. The solutions lie in the supply-side structural reforms through which a new dynamic equilibrium in supply and demand will be created. The year 2017 is an important year in the 13th Five-Year Plan and a year for deepening the supply-side structural reforms. We will continue to implement the decisions adopted at the 18th CPC National Congress, the 3rd, 4th, 5th and 6th Plenary Sessions of the 18th CPC Central Committee, take coordinated measures to promote the overall plan of pursuing balanced economic, political, cultural, social and ecological development at the same time and of comprehensively establishing a well-off society, deepening reforms, ruling by law and strengthening Party discipline, follow the general principle of seeking progress while maintaining stability, and adopt and implement the new development philosophy. We need to adapt to, properly understand and guide the new normal in economic development, continue to focus on the quality and efficiency of economic growth and the overall policy design featuring stable macro policy, targeted industrial policy, flexible micro policy, concrete reform policy, and with social policy providing the basic bottom line. We will continue to focus on promoting supply-side structural reforms, boost aggregate demand, strengthen expectation guidance, leverage the role of innovation in driving growth, and do a good job in promoting stable growth, reform, structural adjustment, people’s welfare and risk prevention, in order to pursue stable and sound growth and social harmony. The PBC will implement a sound and neutral monetary policy, keep liquidity at a reasonable and stable level, and create a favorable monetary and financial environment for growth of the real economy. The financial reform will be deepened, through improving corporate governance, and fostering the awareness of prudent operation and compliance, to hold financial institutions accountable for risk management. A multi-layered capital market system will be established by improving rules governing market functioning and the market-based, rule-based default response mechanism. The regulatory capacity and regulatory coordination will be strengthened to have coordinated regulation over systemically important financial institutions, financial holding companies and important financial infrastructure and implement comprehensive financial statistics. Measures will be taken to establish and improve asset management product standards and its regulation and to form a synergy between financial market development and regulation, with a view to addressing the weaknesses in regulation and avoiding regulatory vacuum. Greater importance will be attached to financial risk control. Efforts will be made to enhance systemic risk monitoring and assessment, to address a number of risky spots, to improve the deposit insurance system, and to explore to establish a market-based mechanism for financial institution resolution, in order to make sure that no systemic financial risks will emerge.

Abbreviations and Acronyms

ABC	Agricultural Bank of China
ADBC	Agricultural Development Bank of China
AML	Anti-money laundering
AMP	Asset Management Product
APG	Asia/Pacific Group on Money Laundering
ASEAN	Association of Southeast Asian Nations
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BOC	Bank of China
BOCOM	Bank of Communications
BoE	Bank of England
BOP	Balance of payments
CABD	County Area Banking Division
CAR	Capital adequacy ratio
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CCP	Central counterparty
CD	Certificate of deposit
CDB	China Development Bank
CDS	Credit default swap
CET1	Common Equity Tier 1
CFETS	China Foreign Exchange Trade System
CFT	Combating the Financing of Terrorism
CFTC	Commodity Futures Trading Commission
CIPS	Cross-border Inter-bank Payment System
CIRC	China Insurance Regulatory Commission
CMG	Crisis management group
CPC	Communist Party of China
CPI	Consumer price index

CPMI	Committee on Payments and Market Infrastructures
CSI	China Securities Index
CSRC	China Securities Regulatory Commission
D-SIB	Domestic systemically important bank
EAG	Eurasian Group on Combating Money Laundering and Financing of Terrorism
ECB	European Central Bank
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
ETF	Exchange-traded fund
EU	European Union
EUR	Euro
EximBank	Export-Import Bank of China
FATF	Financial Action Task Force
FDIC	Federal Deposit Insurance Corporation
FMI	Financial market infrastructure
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council
GAC	General Administration of Customs
GBP	Great Britain Pound
GDP	Gross Domestic Product
GEB	Growth Enterprise Board
GPFI	Global Partnership for Financial Inclusion
G-SIB	Global systemically important bank
G-SIFI	Global systemically important financial institution
G-SII	Global systemically important insurer
HICP	Harmonized Index of Consumer Prices
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
ICBC	Industrial and Commercial Bank of China
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPO	Initial public offering
ISDA	International Swaps and Derivatives Association
JPY	Japanese Yen
JSCB	Joint-stock commercial bank

LCB	Large commercial bank
LEI	Legal Entity Identifier
LGFV	Local government financing vehicle
M&A	Mergers and acquisitions
MLF	Medium-term Lending Facility
MMF	Money market fund
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MPA	Macroprudential Assessment
NBS	National Bureau of Statistics
NDRC	National Development and Reform Commission
NPL	Non-performing loan
OTC	Over the counter
PBC	People's Bank of China
PFMI	Principles for Financial Market Infrastructures
QDII	Qualified Domestic Institutional Investors
QFII	Qualified Foreign Institutional Investors
R&D	Research and development
RAP	Resolvability assessment process
RCAP	Regulatory Consistency Assessment Programme
RMB	Renminbi
ROA	Return on assets
ROE	Return on equity
ROI	Return on investment
RQFII	RMB Qualified Foreign Institutional Investors
RRP	Recovery and resolution plan
SAFE	State Administration of Foreign Exchange
SDR	Special Drawing Right
SEACEN	South East Asian Central Banks
Shibor	Shanghai Interbank Offered Rate
SIFI	Systemically important financial institution
SLF	Standing Lending Facility
SME	Small- and medium-sized enterprise
SPV	Special purpose vehicle
TLAC	Total Loss Absorbing Capacity
TSF	Total Social Financing

U.K.	United Kingdom
U.S.	United States
USD	U.S. Dollar
VAT	Value Added Tax
WMP	Wealth Management Product
y-o-y	Year-on-year

CONTENTS

Chapter Ⅰ

International Economic and Financial Environment

In 2016, the world economy experienced a slow recovery. Major economies kept diverging both in terms of growth momentum and monetary policies. Black swan events emerged frequently in economic, political and social arenas. Populism, de-globalization and investment and trade protectionism accumulated their popularity. All above added to geopolitical uncertainties. Looking forward to the year 2017, the recovery of the world economy may still suffer from kinds of uncertainties and black swan events, and major economies should be well prepared for the adverse shocks so as to maintain a stable growth.

I. Economic Developments in Major Economies

In 2016, the world economy continued to undergo a slow recovery and lack growth momentum. Growth continued in the U.S., turned to be better in the euro area, remained relatively slow in Japan and stabilized to some extent in emerging market economies. Meanwhile, Japan suffered from limited policy space and emerging market economies were still faced with pressure from adjustment and transformation.

The U.S. economy kept recovering. The U.S. economy performed a little bit weak in the first half of 2016, but stabilized and recovered since the third quarter. The annual GDP growth rate recorded 1.6 percent due to the weak growth in the first half of the year, lower than the growth rate of 2.5 percent in 2015. Inflation went upward slightly and stayed above 1.5 percent since September. The labor market continued to improve and the unemployment rate dropped to 4.6 percent in November, the lowest level since August 2007. However, there was still some volatility in the short-term data like new non-agricultural jobs.

The economy in **the euro area** improved slightly. Resulted from the weak domestic demand and exports, the growth rate of euro area in 2016 recorded 1.7 percent, lower than that of 2015 but better than the second half of 2015. Deflationary pressure mitigated, with the HICP in December recording 1.1 percent y-o-y, the highest level since September 2013. The labor market improved and unemployment rate dropped to 9.6 percent in December, the lowest level since May 2009. Meanwhile, the notable output gap, refugee issues and banking sector risks might undermine the sustainable recovery.

Recovery in **Japan** still lacked momentum. The easing and stimulus policies applied in recent years harvested limited effects, and the growth rate recorded 1 percent in 2016. CPI remained negative for consecutive 6 months during 2016, which indicated a significant deflationary pressure. Labor market remained relatively stable, while household consumption decreased and investment and exports performed stagnantly.

Table 1.1 Macro-economic and Financial Indices in Major Advanced Economies

Country	Index	2016Q1			2016Q2			2016Q3			2016Q4		
		Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
United States	Real GDP Growth Rate (annualized quarterly rate, %)	0.8			1.4			3.5			1.9		
	Unemployment Rate (seasonally adjusted, %)	4.9	4.9	5	5	4.7	4.9	4.9	4.9	4.9	4.8	4.6	4.7
	CPI (y-o-y, %)	1.4	1	0.9	1.1	1	1	0.9	1.1	1.5	1.6	1.7	2.1
	DJ Industrial Average (closing number)	16 466	16 516	17 685	17 774	17 787	17 930	18 432	18 401	18 308	18 161	19 124	19 763
Euro Area	Real GDP Growth Rate (annualized quarterly rate, %)	1.7			1.6			1.8			1.7		
	Unemployment Rate (seasonally adjusted, %)	10.4	10.3	10.2	10.2	10.1	10.1	10	10	9.9	9.8	9.8	9.6
	HICP (y-o-y, %)	0.3	-0.2	0	-0.2	-0.1	0.1	0.2	0.2	0.4	0.5	0.6	1.1
	EURO STOXX 50 (closing number)	3 045	2 946	3 005	3 028	3 063	2 865	2 990	3 023	3 002	3 055	3 052	3 291
Japan	Real GDP Growth Rate (annualized quarterly rate, %)	1.9			2.2			1.2			1.2		
	Unemployment Rate (seasonally adjusted, %)	3.2	3.3	3.2	3.2	3.2	3.1	3	3.1	3	3	3.1	3.1
	Core CPI (y-o-y, %)	-0.1	0.2	0	-0.3	-0.5	-0.4	-0.4	-0.5	-0.5	0.1	0.5	0.3
	NIKKEI 225 (closing number)	17 518	16 086	16 759	16 666	17 235	15 576	16 569	16 887	16 450	17 425	18 308	19 114

Source: Statistical Bureaus and Central Banks of the Relevant Economies.

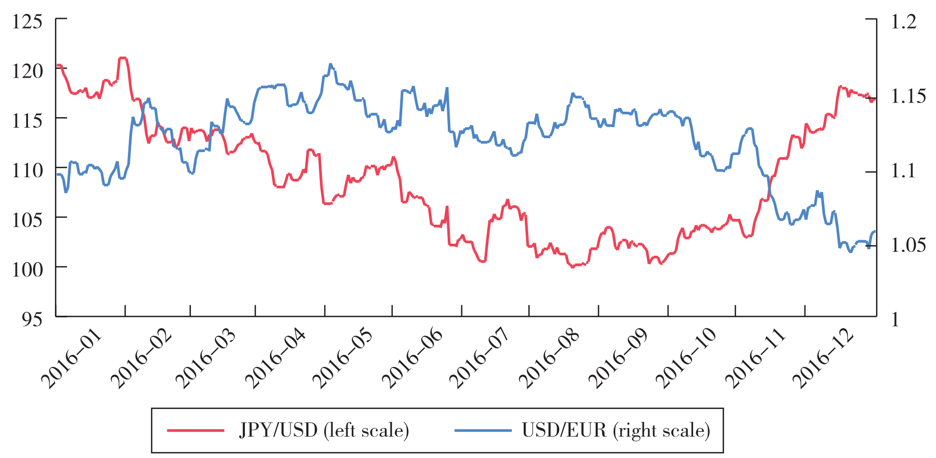
Growth in **emerging market and developing economies** stabilized. According to IMF statistics, major emerging market and developing economies grew by 4.1 percent in 2016, the same with 2015, which indicated that these economies were still playing an essential role in the world economic recovery. In particular, India kept a fast growth, with an annual growth rate of 7.1 percent in 2016, but still suffered from high NPL rate in the banking sector, weak private investment and inefficient use of capacity, etc.. Due to a pick-up in commodity prices including the oil price, economy in Russia stablized and Brazil successfully controlled the recession speed and inflation rate. However, against the backdrop of sluggish global total demand and a stronger U.S. dollar, some emerging market economies were still faced with potential risks like weak external demand and volatile cross-border capital flows, thus suffered from pressures of economic adjustment and transformation.

II.International Financial Market Performance

In 2016, affected by factors of world economic recovery and geopolitical issues, the US Dollar Index kept rising, yields of treasury bonds and return rates of money markets in major economies diverged, and stock markets and commodity markets improved.

The US Dollar Index kept rising. As of end-2016, the US Dollar Index recorded 102.38, up by 3.74 percent compared with the last year. Due to risk aversion and arbitrage, the exchange rate of JPY/USD closed at 116.87 yen per dollar, appreciating 2.93 percent over the end of the last year. Currencies in other major advanced economies depreciated against the US Dollar to different extents. The exchange rates of the USD/EUR and USD/GBP recorded 1.05 dollar per euro and 1.23 dollar per pound, with the depreciation being 3.2 percent and 16.3 percent. As to emerging market economies, Russian ruble, Brazilian real and the South African rand appreciated against the U.S. dollar by 19.08 percent, 21.7 percent and 12.60 percent respectively. Indian rupee, Mexican peso and Turkish lira depreciated by 2.57 percent, 17.11 percent and 17.30 percent respectively (Figure 1.1).

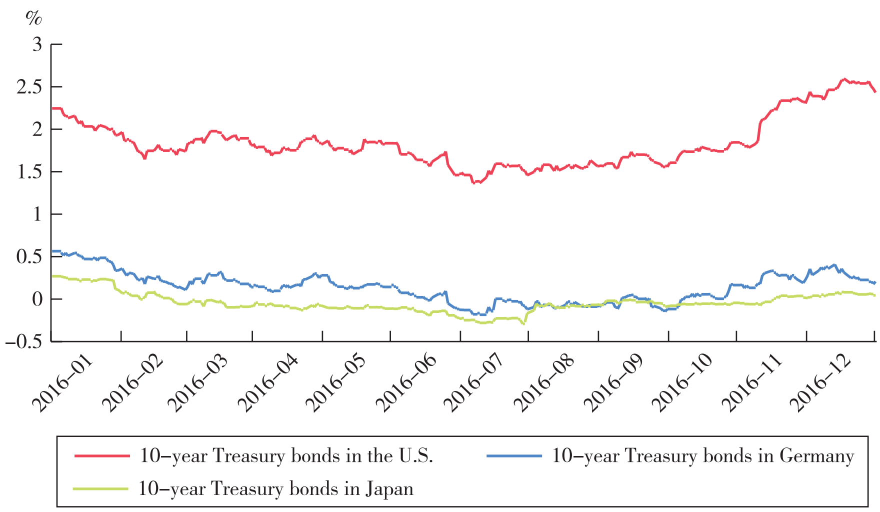
Figure 1.1 Exchange Rate Movements of Major Currencies



Source: Reuters.

Treasury bonds yields in major economies continued to diverge. As of end-2016, 10-year Treasury bond yield in the U.S. closed at 2.432 percent, up by 16 basis points compared with the end of 2015. 10-year Treasury bond yields in other advanced economies like Germany, United Kingdom and Japan closed at 0.207 percent, 1.24 percent and 0.049 percent, down by 43, 72 and 22 basis points respectively. As to emerging market economies, 10-year Treasury bond yields in India, Russia and Brazil dropped by 124, 136 and 503 basis points respectively compared with end -2015, and those in Mexico and Turkey rised by 118 and 62 basis points respectively (Figure 1.2).

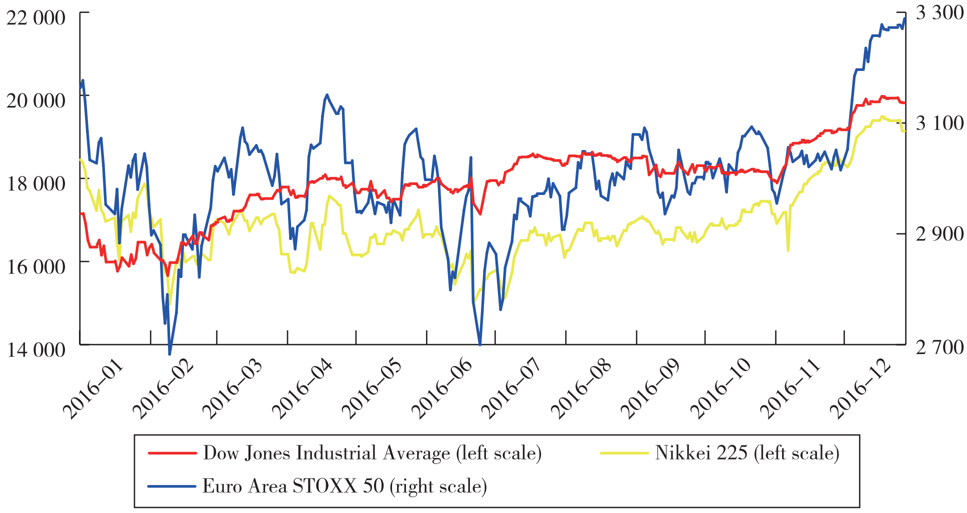
Figure 1.2 Yields of Treasury Bonds in Major Economies



Source: Reuters.

There was a general stock market rally in major economies. As of end-2016, the Dow Jones Industrial Average Index, Japanese Nikkei 225 Index, Euro Area STOXX 50 Index, German DAX Index and U.K. FTSE 100 Index increased by 13.42 percent, 0.42 percent, 0.70 percent, 6.87 percent and 14.43 percent respectively over the year. As to emerging market economies, stock markets in India, Indonesia, Brazil and Russia increased by 1.95 percent, 15.32 percent and 52.22 percent respectively compared with end-2015 (Figure 1.3).

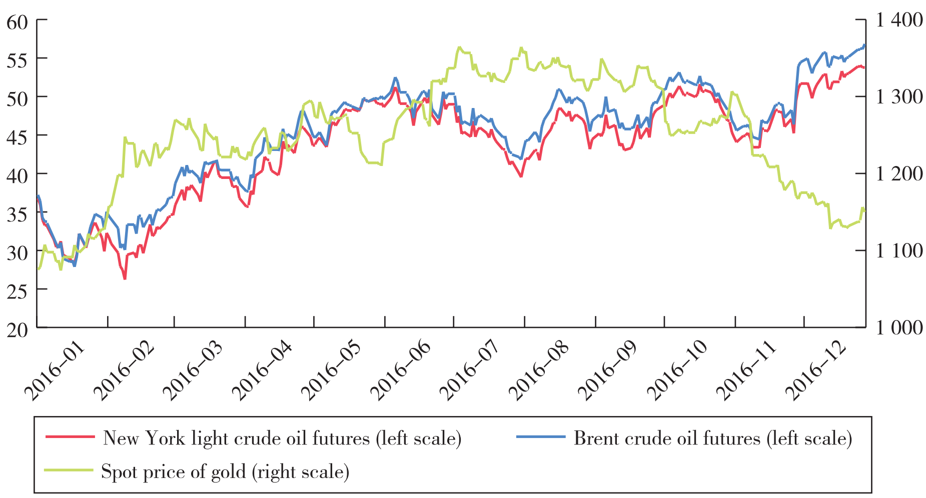
Figure 1.3 Major Stock Indices



Source: Reuters.

The international commodity prices began to rise. As of end-2016, the U.S. Commodity Research Bureau (CRB) Spot Index, which comprises of most commodities on the international markets, finished the consecutive decline and closed at 423.08, up by 48.38 y-o-y. The London Brent crude oil futures and New York light crude oil futures closed at USD 56.82 and USD 53.72 per barrel respectively, up by 52.41 percent and 45.03 percent respectively. The global gold price rised with fluctuation and closed at USD 1150 per ounce, up by 8.46 percent compared with end-2015 (Figure 1.4).

Figure 1.4 Price Indices of Gold and Crude Oil on the International Markets



Source: Reuters.

Global money market interest rates diverged. In 2016, the USD Libor in the London Inter-bank Market edged up amid fluctuation due to the expectation that the U.S. Federal Reserve will raise interest rates, and accelerated to hike since November to end up with 0.692 percent as of end-2016, up by 32 basis points compared with the beginning of 2016. Influenced by the upgrade of accommodative monetary policy by the ECB and Brexit effect, the Euro Libor closed at -0.414 percent, down by 13 basis points compared with the beginning of 2016. The Euribor maintained its declining tendency and closed at -0.329 percent, down by 9 basis points compared with the beginning of 2016.

III. Monetary Policies of Major Economies

In 2016, affected by the different recovery momentum and political unrest, major advanced economies and part of emerging market economies further diverged in their monetary policies.

The U.S. Federal Reserve raised the policy rates. On December 14, 2016, the Federal Reserve announced to raise the target range of the federal funds rate by 25 basis points to 0.5-0.75 percent, and anticipated that economic conditions would evolve in a manner that would warrant only gradual rises in the federal funds rate. The Federal Reserve also revised upward projections for short-term economic growth and inflation expectations, and the number of potential rate hikes in 2017 was up to three times by market expectation.

The ECB stepped up its accommodative monetary policy. On March 10, 2016, the ECB reduced interest rates on the main refinancing operations (MROs), the deposit facility and the marginal lending facility by 5 basis points, 10 basis points and 5 basis points respectively to 0 percent, -0.40 percent and 0.25 percent. In addition, it scaled up its monthly asset purchases to EUR 80 billion, starting from April 2016. In the meantime, investment-grade euro-denominated bonds issued by non-bank corporations in the euro area were added to the eligible asset list. Furthermore, starting on June 22, a fresh round of four-year targeted longer-term refinancing operations (TLTRO II) was conducted. On December 8, the ECB decided to keep interest rate unchanged and extend the asset purchase program to December 2017 with the monthly scale of EUR 80 billion, and net asset purchases were intended to continue at EUR 60 billion per month from April to December of 2017.

The Bank of England conducted the accommodative monetary policy. To mitigate the shock of Brexit, at its regular meeting on August 3 the Bank of England announced a stimulus package to boost economic growth. The package includes cutting its benchmark rate by 25 basis points to 0.25 percent, launching a new Term Funding Scheme to provide liquidity for banks at approximately the benchmark rate so as to reinforce implementation of the rate cut in the real economy, purchasing up to GBP 10 billion of U.K. corporate bonds, and expanding the asset purchase scheme for U.K. government bonds by GBP 60 billion, which will bring the total stock of such asset purchases to GBP 435 billion.

The Bank of Japan enhanced its monetary easing. It introduced a negative interest rate on January 29, 2016, under which an interest rate of -0.1 percent instead of the previous 0.1 percent would be applied to part of excess reserve deposits of financial institutions at the Bank of Japan. On July 29, the Bank of Japan decided to scale up the purchase of exchange-traded funds (ETFs) to an annual amount of JPY 6 trillion, and to double its U.S. dollar lending program from USD 12 billion to USD 24 billion so as to provide foreign currency liquidity for Japanese enterprises and financial institutions. In September, the Bank of Japan decided to introduce "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control" to intervene in short-term and long-term interest rates by applying negative interest rates on the reserve deposits of financial institutions at the Bank of Japan and by purchasing Japanese government bonds. It also committed to continuously expand the monetary base until inflation stabilizes above the 2 percent target level.

Monetary policies in the emerging market economies continued to diverge. On the one hand, a number of economies continued to relax their monetary policies to improve economic growth and mitigate external shocks. The central banks of Russia, India, Brazil, Ukraine, Turkey, Hungary, and Indonesia all cut their benchmark rates on several occasions. On June 9, 2016, the Bank of Korea lowered its benchmark rate by 25 basis points to a record low of 1.25 percent. On the other hand, some economies tightened their monetary policies to address domestic inflationary pressures, reduce the impact of the U.S. Federal Reserve's rate hikes, and ease pressures stemming from the depreciation of the local currencies and capital outflows. The Central Bank of Colombia raised its benchmark rate on 6 occasions by a total of 150 basis points to 7.75 percent, and then cut its benchmark rate by 25 basis points to 7.5 percent on December 19. The South African Reserve Bank increased its policy rate twice, up by 75 basis points to 7 percent. The Central Bank of Egypt raised its benchmark rate on 3 occasions by a total of 550 basis points to 14.75 percent. The Central Bank of Mexico increased its benchmark rate on 5 occasions by a total of 250 basis points to 5.75 percent. In addition, some emerging market economies such as Egypt and Nigeria introduced policies to address the financial market turmoil, including a flexible foreign-exchange rate regime.

IV. Risks and Challenges

Nowadays, the world economy is still faced with deep adjustment and rebalancing. There are a lot of uncertainties and unstable factors in a slow growth era.

Rising populism, de-globalization, and protectionism in international trade and investment have gradually evolved into one of the major risks for the global economic recovery. Recent international political developments and inward-looking policies adopted by some economies have contributed to the rise of protectionism throughout the world. Once escalated, the protectionism will certainly slow down or even reverse global policy coordination and economic globalization, undermine trade liberalization, and hamper labor and capital flows. It may also result in unsustainable policies, thus reducing global productivity and economic growth and aggravating financial market turbulence.

Uncertainties remain regarding U.S. economic and trade policies during the new administration. There still remains much to clarify about the U.S. economic and trade policies. The market generally expects that the new administration will adopt an expansionary fiscal policy featuring tax cuts and infrastructure spending. This may help boost U.S. economic growth and global aggregate demand, but it may also increase the U.S. government's fiscal and debt burdens if the funding problems are not properly addressed. In addition, an expansionary fiscal policy will probably push up inflation, which in turn may lead to the quicker-than-expectation rate hikes of the Federal Reserve. Some emerging market economies with huge external debts, high economic vulnerabilities and limited policy space may face increasing pressures from currency depreciation and capital outflows.

Risks persisted in the European banking sector. Problems such as low profitability and high NPL ratio in the banking sector in some countries may bring negative effects to investment. The NPL ratio of Italian banks has jumped to 18 percent, and the parliament has agreed on a rescue program with a total scale of EUR 20 billion. However, the validity of the program remains to be checked. According to its settlement agreement with the U.S. Department of Justice, the Deutsche Bank, one of the major commercial banks in Europe, agreed to pay USD 7.2 billion in penalties and consumer compensation for its misconduct in selling residential mortgage-backed securities from the year 2004 to 2007, and to pay USD 629 million in penalties for money laundering by the judgement of supervisors from the U.S. and U.K.. The Deutsche Bank has ended up with negative profits for two years. If the penalties would weigh down on its capital strength and its future operations, the European banking sector and even the real economy may suffer from further pressures.

Geopolitical tensions emerged in many locations and risks accumulated at a faster pace. The game among the big powers has increasingly complicated geopolitics in the Middle East. The European refugee crisis and the terrorist threat may spark geopolitical tensions in several locations and cause a further accumulation of risks and uncertainties.

V.Outlook

The IMF estimated that the world economy will grow by 3.5 percent and 3.6 percent in 2017 and 2018 respectively, faster than the previous year. However, the downside risk remains. It is essential for the stable performance of the world economy and financial system that all the economies could enhance the coordination on macroeconomic policies, properly deal with the spillover effects of the U.S. policy adjustment and rising populism and protectionism in international trade, and actively conduct structural reforms.

The U.S. economy is expected to rebound. Due to the strong performance in the second half of 2016 and the expectation for the fiscal stimulus policies, the U.S. economy is expected to rebound. According to the estimate by the IMF, the U.S. economic growth will rise from 1.6 percent in 2016 to 2.3 percent in 2017. However, the policy uncertainty of the new administration could undermine the growth perspective. In order to lift potential output and safeguard the fiscal sustainability, efforts should be continued to promote structural reforms, increase labor force participation rate, and introduce tax reforms to simplify the regulation and reduce tax exemptions.

The euro area is expected to grow slower. Affected by the mixed effects between disadvantages like Brexit, oil price rise and policy uncertainties, and favors like the expanding fiscal policy and accommodative monetary policy, the euro area is expected by the IMF to grow by 1.7 percent, the same with 2016. To respond to the negative effects and promote economic recovery, the euro area may continue its accommodative monetary policy and expand its asset purchase program when appropriate. Economies where space permits could provide more support for key areas, while those with limited fiscal policy space should be prudent in fiscal consolidation. Efforts should be continued to push forward structural reforms, focusing on labor, product and service market improvement. The repair of balance sheets of banks and enterprises should be accelerated. A common deposit insurance scheme should be established to safeguard the financial stability.

A slow recovery is anticipated to continue in **Japan.** Due to the weak recovery of world economy, domestic population contraction and the recent appreciation of Yen, the economic recovery will continue to be slow in Japan. According to the estimate of the IMF, the growth rate will be 1.2 percent in 2017. In order to stimulate the recovery, Japan would continue its accommodative monetary policies including the negative interest rates and the asset purchase program to prevent from deflation. To improve the fundamentals from the demand side, efforts should be made to raise labor force participation rate and wage level. In addition, a long-term plan of fiscal consolidation should be made considering the consumption tax hike schedule, and tax base should be expanded by various measures so as to safeguard the fiscal sustainability.

The emerging market economies will still contribute the most to the world economic growth. By the estimate of the IMF, their growth rate will rise from 4.1 percent in 2016 to 4.5 percent in 2017. In order to promote the economic growth and safeguard financial and economic stability, the emerging market economies should deal with the high debt level in their non-financial corporate sector to strengthen their resilience to shocks including tightening of the global financial environment, significant exchange rate fluctuation and capital flow reversion. Structural reforms should be continued and investment enhanced in education and medical treatment to reduce distortion in the product, labor and capital markets. Those countries affected most by the slump in commodity prices should take good advantage of the recent price recovery to adjust their economic structures and stabilize their macro economies.

Chapter II

China's Economic and Financial Performance

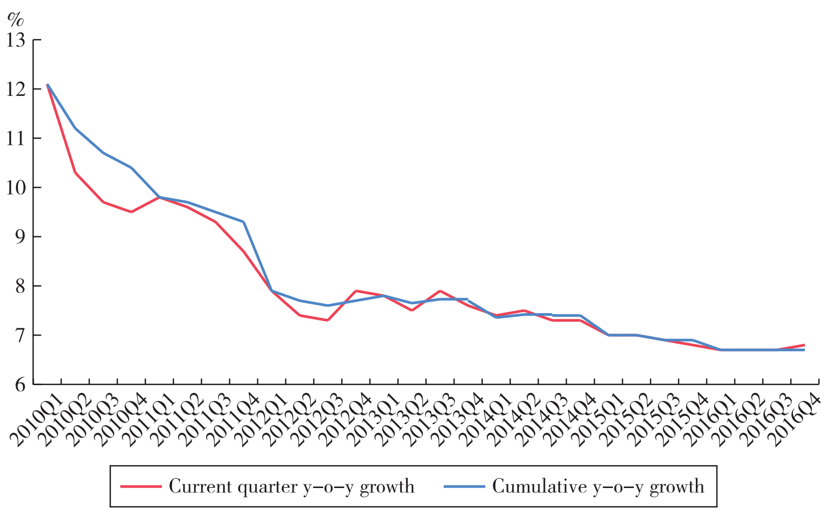
In 2016, facing an increasingly complex environment both domestically and abroad, the Chinese government adhered to the guideline of seeking progress amidst stability, focused on supply-side structural reforms, and expanded aggregate demand in an appropriate manner through a proactive fiscal policy and a prudent monetary policy. Such measures helped to guide expectations of the public, and the economy registered a slower but stable performance with good momentum for growth, thus making a good start for the thirteenth five-year period.

I. Macroeconomic Performance

1. Economic growth remained stable and industrial structure continued to improve

According to preliminary statistics of the National Bureau of Statistics (NBS), GDP in 2016 posted RMB 74.41 trillion yuan, up 6.7 percent y-o-y in comparable price terms. GDP growth in the four quarters registered 6.7 percent, 6.7 percent, 6.7 percent, and 6.8 percent respectively (Figure 2.1), showing a generally stable trend. Broken down by industry, value added of the primary industry, the second industry and the tertiary industry totaled RMB 6.37, 29.62 and 38.42 trillion yuan, up 3.3 percent, 6.1 percent and 7.8 percent respectively y-o-y. In terms of share of added value of the three industries in the GDP, added value of the primary industry accounted for 8.6 percent of the GDP, down by 0.3 percentage point; that of the secondary industry took up 39.8 percent of the GDP, representing a drop of 1.1 percentage points; and that of the tertiary industry accounted for 51.6 percent of the GDP, up 1.4 percentage points. The share of the tertiary industry exceeded 50 percent for the second consecutive year, pointing to continued improvement in the industrial structure.

Figure 2.1 China's Economic Growth



Source: The NBS.

Box 1 Development of the Real Estate Market and Real Estate Financing in 2016

In 2016, sales of housing rose substantially, housing prices in some cities grew rapidly, household residential mortgage registered relatively fast growth, and funds flowing to the real estate market were on the rise. All of these have aroused wide-ranging attention. With a view to containing asset bubbles and safeguarding stable and healthy development of the real estate market, the Chinese government has taken multipronged measures, in particular differentiated regulatory measures specific to each city's conditions, in addition to conventional measures. Until now, excessive investment inflows into the real estate market have been put under control, and rapid growth of household residential mortgage has moderated.

Sales of housing grew by a large margin, and gradually stabilized toward the end of the year. According to the NBS data, the total floor area of sold units posted 1.57 billion square meters in 2016, up 22.5 percent y-o-y, which was 16 percentage points higher than that in 2015. Specifically, the floor area of sold residential housing grew by 22.4 percent, representing an acceleration of 15.5 percentage points from 2015. After the launch of the regulatory measures, the floor area of sold units registered 520 millionsquare meters in the fourth quarter, an increase of 14.4 percent y-o-y, but a deceleration of 12.4 percentage points compared to the average growth of 26.8 percent in the previous three quarters.

Housing prices spiraled up in certain cities, but the growth moderated toward the end of the year. At the beginning of 2016, housing prices in tier-1 cities grew rather rapidly. Since the policies were tightened in tier-1 cities in March, prices in some core tier-2 cities started to post highest growth, and the trend gradually spread onto other tier-2 and tier-3 cities. As regulatory measures were intensively launched from October, the turnover of the real estate market dropped markedly, and price growth moderated. Calculated by simple arithmetic average, the monthly growth of the price index of newly built residential housing posted 4.4 percent, 1.8 percent, 0.4 percent and -0.1 percent between September and December in the 16 priority cities[①].

① Since Suzhou is not included in the NBS' survey of housing prices of 70 big-and-medium-sized cities, the calculation of the 16 cities' housing prices does not include Suzhou either, but this does not alter the analysis or conclusion.

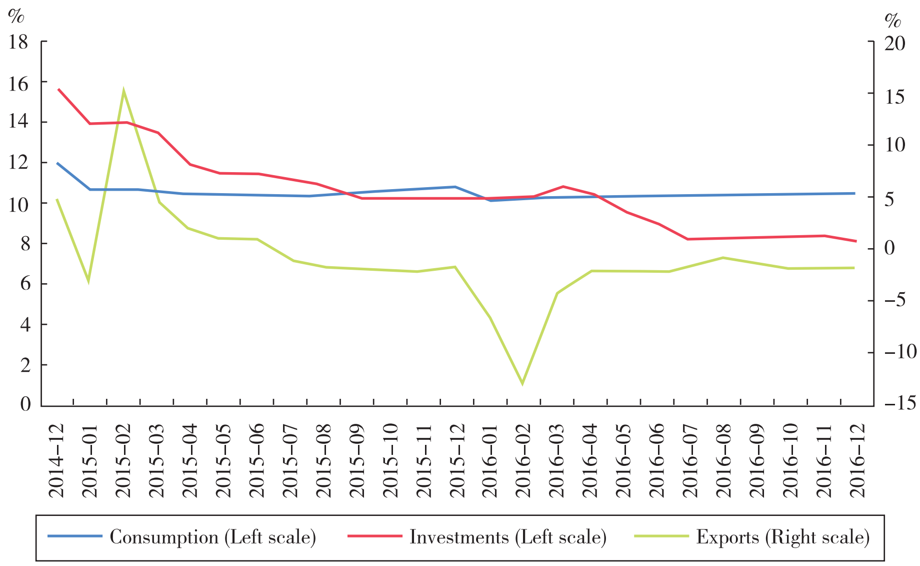
Decline of land sales decelerated, and real estate investment rebounded. Recovery in housing sales improved land sales and incremental housing construction. In 2016, completed land sales totaled 220 million square meters, down by 3.4 percent y-o-y, representing a significant deceleration from the decline of 31.7 percent in 2015. Nationwide real estate investment reached RMB 10.3 trillion yuan, up 6.9 percent y-o-y, representing a notable turnaround from the growth of 1 percent in 2015. The floor area of newly started real estate projects grew by 8.1 percent y-o-y to reach 1.67 billion square meters, and maintained positive growth from the start of the year, reversing the decrease of 14 percent in 2015 in y-o-y terms.

Real estate loans grew rapidly, with an increasing share in the total lending. By the end of December 2016, outstanding real estate loans by financial institutions stood at RMB 26.7 trillion yuan, up 27 percent y-o-y, and 13.5 percentage points faster than the y-o-y growth rate of total outstanding loans. At end-December, outstanding real estate loans accounted for 25 percent of the total outstanding loans, representing an increase of 2.7 percentage points from end-2015. In 2016, new real estate loans posted RMB 5.7 trillion yuan, an acceleration of RMB 2.1 trillion yuan y-o-y, accounting for 44.8 percent of the total incremental loans.

2. Investments grew slowly amidst stabilization, and BOP generally remained in equilibrium

In 2016, investments in fixed assets totaled RMB 60.6 trillion yuan, up 7.9 percent y-o-y (Figure 2.2), representing a deceleration of 1.9 percentage points from 2015. Retail sales of consumer goods registered RMB 33.23 trillion yuan, up 10.4 percent y-o-y, representing a deceleration of 0.3 percentage point from a year ago. Total imports and exports posted RMB 24.33 trillion yuan, down by 0.9 percent y-o-y, a deceleration of 6.1 percentage points of the decline in 2015. Among this total, exports dropped by 2 percent to RMB 13.84 trillion yuan, and imports grew by 0.6 percent to RMB 10.49 trillion yuan. The trade surplus posted RMB 3.35 trillion yuan. The demand structure continued to improve, with final consumption expenditure contributing 64.6 percent to the GDP growth, 4.7 percentage points higher than that in the previous year.

Figure 2.2 Growth of Consumption, Investments and Exports



Source: The NBS, GAC.

In 2016, the current account surplus dropped by 36 percent y-o-y to USD 210.4 billion, accounting for 1.9 percent of the GDP. The capital and financial account posted a deficit of USD 47 billion. Among this total, the non-reserve financial account recorded a deficit of USD 490.3 billion, and reserve assets decreased by USD 443.6 billion. By the end of 2016, the foreign exchange reserves registered USD 3.01 trillion, down by USD 319.8 billion or 9.6 percent from end-2015. The central bank's efforts to stabilize the RMB exchange rate was one of the major reasons for the decline in foreign exchange reserves, and depreciation of other currencies against the U.S. dollar and change in asset prices also played a role. In general, the overall decrease of foreign exchange reserves in 2016 decelerated, and was USD 192.8 billion less than the decline a year ago.

Box 2 Cross-border Capital Flows and RMB Exchange Rate Movements

In 2016, the current account maintained a surplus, whereas the capital and financial account (excluding reserve assets) continued to run a deficit, the decline in foreign exchange reserves slowed down, and pressures on cross-border capital outflows lessened compared with the rush period. The RMB depreciated against the U.S. dollar, but its depreciation was smaller vis-à-vis currencies of other major advanced economies and emerging market economies.

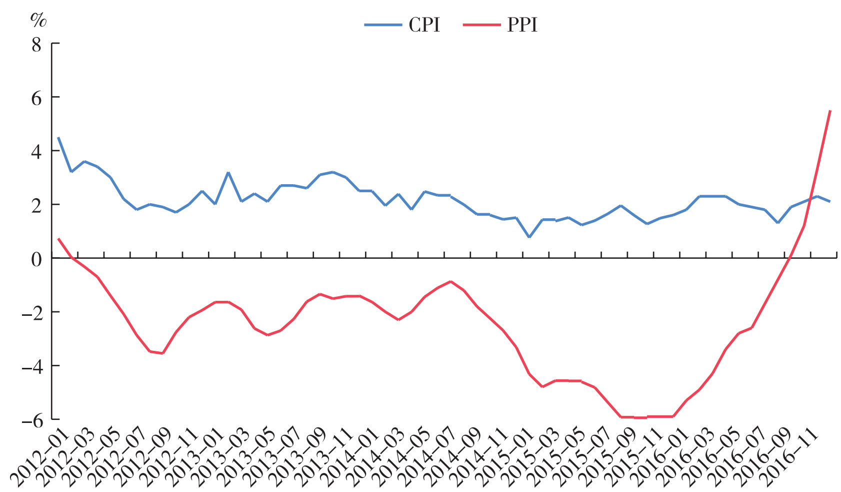
Specifically, cross-border capital flows and the RMB exchange rate movements in 2016 were characterized by the following features: first, capital outflow pressures eased. Foreign exchange settlement and sales by banks posted a deficit of USD 337.7 billion, down by USD 128.1 billion y-o-y. Foreign exchange reserves dropped by USD 319.8 billion to USD 3.01 trillion, representing a deceleration of decrease of USD 192.8 billion from the same period of the previous year. Second, deleveraging of enterprises' foreign-currency-denominated liabilities made positive progress. BIS estimated that outstanding foreign-currency-denominated liabilities arising on the domestic market declined by USD 180 billion or 30 percent at end-March 2016 from end-March 2014. Third, the RMB remained generally stable against a basket of currencies, but depreciated against the U.S. dollar. On December 30, 2016, the CFETS RMB exchange rate index was 94.83, close to the highest level in the previous five months. The RMB/USD central parity posted 6.9370, a depreciation of 6.4 percent from end-2015. Throughout 2016, the annualized volatility of the CFETS RMB exchange rate index was 2.8 percent, lower than that of the RMB/USD central parity of 3.6 percent.

In 2017, risks emanating from policy uncertainties of the U.S. administration, concern over U.K. "hard Brexit", national elections in a few countries in the euro area, and reform slippage and potential fiscal problems in some euro area countries might again give rise to global financial market turbulence. Although the U.S. dollar is expected to appreciate, the possibility cannot be ruled out of which the U.S. dollar is ahead of market expectations and might fall from a high level. Domestically, positive changes and highlights in the economic performance have been on the rise. Economic growth stabilized and turned around, with the economic structure continuing to improve. As the financial markets are further opened up, the positive role of foreign investors' increasing holding of RMB assets will gradually unfold. The Central Economic Work Conference in 2016 called for continued deepening of supply-side structural reforms. As the various reforms continue to deepen, the quality and efficiency of China's economic growth will improve, the fundamentals underpinning the RMB exchange rate will strengthen, and the RMB will be better placed to remain generally stable at a reasonable and equilibrium level with greater flexibility.

3. The CPI grew modestly, whereas the PPI turned positive

In 2016, the CPI was up 2 percent y-o-y, representing an acceleration of 0.6 percentage point from the previous year (Figure 2.3). In the four quarters, the CPI growth posted 2.1 percent, 2.1 percent, 1.7 percent and 2.2 percent respectively. Broken down into different items, food prices rose by 4.6 percent, an acceleration of 2.3 percentage points from the last year, and nonfood prices rose by 1.4 percent, an acceleration of 0.4 percentage point from 2015. The prices of consumer goods and services grew by 1.9 percent and 2.2 percent respectively y-o-y, representing an acceleration of 0.7 and 0.2 percentage point respectively from the previous year. The PPI became positive in September and continued to rise. It fell by 1.4 percent y-o-y, representing a deceleration of 3.8 percentage points from 2015. In particular, the prices of production materials dropped by 1.8 percent y-o-y, representing a deceleration of 4.9 percentage points, while those of consumer products kept par with those in the last year. The Purchasing Price Index of Raw Material (PPIRM) declined by 2.0 percent y-o-y, a deceleration of 4.1 percentage points from the previous year.

Figure 2.3 Monthly Movements of the Major Price Indices, y-o-y



Source: The NBS.

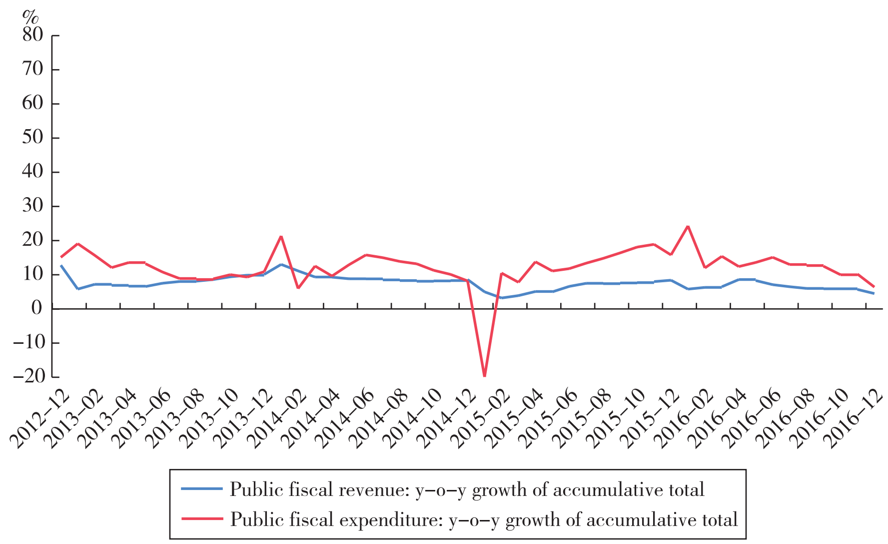
4. Growth of fiscal revenue and expenditure slowed down

In 2016, national general public budget revenue posted RMB 15.96 trillion yuan, up 4.5 percent y-o-y (the same coverage applies below), representing a deceleration of 1.3 percentage points from the last year (Figure 2.4) and continuing the downward trend. Among this total, general public budget revenue of the central government posted RMB 7.24 trillion yuan, accounting for 45.4

percent of the total revenue and representing a y-o-y growth of 1.2 percent; general public budget revenue of local governments posted RMB 8.72 trillion yuan, representing a y-o-y growth of 7.4 percent. In terms of the revenue structure, tax revenue registered RMB 13.04 trillion yuan, accounting for 81.7 percent of the total, and up by 4.3 percent y-o-y; non-tax revenue registered RMB 2.92 trillion yuan, up by 5 percent y-o-y.

National general public budget expenditure reached RMB 18.78 trillion yuan, an increase of 6.4 percent y-o-y, and a deceleration of 6.8 percentage points from the previous year. Among this total, general public budget expenditure of the central government grew by 7.3 percent y-o-y to RMB 2.74 trillion yuan; general public budget expenditure of local governments grew by 6.2 percent y-o-y to RMB 16.04 trillion yuan.

Figure 2.4 Growth of Fiscal Revenue and Expenditure



Source: The MOF.

5. Profits of industrial enterprises improved

In 2016, revenue of main business of statistically large industrial enterprises increased by 4.9 percent y-o-y[①] to RMB 115.2 trillion yuan, up by 4.1 percentage points from the last year. Realized profits totaled

① As the coverage of statistically large industrial enterprises changes every year, in order to make the 2016 data comparable with those in the previous year, the coverage in 2016 used to calculated y-o-y growth and growth volume of various indicators is the same with that in the report year, but different from that of the data published in 2015.

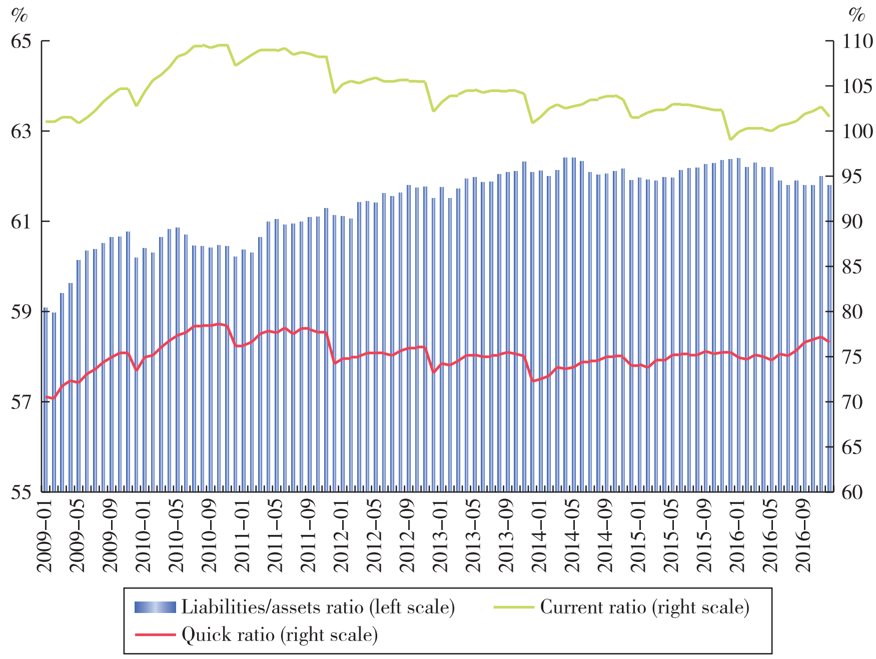
RMB 6.88 trillion yuan, up by 8.5 percent y-o-y, representing an acceleration of 10.8 percentage points from the last year. The profit margin of main business posted 5.97 percent, an improvement of 0.21 percentage point y-o-y. Among the 41 industrial categories, 29 earned more profits than in the previous year, one industry remained unchanged, and 11 witnessed declines in gross profits. In particular, gross profits in the manufacturing industry grew rapidly by 12.3 percent y-o-y to reach RMB 6.23976 trillion yuan, whereas gross profits in the mining industry dropped heavily by 27.5 percent to register RMB 182.52 billion yuan.

According to the PBC Survey of 5,000 Industrial Enterprises, business operations improved. Revenue of main business of sample enterprises improved from a y-o-y decline of 8.2 percent in 2015[①] to a y-o-y increase of 0.7 percent in 2016[②]. Gross profits grew by 25.3 percent y-o-y, 52.2 percentage points larger compared to that in 2015. In terms of asset turnover, in 2016, the inventory turnover ratio and the total asset turnover ratio of the sampled enterprises was 5.0 times and 0.7 time respectively, at a par with those in the previous year. The operating cycle was 142.7 days, 1.2 days more than that of the previous year. The liabilities/asset ratio dropped by 0.6 percentage point from 2015 to 61.8 percent. The current ratio was 101.6 percent, up by 2.6 percentage points y-o-y. The quick ratio was 76.6 percent, gaining 2.6 percentage points y-o-y (Figure 2.5). The interest coverage multiplier was 4.1 times, up 0.9 time y-o-y.

① Due to adjustment of sample enterprises, updating of financial data and other reasons, data for end-2015 in this report are newly published and adjusted, and there may be some differences between these data and those used in the previous annual report.

② Due to annual report audit, data reporting by some enterprises might be delayed. The end-2016 financial data in the report have been updated based on the newest data as of end-March 2017, and might be different from the final annual report data.

Figure 2.5　Liabilities/assets Ratio, Current Ratio and Quick Ratio of 5 000 Industrial Enterprises

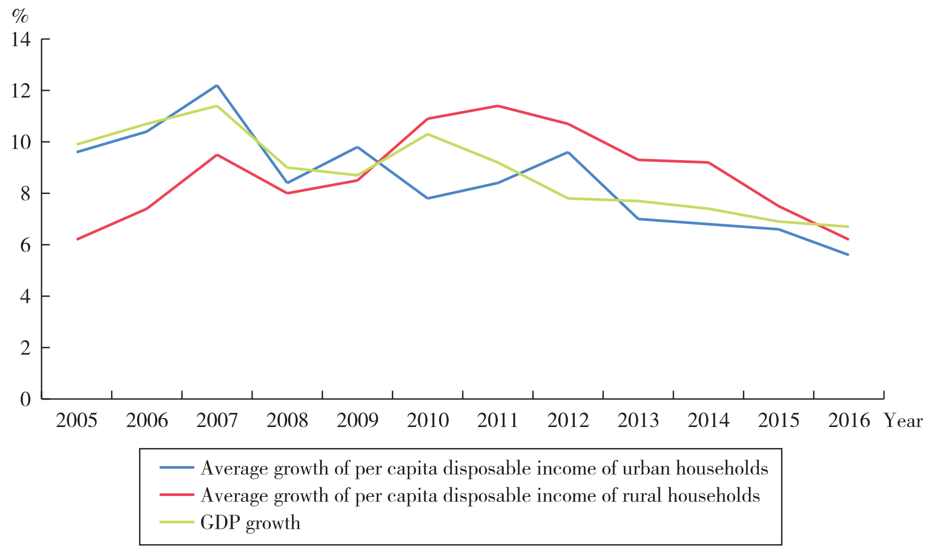


Source: The PBC.

6. Employment remained generally stable, and household income grew steadily

In 2016, newly employed population in the urban areas reached 13.14 million, 20,000 more than that of the previous year. Urban registered unemployment rate posted 4.02 percent, down by 0.03 percentage point from 2015. Per capita disposable income posted RMB 23,821 yuan, representing a price-adjusted y-o-y real growth of 6.3 percent. Per capita disposable income of urban households reached RMB 33,616 yuan, representing a price-adjusted real growth of 5.6 percent, down by 1 percentage point from the previous year. The per capita disposable income of rural households registered RMB 12,363 yuan, representing a price-adjusted y-o-y real growth of 6.2 percent, a deceleration of 1.3 percentage points from the previous year (Figure 2.6). The income gap between urban and rural households continued to narrow, reflected by the real growth of per capita disposable income of rural households outpacing that of urban households by 0.6 percentage point.

Figure 2.6 Growth of Per Capita Income of Urban and Rural Households and GDP



Source: The NBS.

Households continued to shift bank deposits to wealth management funds. At end-2016, outstanding deposits of the household sector stood at RMB 60.7 trillion yuan, up 9.9 percent y-o-y, an acceleration of 1 percentage point from the previous year. Outstanding household loans posted RMB 33.4 trillion yuan, up by 23.5 percent y-o-y, an acceleration of 6.7 percentage points from the end of 2015. In particular, mortgage loans grew by RMB 4.8 trillion yuan from the beginning of the year, up by RMB 2.3 trillion yuan y-o-y. At end-2016, outstanding wealth management funds reached RMB 29.1 trillion yuan, up 23.6 percent y-o-y. Clients' asset management schemes of securities firms registered RMB 17.58 trillion yuan, up 48 percent y-o-y; mutual funds managed by fund management companies posted RMB 9.2 trillion yuan; funds put in special wealth management accounts of fund management companies or their subsidiaries totaled RMB 16.9 trillion yuan, and market capitalization of the negotiable A-shares held by individual investors reached RMB 14.62 trillion yuan. Outstanding NPLs for the household sector increased, whereas the NPL ratio dropped. At end-2016, outstanding NPLs of household loans (including both non-business loans and business loans) posted RMB 572.82 billion yuan, 61.8 billion yuan more than that at the beginning of the year, and the NPL ratio was 1.7 percent, down by 0.18 percentage point from the beginning of the year. Outstanding NPLs in areas of household mortgage loans, credit card loans and auto loans posted RMB 63.32 billion yuan, RMB 75.15 billion yuan and RMB 5.91 billion yuan respectively, representing an increase of RMB 13.05 billion yuan, RMB 15.99 billion yuan and RMB 870 million yuan respectively from the beginning of the year. The NPL ratios of household mortgage loans, credit card loans and auto loans posted 0.4 percent, 1.9 percent and 0.8 percent respectively.

Box 3 Inclusion of the RMB into the SDR Currency Basket Became Effective

On November 30, 2015, the IMF decided to include the RMB into the currency basket of the Special Drawing Right (SDR). Since this was the first time in history to expand the SDR basket, it was decided that the new basket would become effective on October 1, 2016, in order to allow SDR users to make good preparations for accounting and trading.

With a view to facilitating smooth inclusion of the RMB into the SDR, the PBC and the SAFE worked closely with other administrative agencies to advance preparatory work in an orderly manner. First, the financial markets were further opened up to foreign investors. The PBC allowed foreign private institutional investors to invest in the inter-bank bond market without any quotas, and provided detailed operational guidelines to facilitate foreign central banks and similar institutions' access to the onshore markets. Second, technical issues concerning exchange rates for SDR valuation purpose were solved. The Bank of England began to provide the IMF with the RMB/USD exchange rate at noon in London on a daily basis, which is used for the SDR valuation. In order to extend onshore RMB trading to overlap the London market operating hours, starting from January 4, 2016, the CFETS operating hours were prolonged by 7 hours. Third, the short-term treasury bond yield curve was improved to meet the operational requirement for inclusion of the RMB into the SDR basket. The Ministry of Finance started to issue three-month treasury bills on a weekly basis from the fourth quarter of 2015, and improved the mechanism for issuing short-term treasury bills to make the yield of the three-month treasury bills more accurate. Fourth, data transparency and communication with the market was improved. The PBC and the SAFE participated in the International Banking Survey (IBS) and the Coordinated Portfolio Investment Survey (CPIS) starting from December 2015. The PBC improved communication with the market and coordination with other economies with regard to monetary policy, macroprudential management, capital flows and other issues that the international community was closely following, which helped to guide market expectations, enhance confidence in China's economic and reform prospects, and create a benign international environment for the inclusion of the RMB into the SDR.

On October 1, 2016, the IMF announced that the new SDR basket with the RMB as a fifth currency along with the U.S. dollar, the euro, the Japanese yen, and the British pound became effective. The weights of the U.S. dollar, the euro, the RMB, the Japanese yen, and the British pound are 41.73 percent, 30.93 percent, 10.92 percent, 8.33 percent, and 8.09 percent respectively. The currency amounts were also calculated, including 0.58252 U.S. dollar, 0.38671 euro, 1.0174 RMB, 11.900 Japanese yen, and 0.085946 British pound. The SDR exchange rate and interest rate were also adjusted correspondingly after including the RMB exchange rate and the 3-month Chinese government bond yield in the calculation.

The international community reacted positively to the RMB's inclusion into the SDR basket, and RMB-denominated assets became more attractive globally. The IMF, BIS, World Bank and other international organizations increased their holdings of RMB assets when adjusting asset allocation in line with the new SDR basket. In the meantime, the RMB assets held by foreign central banks were recognized as foreign reserves by the IMF, and the IMF made corresponding revisions to the template of the Currency Composition of Foreign Exchange Reserves (COFER) by including the RMB. Moreover, the RMB starts being used in IMF financial transactions including quota subscription, borrowing and repayment under IMF lending programs, and interest payment.

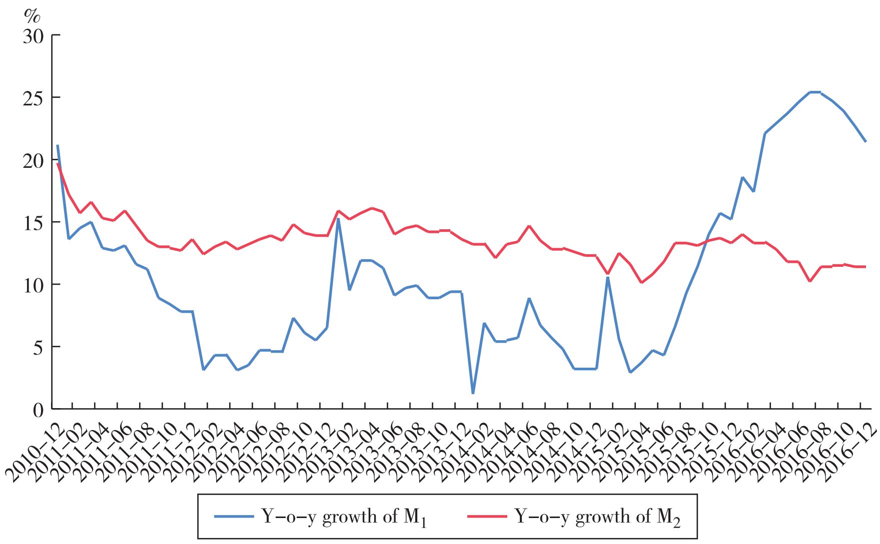
The inclusion of the RMB into the SDR basket is of great significance to the international monetary system (IMS), would help diversify the IMS, make the SDR basket more representative of the major currencies widely used in international transactions, and therefore strengthen the representativeness and attractiveness of the SDR itself. At the same time, RMB's inclusion into the SDR basket could further promote the use of the RMB by enterprises and individuals in cross-border trade and investment activities, strengthen market confidence, improve supply and demand on the foreign exchange market, and promote the stability of the RMB exchange rate. In general, the inclusion of the RMB into the SDR basket is an important milestone of China's integration into the global financial system, and represents a new starting point for China's financial reform and opening up. China will take advantages of this opportunity to further deepen financial reforms, expand financial opening-up, and make active contribution to promoting global economic growth, safeguarding global financial stability and improving global economic governance.

II. Monetary and Financial Performance

In 2016, despite increasingly complex economic and financial conditions at home and abroad, China continued to implement a sound monetary policy in a flexible and well-calibrated manner, made preemptive adjustment and fine-tuning when appropriate, and made monetary policy better targeted and more effective, in order to create a neutral and appropriate monetary and financial environment for economic growth and supply-side structural reforms. In general, the sound monetary policy achieved good results, liquidity in the banking system was reasonably adequate, money, credit, and Total Social Financing (TSF) grew relatively fast, interest rates remained at a subdued level, and the monetary and financial environment remained generally stable.

Monetary aggregates kept growing steadily. At the end of 2016, outstanding M_2 stood at RMB 155.01 trillion yuan, up 11.3 percent y-o-y, representing a deceleration of 2 percentage points from end-2015. Outstanding M_1 stood at RMB 48.66 trillion yuan, up 21.4 percent y-o-y, representing an acceleration of 6.2 percentage points from end-2015. M_0 grew by 8.1 percent y-o-y to RMB 6.83 trillion yuan, representing an acceleration of 3.2 percentage points from end-2015. On a net basis, the central bank pumped cash in the amount of RMB 508.7 billion yuan into the economy throughout 2016, an increase of RMB 213 billion yuan y-o-y. In 2016, M_2 growth slowed down after an uptick, and posted a relatively stable growth trend throughout the year. Liquidity in the banking system was reasonable and adequate. Affected by factors such as lower opportunity cost of enterprises' holding of demand deposits in a low interest rate environment, local government bond swap that locked in some capital, and brisk trading on the real estate market that pushed up demand for money, growth of M_1 remained relatively fast, and decelerated gradually starting from August, and the divergence between M_1 and M_2 also narrowed (Figure 2.7).

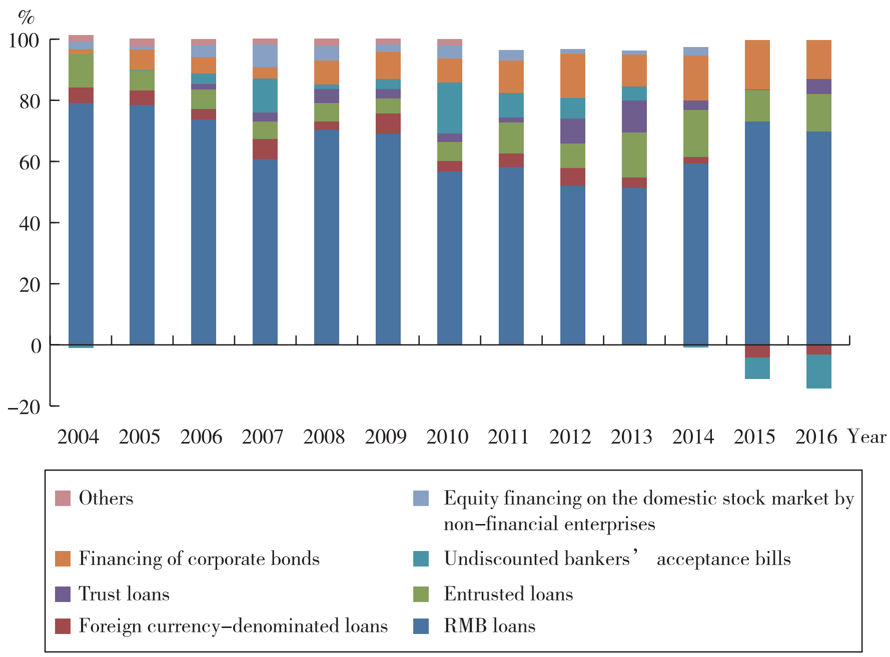
Figure 2.7 Growth of Money Supplies



Source: The PBC.

TSF grew appropriately. According to preliminary statistics, the stock of TSF as of end-2016 registered RMB 155.99 trillion yuan, up 12.8 percent y-o-y, and an acceleration of 0.3 percentage point from the end of 2015. The incremental TSF grew by RMB 2.4 trillion yuan y-o-y to RMB 17.8 trillion yuan. With regard to the composition of the flows, first, the share of corporate bond and equity financing remained generally stable. In 2016, bond and equity financing on the domestic markets by non-financial enterprises totaled RMB 4.24 trillion yuan, up by RMB 543.1 billion yuan y-o-y. This amount accounted for 23.8 percent of the TSF, down by 0.2 percentage point y-o-y. Second, the share of entrusted and trust loans rose. In 2016, the total entrusted and trust loans posted RMB 3.05 trillion yuan, an increase of RMB 1.41 trillion yuan y-o-y, accounting for 17.1 percent of the flow of TSF, up by 6.4 percentage points from the same period of the previous year. Third, new RMB loans rose substantially. The new RMB loans amounted to RMB 12.44 trillion yuan, up RMB 1.17 trillion yuan y-o-y, accounting for 69.9 percent of the flow of TSF. Fourth, undiscounted bankers' bills of acceptance declined markedly y-o-y (Figure 2.8).

Figure 2.8　Shares of Different Financing Modes in Total Social Financing



Source: The PBC, NDRC, CSRC, CIRC, China Central Depository & Clearing Co., Ltd. (CCDC), National Association of Financial Market Institutional Investors (NAFMII), and etc..

Loans of financial institutions registered stable and relatively fast growth, with subdued and stable lending interest rates. At end-2016, outstanding deposits in domestic and foreign currencies of all financial institutions posted RMB 155.52 trillion yuan, up 11.3 percent y-o-y. RMB deposits increased by RMB 14.88 trillion yuan from the beginning of the year, representing a deceleration of RMB 92.4 billion yuan y-o-y. Deposits denominated in foreign currencies grew by USD 84.5 billion, an increase of USD 67.8 billion y-o-y. Outstanding loans in domestic and foreign currencies of all financial institutions registered RMB 112.06 trillion yuan, up 12.8 percent y-o-y. RMB-denominated loans grew by RMB 12.65 trillion yuan from the beginning of 2016, representing an acceleration of RMB 925.7 billion yuan. Loans denominated in foreign currencies dropped by USD 44.5 billion, a deceleration of USD 5.7 billion. Lending interest rates of financial institutions remained at a low level. In December, the weighted average interest rate of loans to non-financial enterprises and other sectors stood at 5.27 percent, at a par with that in December 2015.

III. Outlook

At present, the Chinese economy has generally stabilized with positive signs. Growth rate remained within a reasonable range, with improved quality and efficiency. The economic structure continued to improve, and innovation has played a stronger role in boosting development. New breakthroughs have been made in reform and opening-up, and the design of opening-up was further optimized. Nevertheless, there are still many outstanding problems, such as overcapacity, challenges on upgrading of the demand structure, lack of endogenous growth drivers, rising financial risks, elevated leverage of non-financial institutions, risks from local government indebtedness, real estate bubble risks in some localities, declining asset quality of banks, disorderly innovation of financial products, and etc.

In 2017, it is essential to comprehensively implement the spirit of the 18th CPC National Congress, the third, fourth, fifth, and sixth Plenary Sessions of the 18th CPC Central Committee, press ahead with the overall arrangement of promoting balanced economic, political, cultural, social and eco-system development, and of comprehensively establishing a well-off society, deepening reforms, ruling by law and strengthening Party disciplines, stick to the overall principle of seeking progress while keeping stability, establish and implement the new development philosophy, adapt to and guide the new normal of economic development, promote quality and efficiency of development, continue to focus on supply-side structural reforms, expand the aggregate demand appropriately, strengthen guidance of expectations, make innovation a stronger growth driver, strike a good balance among stabilizing growth, promoting reforms, adjusting the structure, improving people's living standards and mitigating risks, and promote stable and healthy economic development and social harmony and stability.

A proactive fiscal policy and a prudent monetary policy will be implemented. The fiscal policy should become more proactive, and the budget constraint should accommodate the need for advancing the supply-side structural reforms, reducing enterprises' tax burden, and ensuring adequate guarantee of social living programs. The monetary policy needs to be prudent and neutral, while adapting to the evolution of money creation mechanism, properly manage the monetary supply, improve the monetary policy transmission channels and mechanism, and ensure generally stable liquidity in the system. The market-oriented reform of the exchange rate regime will continue, and the status of the RMB in the IMS should be kept stable.

Efforts will be made to further reduce overcapacity, destock, deleverage, cut costs and shore up the weak spots. With regard to reducing overcapacity, continued efforts will be made to carry out capacity reduction in the steel and coal industries, dispose of zombie enterprises, and cut capacity in other overcapacity industries in a market-oriented and law-compliant manner. In terms of destocking, policies will be made and calibrated specific to local conditions, with the focus laid upon excessive inventory of housing in the third- and fourth-tier cities. Regarding deleveraging, efforts will focus on corporate leverage in the precondition of controlling the overall leverage of the economy. Further measures will be taken to cut tax, expenses and factor costs. To shore up weak spots, efforts will start with the important areas and key links that severely hamper social and economic development, as well as outstanding issues that the general public is acutely concerned about. Both the tangible and intangible weak spots should be dealt with, and the same applies to development and institutional weak spots. Efforts to alleviate poverty should be well targeted, and the various policies should be earnestly implemented.

Financial reforms will continue to be deepened. The market-oriented interest rate reform will be deepened, with the central bank playing a more pivotal role in interest rate management. A fair and reasonable market pricing environment should be maintained, and continuous efforts are needed to improve a market-based interest rate formation, regulation and transmission mechanism. Efficiency of the Standing Lending Facility (SLF) operation should be enhanced to leverage on its role as the ceiling of the interest-rate corridor. A market-based RMB exchange rate regime will be further improved to allow the market to play a more critical role. Efforts will be made to actively guide and stabilize market expectations, promote balanced capital flows, and keep the RMB exchange rate generally stable at a reasonable and equilibrium level. A multi-layered capital market system will be built, market rules will be improved, and a market-based and law-compliant default and resolution mechanism will be enhanced. Corporate governance of financial institutions will be improved to strengthen the concept of prudence and compliance, and to hold financial institutions accountable for risk management. The reform plans on development financial institutions and policy banks should be carried out in an all-round manner. Explorations will be made to reform of provincial-level unions of rural credit cooperatives. The market-oriented and law-compliant debt-equity swap program will be advanced in a prudent manner.

The pilot program on financial liberalization in the free trade zones will be pushed ahead. A green financial system that covers banks, securities firms and insurance companies will be promoted.

Measures will be taken to strengthen macroprudential management, and prioritize containing financial risks. Strengthened efforts will be made to judge, analyze and give early warnings of financial risks, with focus laid upon risks emanating from overcapacity industries, bank asset quality, the capital market, various local exchanges, use of insurance funds, cross-sector financial businesses and illicit fund-raising. Regulatory capacity needs to be improved, and strengthened financial regulatory coordination would help coordinate regulation over systemically important financial institutions, regulation of financial holding companies and financial infrastructure, and comprehensive statistics compilation of the financial sector, and promote standards setting for asset management products. As a result, synergy can be formed for development and regulation of the financial sector, shore up the weak spots in regulation, and avoid regulatory vacuum. The deposit insurance system will be improved, and explorations will be made to establish a market-based resolution mechanism for financial institutions.

Chapter III

Banking Sector

In 2016, China's banking sector conscientiously implemented the major policy decisions of the CPC Central Committee and the State Council, pushed ahead with the five priority tasks —cutting overcapacity, reducing excess inventory, deleveraging, lowering costs and strengthening areas of weakness, achieved positive progress in reforms, improved the capacity to bolster the real economy and social development, and enhanced capabilities of risk prevention. However, the foundation for economic stability is still not firm enough, and risks continue to accumulate in certain areas. Thus the banking sector should attach more importance to risk prevention, while stimulating reforms and innovations, so as to ensure a sustainable growth and to create a favorable financial environment for economic growth and social development.

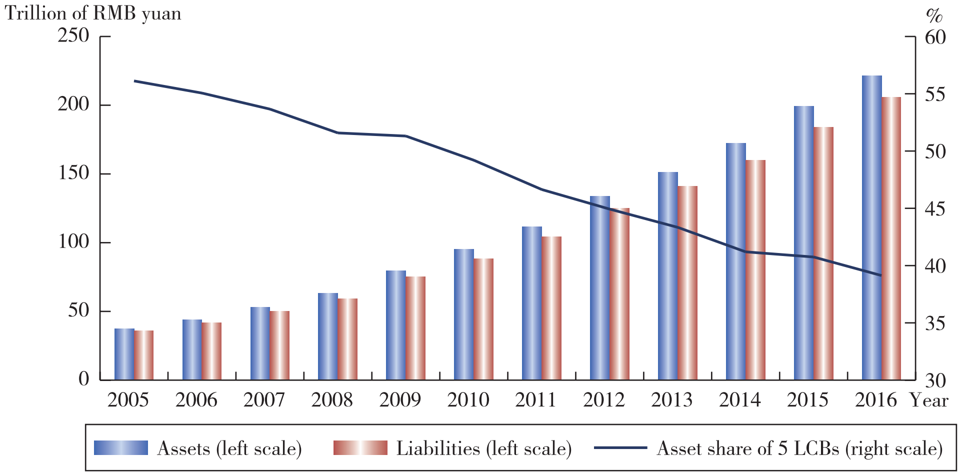
I. Recent Developments

1. Total assets and liabilities mounted up steadily, and banking structure was further improved

Total assets and liabilities maintained a steady growth. By end-2016, total assets of banking institutions increased by RMB 31.68 trillion yuan or 15.8 percent on a y-o-y basis to RMB 232.25 trillion yuan. The growth rate was 0.13 percentage point higher than that of last year. Total liabilities amounted to RMB 214.82 trillion yuan, an increase of RMB 29.7 trillion yuan or a y-o-y growth of 16.04 percent from the previous year. The growth rate was 0.97 percentage point higher than that of last year. Collectively, assets of the five large commercial banks (LCBs) accounted for 37.29 percent of total commercial bank assets, 1.92 percentage points lower than the previous year. The asset proportion of joint-stock commercial banks (JSCBs) and city commercial banks increased by 0.16 and 0.78 percentage point respectively. The asset proportion of rural financial institutions maintained at the same level as last year (Figure 3.1).

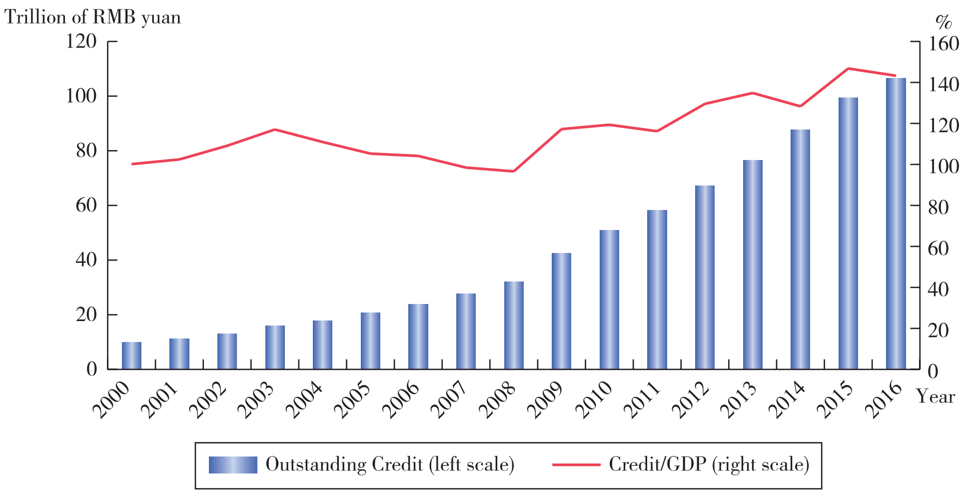
Total deposits and loans grew at a slower pace. By end-2016, the outstanding bank deposits denominated in both domestic and foreign currencies increased by RMB 15.63 trillion yuan or 12.53 percent y-o-y to RMB 140.42 trillion yuan. The growth rate increased by 0.57 percentage point compared to that of 2015. The outstanding loans were up by RMB 7.25 trillion yuan to RMB 106.6 trillion yuan. The growth rate was 7.28 percent y-o-y, 5.09 percentage points down from 2015 (Figure 3.2). In terms of maturity, the increment of medium- and long-term loans denominated in RMB had a substantial increase, and totaled RMB 58.95 trillion yuan by end-2016, an increase of RMB 8.94 trillion yuan or a y-o-y growth of 17.9 percent. In terms of institutions, JSCBs, city commercial banks and rural financial institutions witnessed greater expansion in loan volume.

Figure 3.1 Total Assets and Liabilities of Banking Institutions



Source: The CBRC.

Figure 3.2 Changes in RMB Credit Structure of Banking Institutions



Source: The PBC and NBS.

Banking structure was optimized. Both the number and market share of small- and medium-sized banking institutions showed continuous expansion, leading to a lower market concentration and more intense competition. By end-2016, there were 134 city commercial banks, 1114 rural commercial banks, 40 rural cooperative banks, 1125 rural credit cooperatives and 1443 village banks. The pilot private bank scheme demonstrated a significant step forward by giving licenses to 3 new private banks, and the total number of private banks reached 8. In terms of assets, the market share of small- and medium-sized banking institutions rose by 0.82 percentage point to 25.11 percent.

2. Favorable strategies were launched to bolster economic upgrading, and financial service to fragile industries was promoted

Work to push forward five priority tasks achieved preliminary success. In accordance with the principles of market-orientation and legalization, the banking sector carried out deleveraging strategies in a prudent way, supported the cutting of overcapacity in steal and coal sectors, and took powerful measures to extricate the industries in stress. The differentiated housing credit policies were improved, and credit restrictions were further intensified in major cities, such as Shanghai, Shenzhen and etc.. Solid credit was extended to perceived fragile industries, and strenuous efforts were made to improve financial services for people's livelihood, including startup and innovation, small and micro enterprises, health care, elderly care services, employment and student grants, etc.. At end-2016, the credit extended to government-subsidized housing projects increased by 58.7 percent, while the medium- and long-term loans extended to service industry increased by 11.4 percent.

Box 4 Carrying out Deleveraging in An Active and Prudent Way

In recent years, the high leverage and excessive growth of corporate debt were perceived as a heavy debt burden of enterprises in China. In the context of increasing complexity of world economic environment and great downside pressures on the domestic economy, some enterprises were operating under stress, leading to higher leverage risks. To fully implement the supply-side structural reforms directed by the CPC Central Committee and the State Council and push ahead with the five priority tasks, while at the same time to foster a modern enterprise system and strengthen the resilience of the mid-term economic growth, the NDRC, PBC, MOF and CBRC worked jointly to develop supporting documents on reducing corporate leverage and conducting market-oriented debt-to-equity swaps.

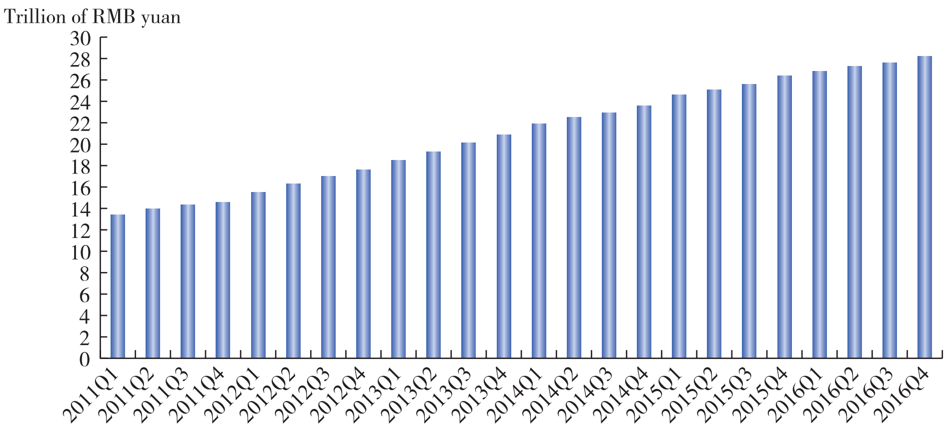
On October 10, 2016, the State Council released *the Opinions on Reducing Enterprise Leverage in a Proactive and Prudent Way*, together with its appendix—*Guidelines on Carrying Out Debt-for-equity Swaps in a market-oriented approach*. The Opinions presented a set of measures. First, the general idea of reducing leverage was clarified. Based on a proactive fiscal policy and prudent monetary policy, the initiative to reduce enterprise leverage would be steadily and actively conducted in a market-oriented and law-based approach. The move should also be implemented by treating both root causes and symptoms, and be integrated with other policy measures. The leverage reduction would contribute to promoting the supply-side reforms, deepening the reforms of state-owned enterprises, strengthening the economic restructuring and upgrading, and building up a solid basis for long-term sustainable economic growth. Second, the government called for conducting leverage reduction in a market-oriented and law-based approach, and the implementation should be coordinated and integrated with other policy measures in an orderly manner. The market should play a decisive role in resource allocation, and the move should be promoted in accordance with the laws and rules. Third, the Opinions identified seven detailed approaches to achieving a steady leverage reduction, which encouraged mergers and acquisitions, self-discipline measures including the establishment of a modern enterprise system, revitalization of stock assets of enterprises, refining debt structures, debt-for-equity swaps in a market-oriented approach, a law-based bankruptcy system and an active equity market. Fourth, complementary policies and measures were specified. The Opinions urged improving supporting fiscal and tax policies, enhancing self-discipline of market participants, improving financial institutions' management of credit lines, promoting regulation on investor qualification, reducing the social responsibility burden of enterprises, ensuring the staff resettlement of restructured enterprises, implementing supporting polices for industrial upgrading, monitoring and preventing associated risks, streamlining procedures for policy implementation and urging governments at all levels to participate proactively. All these supporting measures would be launched to establish a benign environment for leverage reduction.

Market-oriented debt-for-equity swaps would be an important measure to reduce enterprise leverage, and also a key node of stabilizing economic growth, stimulating reforms, promoting restructuring and preventing risks. Debt-for-equity swaps were believed to be an effective way of deleveraging, revitalizing enterprises' capital position, mitigating debt risks, reducing costs, and improving their operational efficiency and competitiveness. Meanwhile, for the enterprises, debt-for-equity swaps would promote the diversification of their shareholding structure, facilitate their restructuring, and improve their modern corporate governance. The whole program would be launched under the market-oriented and law-based principles. It would be left to the market to decide which companies would be qualified for the program and what would be the prices for the swaps. Fund-raising and the withdrawal of equity rights would also be conducted following the market principles and in accordance with the laws and rules. First, zombie companies, companies with bad credit records or with overcapacity would be strictly forbidden from participating in the program. Second, the program would not offer a free lunch. All the related entities would independently negotiate to agree on the size and pricing of the swaps in accordance with the market fair value. All the market participants should be responsible for their own decisions and bear the risks and profits; the government would not provide guarantee for any losses during the whole approach. Third, the funding sources for the program should come from the market. The qualified institutions to conduct swaps would be encouraged to raise funds from social investors, so as to transform social funds to social capital in an orderly manner. Fourth, the government would not step into the program directly or choose and match the candidate companies for the swaps. Governments at all levels should improve rules and policies, supervise in accordance with laws, safeguard the level playing field of the market, ensure social stability and fulfill the social security responsibilities, such as protecting workers' legitimate rights and interests, so that the debt-for-equity swaps program could be launched steadily following a market-oriented and law-based approach.

Since the promulgation of the opinions, entities like commercial banks have made some pilot trials under the market-oriented and law-based principles, and the program has made obvious progress. The existing contracts are deemed to be efficient to tackle high corporate debt and achieve the objectives of deleveraging, cutting funding cost, stimulating corporate restructuring and improving funding structure. For the next step, we need to continue to explore and innovate, improve regulatory schemes, implement complementary policies, create a favorable market and policy environment, and push forward the debt-for-equity swap program to reach effective achievements.

Strenuous efforts were made to foster agriculture, rural areas and farmers. Business models to provide financial support to agriculture, rural areas and farmers continued to innovate, the pilot program of loans collateralized with contracted land and property operational rights for rural housing was prudently promoted, and the scale of agro-related loans was steadily enlarged. At end-2016, the outstanding agro-related loans reached RMB 28.2 trillion yuan, with a y-o-y growth of 7.1 percent (Figure 3.3). With improved capital capacity, financial performance and corporate governance, rural financial institutions provided firming financial support to the rural sector. By end-2016, the outstanding loans of rural financial institutions amounted to RMB 13.95 trillion yuan, with a y-o-y growth of 11.52 percent.

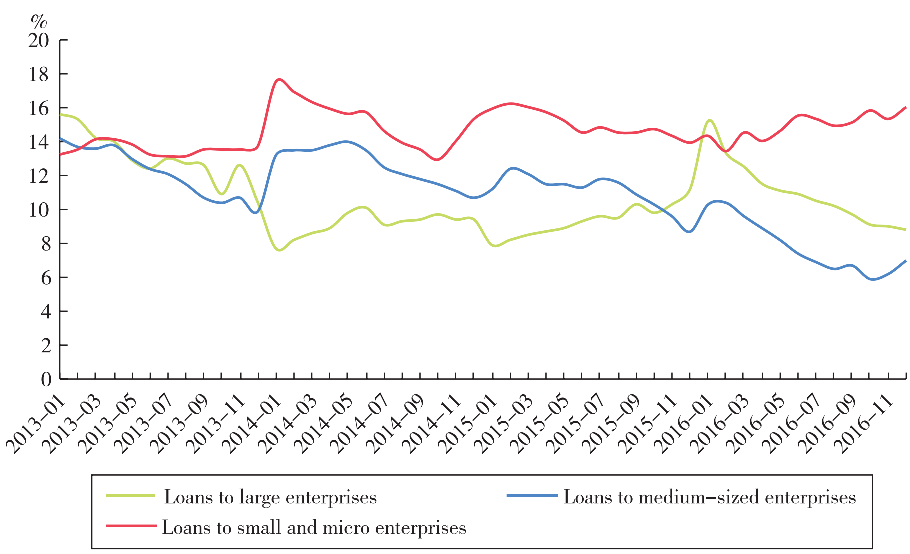
Figure 3.3 Outstanding Agro-Related Loans



Source: The PBC.

Financial services to small and micro enterprises were improved. By end-2016, the outstanding loans to small and micro enterprises reached RMB 26.7 trillion yuan, accounting for 37.8 percent of total corporate loans. The y-o-y growth was 13.8 percent, 6.1 and 7.1 percentage points higher than the loan growth to large enterprises and medium-sized enterprises respectively (Figure 3.4). In 2016, newly originated loans to small and micro enterprises registered RMB 3.24 trillion yuan, accounting for 50.7 percent of new corporate loans. By end-2016, there were 8673 micro-lending companies with a total lending balance of RMB 927.3 billion yuan, which contributed to alleviating the funding stress of small and micro enterprises.

Figure 3.4 Year-on-Year Growth of Loans to Large, Medium- and Small-sized Enterprises



Source: The PBC.

3. Reforms of financial institutions were pushed forward, and their capabilities of risk prevention were enhanced

Reforms of the development financial institution and policy banks continued to be pushed forward. The Articles of Association for the CDB, the EximBank and the ADBC were approved in November 2016. The Articles of Association further refined the tasks and measures proposed by the relevant reform plans, which would help to urge the three banks to enhance business function, improve corporate governance and enlarge the scale of financial support to crucial areas and fragile industries. In 2016, both the CDB and the ADBC established business units dedicated to poverty alleviation. At the same time, work to improve governance structure and to define business scope was well underway.

Reforms of LCBs were advanced. Progress was made in the reforms of ICBC, ABC, BOC, CCB and BOCOM. Great achievements came into spotlight, including the refined corporate governance, accelerated restructuring, and continuous enhancement of management capacity, service quality, risk prevention and international competitiveness. By end-2016, CAR of the 5 LCBs stood at 14.61 percent, 13.04 percent, 14.28 percent, 14.94 percent and 14.02 percent, respectively. NPL ratio recorded 1.62 percent, 2.37 percent, 1.46 percent, 1.52 percent and 1.52 percent, respectively. The whole year net profits registered RMB 279.1 billion yuan, RMB 184.1 billion yuan, RMB 184.1 billion yuan, RMB 232.4 billion yuan and RMB 67.2 billion yuan, with a y-o-y growth of 0.5 percent, 1.82 percent, 2.58 percent, 1.53 percent and 1.03 percent, respectively. Pilot reform of ABC’s County Area Banking Division (CABD) was steadily implemented, the management regime and the operational mechanism continued to improve, and the financial services dedicated to rural areas further extended. In total, the ABC's loans to rural areas recorded RMB 3.18 trillion yuan, a y-o-y increase of RMB 317.3 billion yuan. The growth rate was 11.09 percent, 1.47 percentage points higher than that of the ABC's total loans. The in-depth reform plan of the BOCOM was pushed forward, with powerful measures to improve corporate governance, deepen internal reform and bring vitality and profitability to the operation.

Reforms of other financial institutions were promoted. The commercialization of financial asset management companies made significant progress. The China Orient Asset Management Co., Ltd. and the China Great Wall Asset Management Co., Ltd. were formally established in October and December respectively. The Postal Savings Bank of China was listed in Hong Kong in September.

Box 5 Revising the Articles of Association for the Developing Financial Institution and Policy Banks

In December 2014, the reform plan of the ADBC was approved, while in March 2015, the reform plans of the CDB and the EximBank were also in place. According to the reform plans, the PBC coordinated with relevant authorities and promoted the revision of their Articles of Association based on comprehensive researches. In late November of 2016, the State Council approved the Articles of Association of these three banks.

The revision followed three principles. First, the revision should adhere to the direction of reforms toward the socialist market economy, stick to the reform plans, follow the request from the CPC Central Committee and the State Council with regard to the three banks’ reforms, and define the detailed tasks and measures based on the reform plans. Second, systematic research should be carried out to learn the drafting process, objectives, framework and content of the Articles of Association of international policy financial institutions, so as to draw on international experiences. Third, the revision should adapt to the needs of national development and also the economic and financial reforms, and serve the national strategies. The targeted banks would be requested to stick to the positioning as policy financial institutions, enhance modern corporate governance, and achieve a sustainable growth.

The refined Articles of Association define for three banks their corporate structures, duties and functions, business scope and management, funding sources, corporate governance, risk management and supervision, and information disclosure, etc. The main content includes the following aspects. First, industrial areas that need these banks’ support are clearly defined. Key areas and weak links in the economy are top priorities. Second, the corporate structure should be conducive to scientific and efficient decision-making and national strategies. Third, the CAR-oriented capital restraint mechanism will be put into effect, and risk management, monitoring and assessment should be improved.

The Articles of Association are the important institutional foundations for regulating the three banks’ business behaviors, ensuring the effective performance of their responsibilities and giving full play to their role as developing and policy financial institutions. The revision will stimulate the three banks to strengthen their functions, improve their modern corporate governance, and build up a mechanism for more sustainable development, so as to play proactive roles in stabilizing the economic growth, promoting economic restructuring, supporting shantytown renovation and infrastructure building, boosting foreign trades and implementing the "going-global" strategy.

4. The effectiveness of supervision was intensified and fully participation in the international banking regulatory reforms was committed

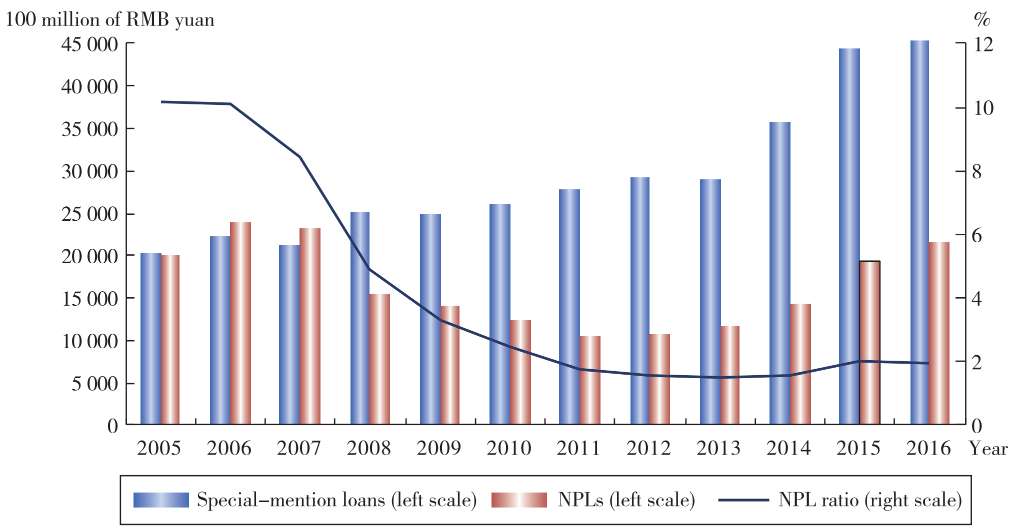
Effectiveness of domestic banking regulation was further ensured. The PBC made broader efforts to enrich the macroprudential toolkit, and upgrade the dynamic adjustment mechanism on differentiated reserve ratio into the Macroprudential Assessment (MPA) system, so as to push the commercial banks forward to fulfill self-discipline and maintain prudent operation through multi-dimensional macro-control measures. Starting in the first quarter of 2017, the PBC would count the off-balance-sheet wealth management products in banks' total credit in the MPA framework, which would urge the banks to strengthen off-balance-sheet risk management, so that the macroprudential framework would be more effective when conducting countercyclical adjustment and guiding the economic restructuring. With reference to the international reforms of financial regulation, the CBRC promulgated a series of regulations, including *the Guidelines on Comprehensive Risk Management of Banking Institutions* and *the Guidelines on Internal Audit of Commercial Banks,* etc. These regulations would strengthen banks' capabilities of risk mitigation and enhance the supervisory effectiveness. Relevant regulatory authorities worked in close cooperation, and made great efforts to enhance risk monitoring and assessment, guard against credit risk and liquidity risk, and strengthen prudential regulation over the asset management activities and shadow banking sector, which made the supervision more targeted and effective.

Relevant authorities continued to actively participate in the international banking regulatory reforms. Relevant authorities, including the PBC, MOF and CBRC, were actively involved in the reforms led by the FSB and BCBS, and steadily promoted the implementation of international standards in China. Within the G-SIB resolution framework, specific measures were taken to establish CMGs for G-SIBs, develop and update RRPs, conduct RAPs and refine the resolution regimes. Relevant authorities continued to participate in the regulatory reforms of the BCBS regarding credit risk, operational risk, leverage ratio, capital floor, etc, and issued international standards with regard to market risk, interest risk in the banking book, securitisation, TLAC holdings treatment, etc. The domestic implementation of Basel III was continuously promoted, so that the domestic banking regulatory framework could be in line with international standards, and the commercial banks could steadily enforce new regulatory standards on capital, leverage ratio and liquidity.

II. Soundness Assessment

Downward pressure on asset quality was alleviated. By end-2016, the total outstanding NPLs of banking institutions recorded RMB 2.19 trillion yuan; the NPL ratio declined y-o-y by 0.02 percentage point to 1.91 percent. NPLs of commercial banks climbed up by RMB 237.8 billion yuan to RMB 1.51 trillion yuan, which demonstrated an upward trend for 21 consecutive quarters. NPL ratio of commercial banks went up by 0.07 percentage point to 1.74 percent, and the increasing amplitude was 0.35 percentage point less than the previous year. Special-mention loans of banking institutions increased by RMB 524.4 billion yuan to RMB 5.28 trillion yuan. Special-mention loan ratio dropped by 0.09 percentage point to 4.6 percent (Figure 3.5). Past due loans increased by RMB 430.3 billion yuan or 15.33 percent to RMB 3.24 trillion yuan; the growth rate was 41.4 percentage points less than that of the previous year. Past due loans of banking institutions accounted for 2.87 percent of the total outstanding loans, which was 0.53 percentage point lower y-o-y. The past due loans over 90 days accounted for 102.6 percent of the total NPLs, which was 7.97 percentage points higher than that of last year. The provision coverage ratio of commercial banks dropped by 4.85 percentage points to 176.4 percent, while provision to loan ratio climbed up by 0.05 percentage point to 3.08 percent.

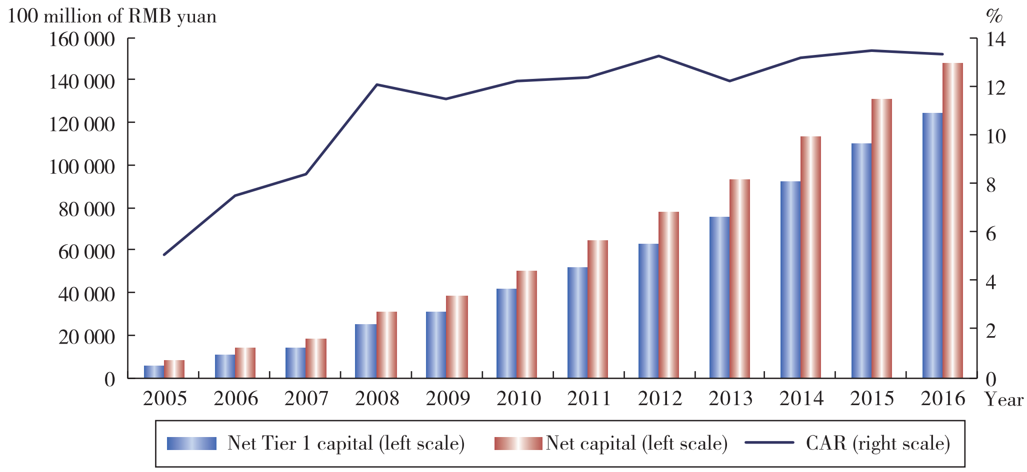
Figure 3.5 Changes of Special-Mention Loans and NPLs of Banking Institutions



Source: The CBRC.

Capital adequacy ratio dropped slightly. By end-2016, the CAR of commercial banks registered 13.28 percent, with a y-o-y decrease of 0.17 percentage point, and the recapitalization pressure loomed in the banking system (Figure 3.6). The CET1 Ratio recorded 10.75 percent, down by 0.16 percentage point from the previous year. Total CET1 of commercial banks accounted for 80.97 percent of the total capital, which still demonstrated a high capital quality in spite of the slight drop of 0.13 percentage point from the last year.

Figure 3.6 CAR and Capital Structure of Commercial Banks①

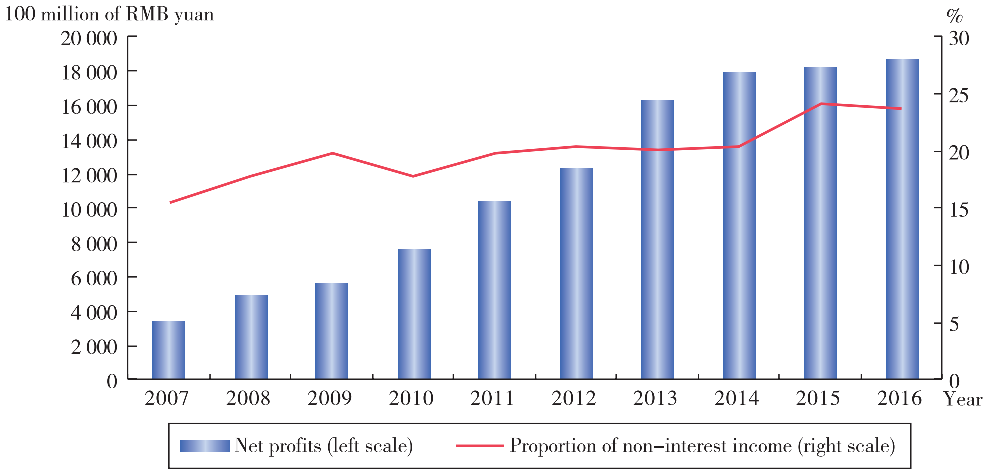


Source: The CBRC.

Growth of profits continued to decelerate. In 2016, banking institutions achieved a net profit of RMB 2.07 trillion yuan. The y-o-y growth rate was 3.65 percent, an increase of 1.27 percentage points over the previous year. By the end of the year, the ROA of banking institutions dropped by 0.11 percentage point to 0.96 percent, while ROE dropped 1.8 percentage points to 12.61 percent. The net interest margin continued to narrow along with the marketization of interest rates. By end-2016, the net interest margin of banking institutions dropped by 0.38 percentage point to 2.09 percent. The proportion of non-interest income to the net income was 26.61 percent, 2.02 percentage points lower than the previous year (Figure 3.7).

① CAR calculation began to follow the Basel Ⅲ rules since 2013.

Figure 3.7 Profitability and Proportion of Non-Interest Income of Banking Institutions



Source: The CBRC.

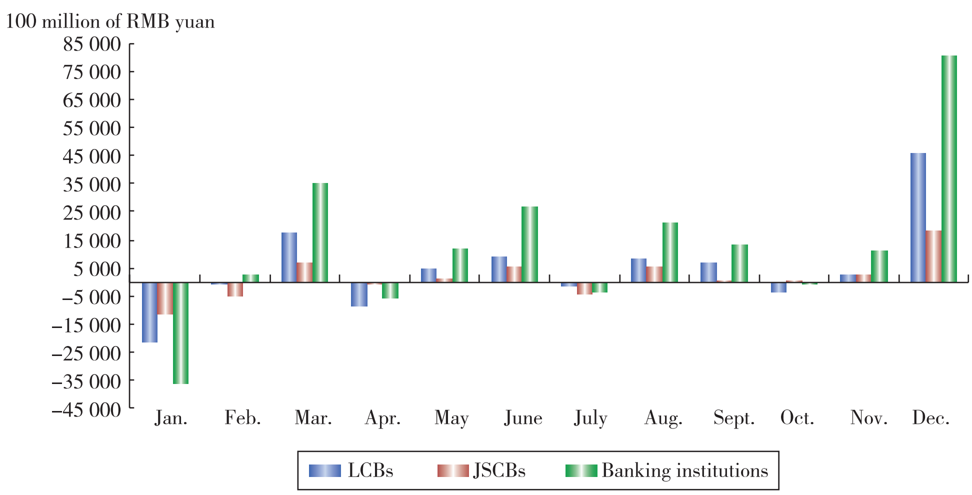
The overall credit risk was manageable and debt risk of non-financial enterprises intensified. In 2016, the overall credit risk of banking institutions was largely under control. However, risk events were not uncommon for enterprises with credit lines over RMB 1 billion yuan, and the credit deterioration mainly emerged in low-end manufacturing industries and industries saddled with overcapacity. Leverage continued to accumulate in non-financial enterprises. Some enterprises relied on loan rolling over, even borrowing new loans to repay the interests of the existing debts, thus the turnover efficiency of incremental financing further deteriorated. Insolvent zombie enterprises, whose products are barely competitive, occupied excessive credit resources, which uplifted the burdensome debt leverage in the non-financial enterprise sector, twisted the credit pricing mechanism and resulted in lower efficiency of the use of credit. Malicious defaults occurred in certain areas.

Great attention should be attached to operational risk and compliance risk. For some banking institutions, corporate governance and internal control were undermined by deficiencies. Weakness still existed in their risk management and compliance management. Noticeable criminal cases occurred frequently, not only in the traditional loan and deposit businesses, but also spread to new businesses, such as inter-bank business, off-balance sheet products, etc. Some banks claimed crimes related to banking notes of large amount and forgery Letters of Guarantee. Along with the implementation of “going-global” strategy, the international compliance risk also accumulated. In addition, due to insufficient internal risk management and lack of prudent supervision, some micro lending companies, credit guarantee companies, and financial leasing companies also claimed risk cases.

Price bubbles emerged in part of the real estate market. In 2016, the real estate market continued to polarize. In some first- or second-tier cities, the housing prices witnessed another significant rise, which was increasingly higher compared to the growth of residents' disposable income. The tendency to price bubbles was intensified through the interconnectedness between the increasing housing prices and financing products, such as down payment loans, loans collateralized by houses, etc. The share of new real estate loans in the incremental loans continued to climb up. By end-2016, the total outstanding real estate loans extended by banking institutions amounted to RMB 26.7 trillion yuan or 25 percent of the total outstanding loans, 2.7 percentage points higher compared to the previous year. The increment of real estate loans in 2016 was RMB 5.7 trillion yuan, accounting for 44.8 percent of the newly originated loans. NPLs to the real estate sector recorded RMB 66 billion yuan, and the NPL ratio climbed up by 0.08 percentage point to 0.77 percent.

Liquidity remained reasonably sufficient while instabilities increased. By end-2016, commercial banks registered a liquidity ratio of 47.55 percent, a deposit to loan ratio of 67.61 percent and a core liability dependency ratio of 56.57 percent, which implied an overall reasonably sufficient liquidity situation. However, the market still faced instabilities. First, the stress of wide fluctuation in banks' deposits remained unchanged. In 2016, for banking institutions, the largest monthly volatility of cross-quarter deposits could be over RMB 8 trillion yuan (Figure 3.8). Second, the stability of banking institutions' funding sources needed to be improved. In 2016, the sequential monthly growth of deposits was all below 7 percent for the whole year, with negative sequential growth for four months. The significant inter-bank exposures, as well as maturity mismatch between assets and liabilities stretched the liquidity management of some small- and medium-sized banks.

Figure 3.8 Monthly Deposits of Banking Institutions in 2016



Source: The CBRC.

The off-balance sheet business continued expansion, while the embedded risks remained. At end-2016, the outstanding balance of the off-balance sheet of banking institutions (including entrusted loans and entrusted investments) registered RMB 253.52 trillion yuan. The outstanding balance accounted for 109.16 percent of the total balance sheet assets, up by 12.04 percentage points from the previous year. Among all the off-balance sheet items, guarantee business registered RMB 19.03 trillion yuan, commitment operations registered RMB 16.08 trillion yuan and financial asset services registered RMB 164.63 trillion yuan. Weakness remained in the management of off-balance sheet business, and contagion between on- and off-balance sheet activities might exaggerate.

Risks embedded in Internet finance and illegal fundraising continued to build. In 2016, risks from Internet finance and illegal fundraising were mitigated to certain extent. However, financial risk events were not eliminated. Some Internet finance business strayed away from the right direction for innovations, some institutions lacked strong awareness of risk prevention, compliance or consumer protection, mechanisms of AML and CFT were not in place, and some institutions even engaged in illegal activities, including illegal fundraising and financial frauds, under the cover of "financial innovation". Large number of unlicensed institutions illegally raised funds through wealth management activities. Criminal cases were claimed frequently for private investment intermediaries, P2P Internet lending, farmers' specialized cooperatives, real estate companies, private equities, etc. Some geracomium institutions, consumption rebate business, and local exchanges were also increasingly involved in illegal fundraising activities. Potential risks loomed in virtual goods like Bitcoin, which attracted large number of speculative investors.

III. Outlook

In 2017, the foundation for a resilient economy and a sound financial market is still not firm, the downside pressure on real economy cannot be overlooked, and great attention should be attached to the challenges and risks confronted by the banking sector. The banking sector will remain committed to the mandate of contributing to the real economic growth, attach more importance to risk prevention, improve risk management and hold on to the bottom line of preventing systemic risks from happening.

Ensuring the implementation of the prudent and neutral monetary policy, and cultivating a benign financial environment for fueling the economic growth. It is important to remain committed to the decisions of the CPC Central Committee and the State Council with regard to the five priorities—cutting overcapacity, reducing excess inventory, deleveraging, lowering costs and strengthening areas of weakness. The PBC will continue to pursue a prudent and neutral monetary policy that is neither too tight nor too loose, conduct appropriate fine-tunings and preemptive adjustments through flexible use of price-based and quantity-based monetary policy instruments, polish the policy toolkit, straighten out the transmission channels for the monetary policy and provide a facilitating monetary and financial environment for the sustainable economic growth. The MPA will be conducted more efficiently, and countercyclical adjustment and risk alert towards financial institutions will be further enhanced.

Deepening reforms of the banking sector, aiming to achieve a more sustainable development. To accelerate the reforms for policy banks and development financial institutions, measures should be taken to cultivate a modern capital restraint mechanism and strengthen corporate governance, so that these institutions could more efficiently facilitate the economic growth and restructuring, and give more effective support to important areas or weak links in the economy. It is crucial to remain committed to the reform agenda of LCBs and other large financial institutions, improve modern institutional arrangements for financial institutions, speed up the restructuring process, and enhance operational efficiency and international competitiveness. The reform of ABC's County Area Banking Division (CABD) should be promoted to enlarge its capacity to serve the rural areas. The restructuring process of asset management companies should also be enhanced.

Promoting vigorously financial innovations, and enriching banking products. The capital replenishment mechanism should be improved by introducing innovative capital instruments, and qualified commercial banks are encouraged to issue contingent convertible Tier 2 capital. Bond trading business over the counter of commercial banks will be stimulated and pilots of NPL securitization will be steadily expanded. Banking institutions will be motivated to accelerate innovations in financial products and financial services, so as to broaden the supporting channels to the real economy. The pilot of venture loan targeted at the technological innovation-based enterprises will be promoted. Efforts should be continued to evaluate and disclose the outcomes of the pilot program of loans collateralized with contracted land and property operational rights for rural housing, and stimulate the supply-side structural reform in the agricultural sector.

Remaining committed to the bottom line of preventing systemic risks from happening, and taking strict precautions against risks in key areas. Greater importance should be attached to risk prevention and efforts should focus on mitigating risks related to banking asset quality, liquidity, inter-bank business, wealth management products, and off-balance sheet business, etc. Close attention should be paid to risks embedded in cross-sector activities, real estate industry, LGFVs, Internet finance and illegal fundraising. It is important to be prepared to combat against shocks from private financing and external financial stress, and attach importance to the international compliance risks. Efforts should be made to improve the macroprudential regulatory framework, manage risk expectations, and cultivate a sound social environment for risk vigilance. Efforts should be enhanced to ensure the efficient resolution of significant risks, and facilitate regulatory coordination and information sharing among agencies. Measures should be taken to enhance the capacity of the deposit insurance regime and explore the mechanism of resolving financial institutions in a market-oriented way. By drawing on the international experiences, relevant agencies should work to build up a domestic supervisory mechanism in line with international standards and improve the robustness of banking supervision.

Chapter IV

Securities and Futures Sector

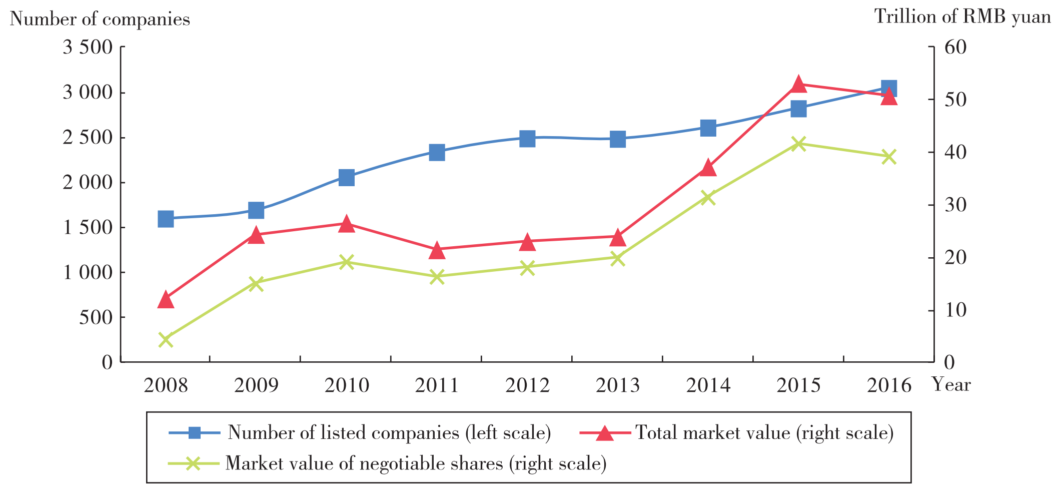
In 2016, the securities and futures sector has undergone sound development, with intensified regulation and improved institutional arrangements. Going forward, efforts are needed to continue to push forward the market-oriented reforms, undertake stringent regulation in accordance with laws and regulations, improve the risk prevention capabilities of securities and futures institutions, and continue enhancing two-way opening up.

I. Recent Developments

1. Main market entities achieved sound development

The number of listed companies increased steadily. At end-2016, there were 3,052 listed companies on the Shanghai Stock Exchange and the Shenzhen Stock Exchange altogether, an increase of 225 from the end of the previous year, with 248 newly listed companies and 23 delisted. The total market value and that of negotiable shares reached RMB 50.77 trillion yuan and RMB 39.34 trillion yuan respectively, a decrease of 4.44 percent and 5.86 percent y-o-y (Figure 4.1). The market value of negotiable shares accounted for 77.45 percent of the total market value, up by 4.16 percentage points from the end of the previous year.

Figure 4.1 Number and Market Value of Listed Companies, 2008-2016



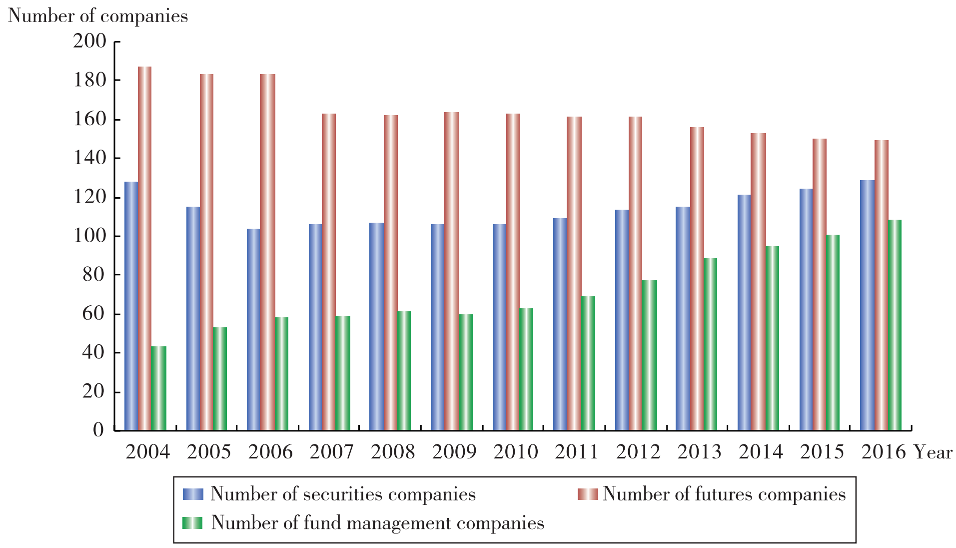
Source: The CSRC.

The number of companies listed on the New Third Board and regional equity markets maintained rather rapid growth. As of end-2016, a total of 10,163 companies were listed on the National Equities Exchange and Quotations System for Small and Medium

Enterprises (New Third Board), an increase of 5,034 from end-2015. The total shares reached 850.9 billion, up 2.87 times y-o-y; total amount of financing reached RMB 139.1 billion yuan, up 14.39 percent y-o-y. Meanwhile, the 40 regional equity markets had about 15,900 listed companies and 56,100 demonstrated companies altogether, achieving various types of equity financing for companies up to RMB 689.6 billion yuan on an accumulative basis.

The number of securities and futures companies was growing continuously. By the end of 2016, there were 129 securities companies, up by 5 y-o-y, of which 26 firms were listed securities companies, up by 2 y-o-y. There were 149 futures companies, down by 1 y-o-y. The number of fund management companies was 108, with an increase of 7 from end-2015 (Figure 4.2).

Figure 4.2 Number of Institutions Operating in the Securities and Futures Sector, 2004-2016



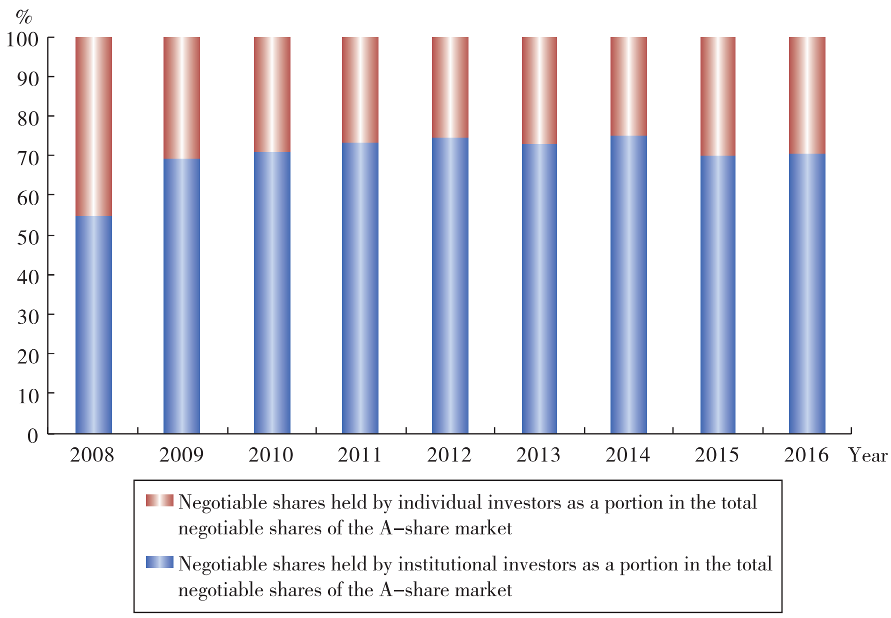
Source: The CSRC.

Overall asset volume of securities and futures companies expanded. By the end of 2016, total assets of securities companies (excluding clients' assets) amounted to RMB 4.37 trillion yuan, down 0.68 percent y-o-y. The total assets of futures companies (excluding clients' assets) totaled RMB 109.706 billion yuan, up 17.68 percent y-o-y. The total amount of mutual funds managed by fund management companies and 13 asset management institutions with mutual fund licenses posted RMB 9.16 trillion yuan, up 9.70 percent y-o-y. 17,433 registered private equity managers were managing 46,505 private equity funds. About RMB 10.24 trillion yuan of private equity funds were subscribed, up 100.78 percent y-o-y.

Development of innovation by securities and futures companies continued. *Fund of Fund (FOF) Guidelines* was promulgated in support of FOF product innovation in mutual funds. In response to the risk management demands of non-financial enterprises, subsidiaries of futures companies specialized in risk management played a positive role in warehouse receipt-based services, over-the-counter options, and basis transactions, steadily expanding pilots of "insurance + futures", pushing forward the screening of delivery warehouses, and expediting the R&D and listing of such futures products as cotton yarn, ethylene glycol, paper pulp, and STR-20 rubber. The capabilities to serve the need of real economy in risk management have been effectively improved.

Institutional investors grew steadily. By the end of 2016, the market value for negotiable shares held by institutional investors on the Shanghai and Shenzhen Stock Exchanges represented 70.64 percent of the total negotiable A-share market value, up 0.46 percentage point y-o-y, above the level of 70 percent for 7 consecutive years (Figure 4.3).

Figure 4.3 Comparison of Proportions of Negotiable Shares Held by Institutional and Individual Investors, 2008-2016



Source: The CSRC.

2. Institutional infrastructure achieved continuous progress

Regulatory rules for listed companies were further improved. The *Administrative Measures of Stock Ownership Incentive of Listed Companies* was promulgated, which intensified regulatory enforcement of information disclosure, improved relevant provisions on participation conditions, implementation and decision-making procedures of stock ownership incentives, accorded companies with autonomous and flexible room of decision making, enhanced ex post regulation, internal accountability, supervision, and penalty. *The Decision on Modifying "the Measures for Administration of Major Asset Restructuring of Listed Companies"* along with supporting provisions were promulgated, which clarified the standards for identifying material IPO under the form of asset restructuring and the timeframe of the "accumulative first" principle, further specified major asset restructuring of listed companies through such measures as banning supporting financing in the material IPO under the form of asset restructuring, prolonging the lockup period of certain shares held by relevant shareholders, intensifying accountability of listed companies and intermediary companies, and thus positively promoted restoration of the market-based valuation system.

Regulatory rules for securities and futures institutions continued improving. The *Administrative Measures on Risk Control Indices of Securities Companies* was revised and implemented, which further improved risk management systems of securities companies to achieve comprehensive risk management. The *Interim Administrative Provisions on Private Equity Asset Management Business of Securities and Futures Institutions* was revised and promulgated, which further clarified the objectives and scope of regulatory measures, and intensified prohibitive provisions governing the eight illegal activities including illegal publicity and marketing, illegal securities and futures business activities, encroachment of legitimate rights and interests of investors, "Cash Pool" business, and excessive incentive, etc. The *Administrative Provisions on Subsidiaries of Fund Management Companies* was revised and promulgated, which preliminarily established a net capital based risk control index system for special account subsidiaries of fund management companies, and detailed regulatory requirements on related transactions of subsidiary companies, prevention of conflict of interests, and the use of proprietary capital. The *Provisional Rules on Management of Risk Control Indicators for Specific-Client Asset Management Subsidiaries of Fund Management Companies* was promulgated, incorporating the businesses of subsidiaries with independent accounts into a risk control indicator system, and ensuring all businesses of different magnitude are matched with corresponding net capital, in facilitation of establishing an overall risk management system of the industry.

The mechanism of safeguarding investors' rights and interests was steadily improved. The *Administrative Measures on the Appropriateness of Securities and Futures Investors* was promulgated, which unified the classification and management requirements for securities and futures investors, explicitly intensified the investor appropriateness examination obligation of securities and futures companies, and built the front line of protection for investors. Pilots of diversified dispute resolution mechanism involving securities and futures companies were kicked off, with major breakthroughs achieved in linking investor protection with the judicial system. The administrative measures on the Securities Investor Protection Fund and the Futures Investor Security Fund were revised and promulgated respectively.

Box 6 Further Improvement of Net Capital Risk Control Indices of Securities Companies

With the development of the industry over recent years, the existing risk control index regime of securities companies could hardly meet the demand arising from the new situations. The securities regulator, therefore, learning from Basel III and relevant IOSCO capital regulatory methods and lessons drawn from stock market abnormal fluctuations, from the perspective of industry development, promulgated the revised *Administrative Measures on Risk Control Indices of Securities Companies* (hereinafter referred to as "*Risk Control Measures*") and its supporting documents in June 2016, which came into effect as of October 1, 2016.

While keeping intact the overall framework of the *Risk Control Measures,* the revision makes adjustments to specific provisions that failed to meet the demand of the industry development. Firstly, it improves the calculation formula of net capital and risk capital reserve, so as to improve the quality of capital and pertinence of risk measurement. The *Risk Control Measures* divides net capital into core net capital and subsidiary net capital, and incorporates risk adjustment of financial assets into the calculation of risk capital reserve, without double deduction of net capital. It shifts from calculation of overall risk capital reserve based on business types into the risked-based approach. Secondly, it improves leverage ratio indices and expands the coverage. The adjustment rationalizes the two leverage indices which are net asset liability ratio and net capital liability ratio, into core net capital / total of on and off balance sheet assets, with regulatory requirement of no lower than 8 percent. Thirdly, two regulatory indices measuring liquidity risks were added, which are liquidity coverage ratio and net stable funding ratio, hence intensifying the maturity match of assets and liabilities. Fourthly, risk control indices of single business line are improved to make them better targeted. Calculation of equity securities is adjusted, subdividing derivatives into equity derivatives and non-equity derivatives, and the calculation of different fund-raising businesses was merged. Fifthly, the countercyclical adjustment mechanism is clarified to improve the effectiveness of risk control. In light of classified regulation of securities companies, industry-specific risks and market conditions, the regulator may undertake dynamic adjustment to calculation of the relevant indices. Sixthly, comprehensive risk management is intensified. All subsidiaries are incorporated into the comprehensive risk management system, with emphasis laid upon risk management of affiliated institutions so as to improve risk management.

The promulgation of the new version of the *Risk Control Measures* means that the risk management concept of the securities sector shifted from "putting risks under control through controlling the size of the business" to "the emphasis of controlling risks in commensurate with the capability of risk management". Going forward, efforts will be made to further enhance the communication and coordination amongst the regulators, promote the calibration of capital regulatory standards for the same type of business but in different sectors, promote fair market competition, and prevent regulatory arbitrage. Efforts will be made to further intensify macroprudential management, detail and clarify the countercyclical risk adjustment mechanism, enhance evaluation of systemically important securities institutions, study and put forward additional capital regulatory requirements. Securities companies will be urged to further improve their comprehensive risk management capabilities, with stress on credit risks and liquidity risks, so as to establish a multi-dimensional and multi-layered early-warning system, in a view to gradually shifting from business development oriented risk management to a better refined and targeted approach.

3. Regulatory enforcement constantly intensified

Reform of the administrative approval system continued to forge ahead. The administrative approval requirements for electing and reassigning legal representatives and main personnel accountable for operation management and regulatory compliance of mutual fund managers were removed, along with seven administrative approval requirements for intermediary services, and licenses for securities and fund businesses were unified.

Inspections and law enforcement were further intensified. In 2016, 603 reported clues of illicit behaviors were accepted. Investigations were launched for 551 such cases, which accounted for 91 percent of total clues and represented a new record high. 302 new cases were opened, up 23 percent over the average of the past three years. 178 new cases involving foreign entities were recorded, up 24 percent y-o-y. The amount of both administrative penalties and fines in 2016 hit a historical record, and the number of people who were denied market access reached its peak. In parallel with continued severe crack-down on illicit information disclosure, insider trading, and market manipulation, intensity was maintained to strike down on other illicit behaviors including undisclosed over-proportional shareholding, and illegal stock trading by practitioners. Inspections were undertaken to investment banking businesses of securities companies, with enhanced intensity of on-site inspections. In 2016, 2 overall inspections and 1 ad hoc inspection were carried out. Administrative and regulatory measures were taken against 7 securities companies and 23 persons were held accountable. For the first time, on-site inspection was undertaken to stock and futures exchanges.

Supervisory cooperation in the securities and futures sector continued to improve. According to the *MOU on Strengthening Supervisory Cooperation in the Securities and Futures Sector to Jointly Safeguard Financial Stability* between the PBC and CSRC, the two agencies shared information with each other, and continued cooperation in cracking down on illicit behaviors in the securities and futures sector, revamping various exchanges, monitoring financial risks, protecting investors' rights and interests, and responding to emergencies. Such cooperative efforts effectively supplemented regulatory deficiencies and safeguarded financial stability.

4. Two-way opening up of the capital market made new progress

The P*rovisions on Connectivity of Stock Markets between the Mainland* and Hong Kong and supportive measures thereof were promulgated, and the Shenzhen-Hong Kong Stock Connect was officially launched, thus facilitating further connectivity of Hong Kong with the Mainland market. Domestic enterprises continued forging ahead with overseas financing throughout the year, with 15 IPOs of H-Share and refinancing of 13 H-Share companies, and the accumulative amount of financing totaled USD 24.6 billion. Panda bonds issued by enterprises were launched and the total fundraising reached RMB 83.6 billion yuan. "Going-out" of stock exchanges made positive progress with the China Europe International Exchange (CEINEX) operating smoothly.

II. Soundness Assessment

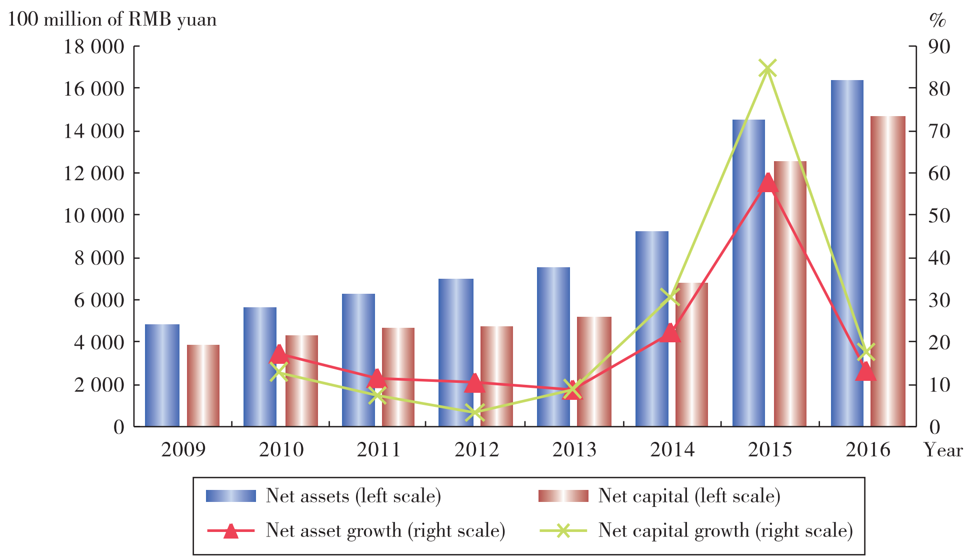
1. Profitability of some listed companies continued decreasing with operation pressures warranting attention

As a result of the contradiction between overcapacity and upgrading of the demand pattern, as well as inadequate inherent drivers of economic growth, profit losses were concentrated in some industries in 2016. Some listed companies experienced difficulties in production and operation with heavy debt burden, struggling at the brink of delisting. By April 30, 2017, all the 3,213 listed companies had published their annual reports, which indicated that 241 of them were in a loss, accounting for 7.5 percent of the total; 163 companies ran a loss for the first time, and 78 companies remained loss-makers. The loss-suffering firms were mainly concentrated in the "chemical raw material and chemical manufacturing industry", "the computer, communication and other electronic equipment manufacturing industry", "special-purpose device manufacturing industry", and "electric machinery and equipment manufacturing industry". Among the first three industries, many enterprises also reported losses in 2015.

2. Securities companies generally operated well, but a few risk events emerged due to slack internal control

In 2016, the overall operation of securities companies was sound with risks under control. By the end of the year, the total assets of securities companies reached RMB 5.79 trillion yuan, down 9.81 percent y-o-y; total net assets posted RMB 1.64 trillion yuan and total net capital amounted to RMB 1.47 trillion yuan, up 13.10 percent and 17.60 percent respectively, marking the third year of growth in a row. In terms of the industrial average, the ratio of net capital to total risk-based capital provisions reached 246.76 percent, down 462.09 percentage points from end-2015; and the ratio of liabilities to net capital posted 253.05 percent, down 143.46 percentage points from end-2015 (Figure 4.4).

Figure 4.4 Changes of Net Assets and Net Capital of Securities Companies, 2009-2016

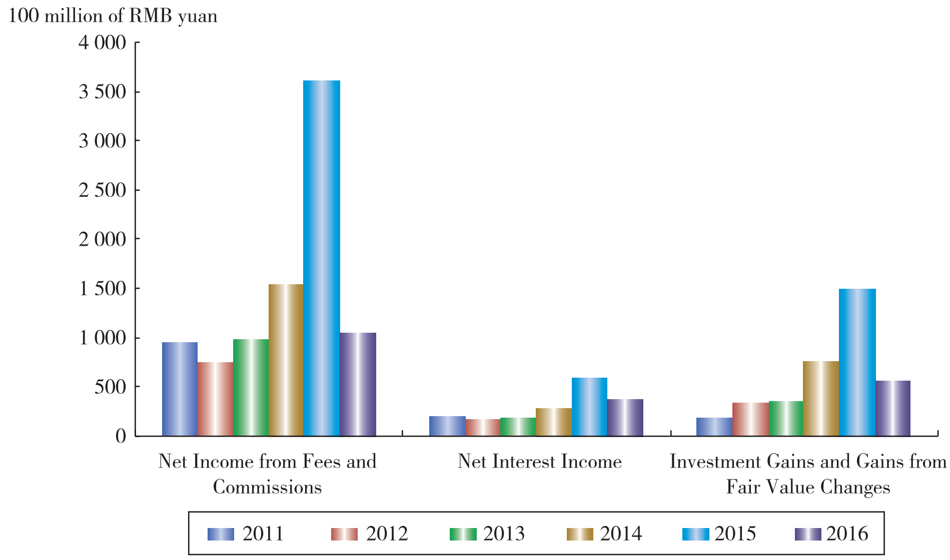


Source: The CSRC.

As a result of decreased trading volume on the stock market, declining market value and deleveraging of the securities asset management business, overall profitability of securities companies underwent substantial drop. The sector generated RMB 327.994 billion yuan of operating revenue in 2016, down 42.97 percent y-o-y. Among others, net income of the agency business (including seat leases) ended up with RMB 105.295 billion yuan, down 60.87 percent y-o-y; net income of the underwriting and sponsorship business reached RMB 51.999 billion yuan, up 24.32 percent y-o-y; net income of financial consultancy reached RMB 16.416 billion yuan, up 19.02 percent y-o-y; net income from investment consultancy posted RMB 5.054 billion yuan, up 12.86 percent y-o-y; net income of asset management posted RMB 29.646 billion yuan, up 7.85 percent y-o-y; net income of securities investment (including fair value variation) posted RMB 56.847 billion yuan, down 59.78 percent y-o-y; and net interest income posted RMB 38.179 billion yuan, down 35.43 percent y-o-y. From the perspective of income composition, agency commission remained the major source of income of securities companies, but the proportion dropped from 46.79 percent in the previous year to 32.10 percent. Net profits accomplished by the entire industry reached RMB 123.445 billion yuan, down 49.57 percent y-o-y (Figure 4.5).

By and large, risk control indices of securities companies conformed with regulatory requirements, and risks were under control. Some individual securities companies, however, overlooked compliance and internal control. They concealed risks through black box, while the risks they actually assumed may exceed the level indicated by risk control

Figure 4.5 Changes of Securities Companies' Income Structures, 2011-2016



Source: The CSRC.

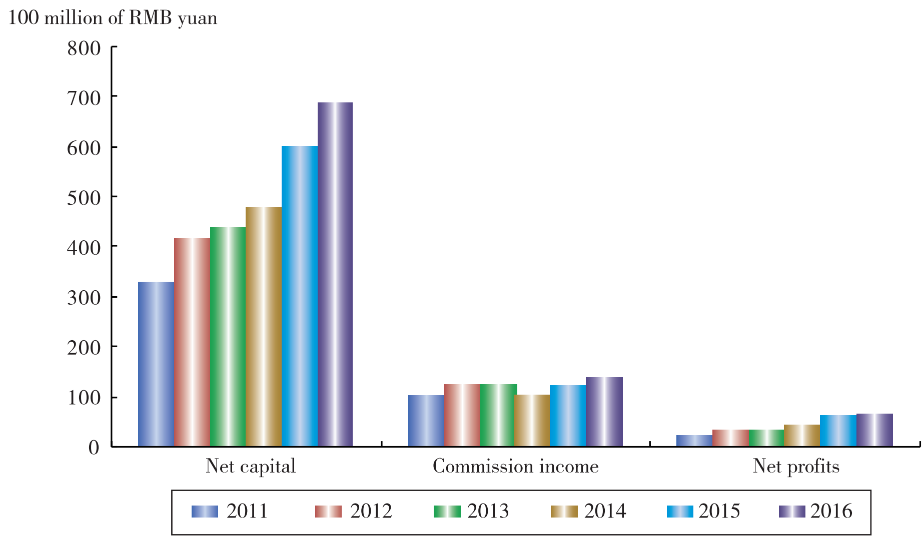
indices and the affordability of their own capital. In the event of major changes occurred to the conditions of capital market, their internal control risks would cause liquidity problems for themselves, and spillover to other financial institutions, hence creating panic in the market and impairing confidence of investors.

3. Futures companies developed steadily with insufficient business diversity

As of end-2016, net assets of futures companies reached RMB 91.153 billion yuan, up 16.42 percent y-o-y; net capital of futures companies reached RMB 68.771 billion yuan, up 14.55 percent y-o-y. The total clients' margins amounted to RMB 434.235 billion yuan, up 14.75 percent y-o-y. The ratio of their net capital to entrusted assets from clients hit 15.82 percent, down 0.05 percentage point from end-2015. During the year, futures companies generated RMB 27.963 billion yuan of operating revenue, up 14.30 percent y-o-y, and RMB 6.567 billion yuan of net profits, up 8.49 percent y-o-y (Figure 4.6).

Amongst various institutions running securities and futures businesses, development of futures companies was constrained by their weak innovation capabilities, monolithic sources of income, and insufficient business diversity. The commission income of futures companies over the year reached RMB 13.892 billion yuan and net interest income RMB 8.71 billion yuan, which accounted for 49.68 percent and 31.15 percent respectively of their operating income.

Figure 4.6 Changes of Major Indicators for Futures Companies, 2011-2016



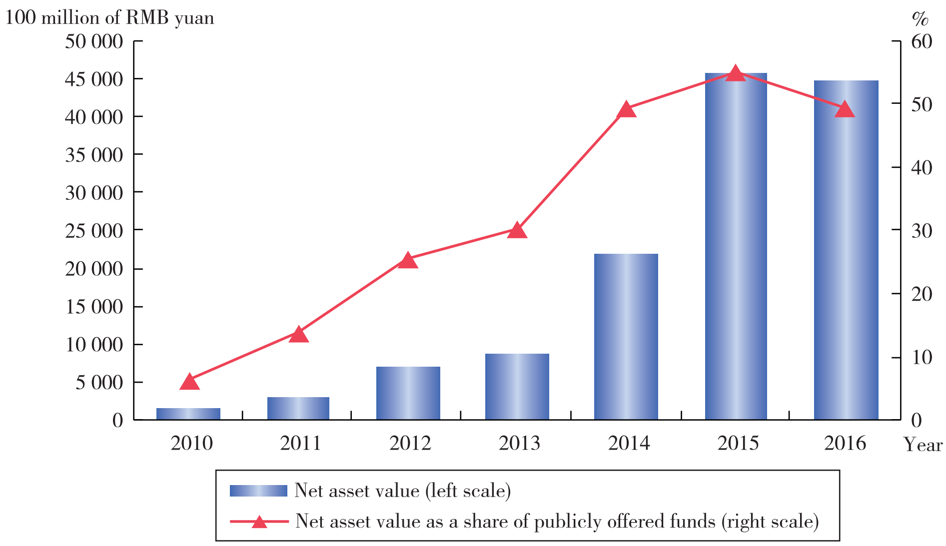
Source: The CSRC.

4. Net value of assets managed by the mutual fund industry grew marginally, while liquidity issue of money market funds heightened

As of end-2016, the net value of publicly offered funds posted RMB 9.16 trillion yuan, up 9.70 percent y-o-y. Among this total, equity funds represented 7.71 percent, down 0.69 percentage point from end-2015; hybrid funds accounted for 21.93 percent, down 5.43 percentage points from end-2015; fixed income funds made up 15.55 percent, up 7.12 percentage points from end-2015; and money market funds comprised of 46.77 percent, up 8.08 percentage points from end-2015.

Due to the rapid development of Internet finance and expansion of inter-company financial businesses, the scale of money market funds grew rather fast from RMB 300 billion yuan as of the beginning of 2012 up to RMB 4.5 trillion yuan as of end-2016, which accounted for nearly 50 percent in the entire publicly offered funds during the two consecutive years of 2015 and 2016 (Figure 4.7). In 2016, affected by credit risks of the bond market amongst other factors, money market funds were under considerable liquidity pressure, which brought about impact on asset prices in other financial markets.

Figure 4.7 Proportion of Net Asset Value of Money Market Funds to Publicly Offered Funds, 2010-2016



Source: Wind.

III. Outlook

Risk prevention and control will be put high on the agenda in 2017. In accordance with the regulatory principles of comprehensiveness and rigorous regulatory compliance by legal provisions, efforts will be undertaken to improve the fundamental institutional development of the market, enhance regulatory accountability, earnestly protect the legitimate rights and interests of investors, urge securities and futures companies to undertake business in a law-compliant and prudent manner, and continuously improve the capabilities of the securities and futures industry to serve the real economy and social development.

1. The market institutional framework will be improved continuously

Earnest efforts will be underway to revise the *Securities Law*, institute legislation of the “Futures Law”, promote the promulgation of regulations on private equity, listed companies, and the New Third Board, as well as the promulgation, on an early date, of criminal judicial interpretations of market manipulation and Rat Trading, and revision of the civil-law-based judicial interpretation of dishonest statements. Efforts will be made to establish a legislation management system of the securities and futures market, and a database for laws and regulations. Revisions will be made to the regulatory methods for integrity of the securities and futures market. The IPO framework will be optimized, with stringent implementation of the responsibilities of sponsor institutions and individuals, standardizing IPO vetting exercise, and promoting equity financing. Efforts will be made to improve the regime of M&A of listed companies, deepen the delisting mechanism, intensify market disciplines, promote the survival of the fittest companies, and allow the capital market to play a role in optimizing resource allocation.

2. Efforts will be made to tighten regulation in accordance with laws and regulations, and enhance protection of investors

Regulatory intensity will be further enhanced by keeping securities and futures institutions accountable for risk control, and urging them to conduct business in compliance with relevant regulations, so as to lay a solid foundation for healthy development of the capital market. Major efforts will be made to crack down on such violations as insider transaction, market manipulation, dishonest information disclosure, etc. Attention and stringent check will be accorded to issues including “fooling” restructuring, reorganization and listing of quasi financial assets, IPO of red chip companies delisited from overseas markets, and quasi reverse merger. More stringent supervision will be conducted over various financial products and persons acting in concert thereof, and leveraged buyout activities should be standardized. Accounting and auditing supervision will be intensified over listed companies and those listed on the New Third Board. Both on-site and off-site inspections will be intensified over various market players. Investor appropriateness management of securities and futures companies will be enhanced along with the responsibility of investor education. Efforts will be underway to study and formulate a regime that handles investors’ complaints concerning the securities and futures market, and promote the establishment of a multi-faceted investor compensation and relief mechanism.

3. The compliant and healthy development of main players of the securities and futures market should be promoted

Stringent efforts will be underway to implement the regulatory rules of risk control indices of securities and funds management institutions, and improve the comprehensive risk management system, to achieve a better balance between business development and risk control capabilities. Continued efforts will be undertaken to implement the management regulations and self-disciplinary rules of subsidiaries of securities and fund management institutions, liquidate and standardize existing subsidiaries, and screen and rectify non-licensed and non-financial businesses, with an emphasis on the promotion of the main businesses of the industry. Efforts will be made to facilitate the innovation by futures risk management companies in OTC markets, to steadily undertake pilot programs on spot and futures hybrid businesses such as "insurance + futures".

4. Measures will be continued to deepen external openness of the capital market

Efforts will be underway to expand outbound financing channels by overseas listing of domestic companies, and promote the reform of the record-based administrative approval of overseas listing and the pilot program on "full circulation" of H shares. Market access will be loosened for QFII and RQFII, with expanded scopes of investment. Investment scope of the Hong Kong connectivity program will be expanded in a well-sequenced manner, and the Shanghai-London connect program will be steadily pushed ahead, so as to attract overseas investors to participate in the capital market through multiple channels. Amendments will be developed for the *Rules for Equity Investment by Foreign Investors in Securities Companies*, to improve the institutional arrangements for the opening-up of the securities industry to the outside world.

Chapter V

Insurance Sector

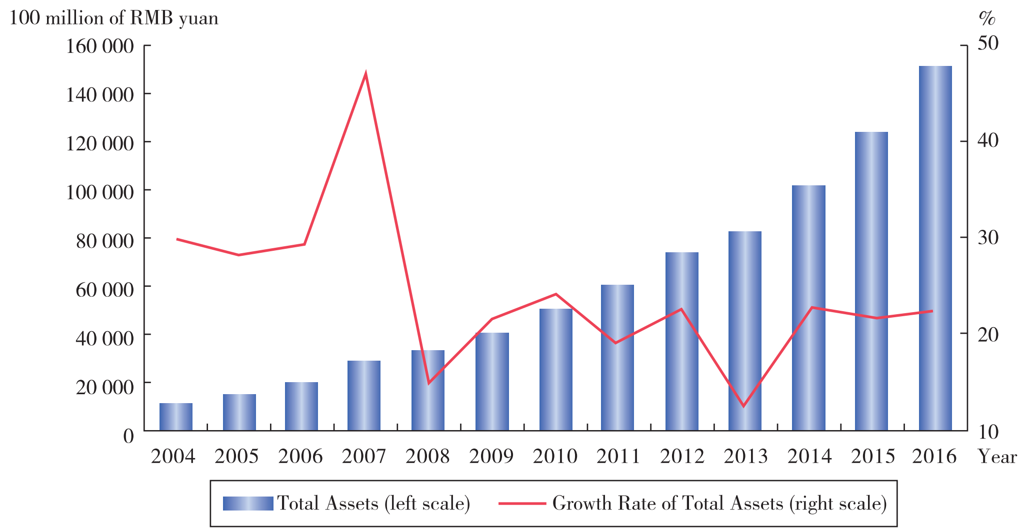
In 2016, China's insurance sector maintained rapid development with expanding size of assets, fast-growing premium income, deepened reforms and enhanced capacity of serving the society. The current domestic and international economic and financial environment is complex and volatile and is faced with more uncertainties. Looking ahead, it is imperative to deepen comprehensive reforms, improve service capability and quality and attach more importance to risk prevention and control, so as to promote the sustainable and healthy development of the insurance sector.

I. Recent Developments

1. Assets size expanded and premium income grew rapidly

As of the end of 2016, the total assets of the insurance sector registered RMB 15.12 trillion yuan, up by 22.3 percent y-o-y (Figure 5.1). Specifically, total assets of property insurance companies, personal insurance companies, reinsurance companies and asset management companies reached RMB 2.4 trillion yuan, 12.4 trillion yuan, 233.8 billion yuan and 42.6 billion yuan, up by 28.5 percent, 25.2 percent, -50 percent and 21 percent respectively compared with those in the previous year. Premium income for the whole year reached RMB 3.1 trillion yuan, a y-o-y increase of 27.5 percent, in which the premium income of property insurance, life insurance, health insurance and accident insurance registered RMB 872.4 billion yuan, 1.7 trillion yuan, 404.2 billion yuan and 75 billion yuan, rising by 9.1 percent, 31.7 percent, 67.7 percent and 18 percent y-o-y respectively.

Figure 5.1 Total Assets and Growth Rate of the Insurance Sector



Source: The CIRC.

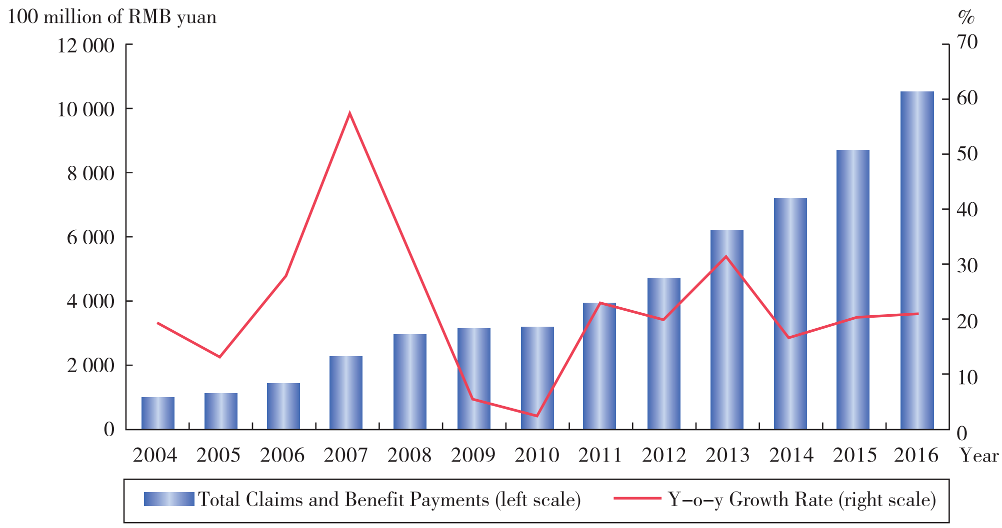
2. The market system improved and the sector became more open

By the end of 2016, there were 203 insurance institutions across the country with 9 newly-founded ones during the year. Among the total, there were 12 insurance group companies (one newly founded), 79 property insurance companies (6 newly founded), 77 personal insurance companies (one newly founded), 22 insurance asset management companies (one newly founded), 9 reinsurance companies and 4 other institutions. Priority was given to mid-west provinces and impoverished areas to establish insurance companies. Pilots of mutual insurance were initiated. The number of internet insurance companies increased, and the proportion of specialized insurance companies rose significantly. The Shanghai Insurance Exchange was established, which focuses on building business platforms for international reinsurance, international shipping insurance, bidding of mega insurance projects and diversification of specific risks. Two-way opening up was promoted, and overseas insurance companies from 16 countries and regions have established 56 foreign-funded insurance institutions while 12 domestic insurance companies have set up 38 overseas operations.

3. Insurance played its risk prevention function and its capability to serve the society was enhanced

The insurance sector provided risk coverage of RMB 2373 trillion yuan to the society, up by 38.1 percent y-o-y. Claims and benefit payments reached RMB 1.05 trillion yuan, increasing by 21.2 percent y-o-y (Figure 5.2). The premium income of agriculture insurance reached RMB 41.77 billion yuan, with participating rural households registering around 204 million and the amount insured close to RMB 2.16 trillion yuan. Payments to 45.75 million rural households totaled RMB 34.8 billion yuan. Critical illness insurance was provided in 31 provinces and cities, which was operated by 17 insurance companies, having covered 970 million population and provided claims and payments of RMB 30.1 billion yuan. The actual reimbursement ratio paid to patients of critical illness was 13.85 percent higher than that of basic medical insurance. The earthquake catastrophe insurance mechanism for urban and rural residential houses was implemented and a business platform for this was put into operation which handled altogether 180,000 cases and provided risk coverage of RMB 17.76 billion yuan. About 10.42 million employees of 50,000 enterprises were covered by the trustee service of enterprise annuities with assets entrusted reaching RMB 485.5 billion yuan. The market of short-term export credit insurance opened up steadily, providing USD 416.7 billion of risk coverage for 82,200 export enterprises. 659 debt, equity and asset-backed plans with a total volume of RMB 1.7 trillion yuan were initiated. The China Insurance Investment Fund raised cumulatively more than RMB 150 billion yuan. The above two progress supported major national strategic projects such as the “One Belt One Road” initiative, the program to promote coordinated development of Beijing, Tianjin and Hebei as well as other major infrastructure projects.

Figure 5.2 Insurance Claims and Benefit Payments and Growth Rate



Source: The CIRC.

BOX 7 Establishment of the Catastrophe Insurance Mechanism Was Accelerated

Effectively responding to catastrophic risks is a difficult issue faced by many countries. An increasing number of countries and regions have the established catastrophe insurance system and made it an important part of the catastrophic risk management system because of its critical role in mitigating disaster losses, protecting people's lives and properties and alleviating the pressure from disaster prevention and loss mitigation on the governments.

China is one of the countries that suffer most from natural disasters and disaster-caused losses are increasing year by year. For a long time, China's catastrophic risk management system has been operated by the government, supported by fiscal revenues and complemented by social donation and charity, which helped to mobilize resources and power of the entire country effectively and quickly to accelerate post-disaster recovery. However, with the rapid economic and social development and the increasing severity of catastrophic risks, the existing system is faced with a series of challenges and problems, such as heavier burdens on the government, the instability and unsustainability of social donation, and a widening gap between response capacity of the insurance sector to catastrophe and what is really needed. In the recent 8 years, direct economic losses from natural disasters reached nearly RMB 4 trillion yuan, but insured losses of which kept at a quite low level. For example, 0.2 percent of total economic losses resulting from the Wenchuan Earthquake were covered by insurance, which was much lower than that of developed countries which usually stands at 30%~40%.

In recent years, China has paid great attention to and encouraged the development of catastrophe insurance. The 3rd Plenary Session of the 18th CPC Central Committee and the *Opinions of the State Council on Accelerating the Development of Modern Insurance Service* require to "building a catastrophe insurance system". The recently released *Opinions of the CPC Central Committee and the State Council on Promoting Reform of Disaster Prevention, Mitigation and Relief Mechanisms* specifies again that the country will accelerate the establishment of catastrophe insurance system and set up steadily a fiscal-supported multi-tiered mechanism for catastrophic risk diversification. On May 12, 2016, the CIRC and the Ministry of Finance released the *Implementation Plan on Establishing the Earthquake Catastrophe Insurance System for Urban and Rural Residential Houses*, which took earthquake insurance as a starting point and followed the principle that the system should be "promoted by the government and adhere to market-oriented operation to safeguard the well-being of the public". The establishment of the system marks that China has ushered into a substantive stage of building a catastrophe insurance system. On July 1, the earthquake catastrophe insurance products for urban and rural residential houses were put to market. The coverage is provided by the urban and rural residential house earthquake catastrophe insurance pool and the risks are shared among policy holders, insurance companies, reinsurance companies, earmarked reserve for earthquake catastrophe insurance and fiscal support. On December 26, the catastrophe insurance platform was put into operation at the Shanghai Insurance Exchange which could issue policies and conduct settlement, and provide the pool with one-stop services including underwriting, claims and settlement.

4. The 13th Five-Year Plan was released and market reform kept deepening

The *13th Five-Year Plan for the Development of the Insurance Sector* was released, which pointed out that by 2020 China would have basically built up a modern insurance service industry with comprehensive coverage, sound functions, security and stability, and integrity and regulated operation, so that insurance would become a basic means for the government, enterprises and residents to manage risks and wealth. Reform on the administration of commercial auto insurance clauses and tariffs was rolled out across the country, which helped to widen coverage while premiums per car were reduced by 5.26 percent compared to the level prior to reform and the average liability limit of commercial third-party liability insurance was up by 17.4 percent. Reform of agricultural insurance product was deepened. Plans of pilots for agricultural products price insurance have been initiated or formulated for 31 provinces and cities including Beijing, Jiangsu and Sichuan, and eight insurance companies have carried out the pilot model of "insurance+futures" in 12 provinces. Efforts were continued to deepen reform in the personal insurance sector, widen product coverage, lower the ceiling of the valuation interest rate of liability reserve of universal insurance, and regulate the settlement interest rate applied to universal insurance by pegging it to the actual investment return. Relevant authorities continued to promote reform of utilization of insurance funds, widened scope of industries whose infrastructures insurance funds could invest in, introduced the public-private partnership investment model and clarified that insurance funds could participate in the Shanghai-Hong Kong Stock Connect pilot program. The role of insurance in medical care, elderly care, health management, technology and other industrial chains was deepened, and the service and innovation capacity of the insurance sector was enhanced.

5. The regulatory system was enhanced and risk prevention was strengthened

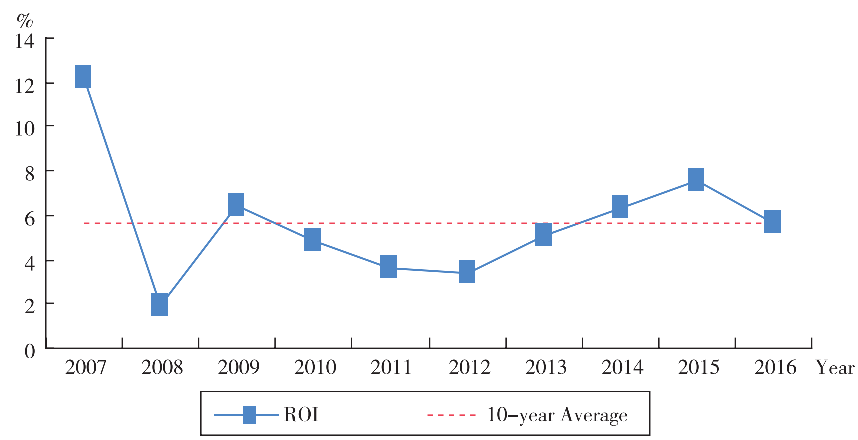
The China Risk-Oriented Solvency System (C-ROSS for short) was rolled out. Measured were taken to carry out comprehensive risk rating based on C-ROSS and regulated companies that did not meet solvency requirements and had huge risks, conduct assessment on solvency risk management for the first time to promote the risk management capacity of the entire sector, enhance information disclosure, and strengthen transparency on solvency-related information and market restraints. By the end of 2016, the comprehensive solvency adequacy ratio of the entire sector was 247 percent which was much higher than the required 100 percent. Companies that were compliant with the solvency requirements accounted for more than 99 percent of the total in terms of number and size. The formulation of guideline for internal control of utilization of insurance funds was promoted and specific rules were set up for unlisted equities, real estate, financial products, infrastructure, etc. Regulation was enhanced over equity investment and major equity investment activities of insurance institutions and non-insurance persons acting in concert. Monitoring of and emergency response to surrender and maturity payments risks were strengthened, and more efforts were put to risk inspection and examination of insurance company governance, associated transactions and auto insurance market. Assessment of risks related to insurance fund investment and liquidity, asset-liability mismatch, spread losses and misleading sales behaviors of universal insurance products of personal insurance companies was enhanced. Efforts were made to establish the prudent regulatory mechanism for asset allocation of insurance companies, clear and regulate the business model where insurance asset management companies served as channel-providers, and enhance information disclosure of shareholders' equity, associated transactions and major investments.

II. Soundness Assessment

1. Challenges to fund utilization and decreasing investment returns

In 2016, the downward pressure on China's economy remained. The market environment was complex and volatile with increasing credit risk and market risk. There were less high-quality investment projects, imposing difficulties on allocation of insurance funds. The insurance sector lowered the share of allocation in fixed income assets such as bank deposits and bonds, and increased proportion in alternative investment sharply. The proportion of investment in bank deposits and bonds to the total portfolio were 18.55 percent and 32.15 percent respectively, down by 3.23 and 2.24 percentage points y-o-y while share of other investment (mainly alternative investment) rose by 7.37 percentage points, reaching 36.02 percent. The total return on investment registered in 2016 RMB 707.1 billion yuan, a decrease of 9.4 percent. Although the average return rate on investment, which stood at 5.66 percent, was 1.9 percentage points lower y-o-y, it still managed to reach the 10-year average (Figure 5.3).

Figure 5.3 Average ROI of Insurance Funds



Source: The CIRC.

Box 8 Preventing Risks of Fund Investment and Promoting the Healthy Development of the Insurance Sector

In recent years, the insurance sector has increased investment in highly risky assets such as alternative investment and equity investment. Although this is beneficial to raising ROI, it has led to accumulation of risks. And a few insurance companies have also encountered some problems in fund investment, which requires close attention.

In terms of alternative investment, China is in the process of eliminating excess production capacity and deleveraging, leading to shrinking profitability of enterprises, sluggish investment demands and dropping ROI of investment projects. The default risk of infrastructure projects has mounted, with insufficient information disclosure and low transparency. In terms of equity investment, a few insurance companies that provided mainly life insurance products with short- and medium-term duration invested too much in the stock market with aggressive strategy, leading to severe term mismatch. Decrease of stock prices of the invested company may easily result in insolvency of the investing insurance companies.

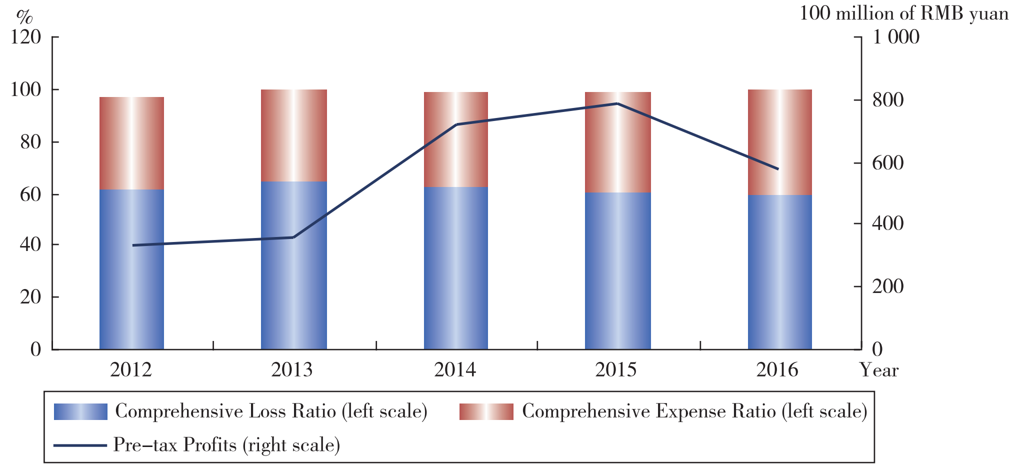
In terms of insurance fund investment, investment activities of a few small- and medium-sized insurance companies seem to be in line with regulatory requirements, but they often have complex transaction structure, multiple embedded products, various types and large number of counterparties, prolonged transaction chain and obscure underlying assets, which may exaggerate the cross-sectional and cross-market transmission of risks. A few major shareholders have taken insurance companies as the financing vehicle by investing huge amount of money in assets of controlling shareholders or other associated parties, which may involve illegal associated transactions, illegal transfer of benefits and using insurance funds to inject capital into themselves or make fake capital replenishment.

To respond to risks related to insurance fund investment, the regulatory authorities have specified that insurance funds should be used to serve major businesses and that the fundamental role of insurance is to provide risk coverage while investment is only a supplementary role, and the insurance sector should not attend to trifles but neglect the essentials. Insurance companies are required to strengthen internal control of investment, management of asset-liability match and disclosure of critical investment information. In the next step, it is important to keep prudent regarding insurance fund utilization, invest in fixed-income assets as the primary choice while non-fixed income assets as supplementary, make equity investment focus on financial investment while strategic investment as supplementary, and be persistent on making long-term investment and value investment, being a benign investor and making sound management of asset-liability match. Efforts should be continued to improve standards on investment ratio limits and solvency regulation, and establish a unitary regulatory information platform based on the idea of being comprehensive, relevant and systemic, so as to conduct penetrating and substantive regulation of multiple embedded products. It is also important to resolve to address risk concerns, punish incompliant institutions and hold liable parties accountable, and safeguard the bottom line of preventing systemic risks.

2. Growth of property insurance premium remained stable and operational profits declined

In 2016, the premium income of property insurance companies registered RMB 926.6 billion yuan, up by 10 percent y-o-y, which was 1.7 percentage points lower than that of the previous year. Reform of tariffs of commercial auto insurance proceeded steadily, and operational performance of auto insurance improved while maintaining stable. The total premium of auto insurance across the country reached RMB 683.5 billion yuan, a y-o-y growth of 10.3 percent, and the underwriting profit registered RMB 5.9 billion yuan, up by 70.3 percent y-o-y. However, against the backdrop of macroeconomic slowdown, insurance products closely related to economic momentum such as cargo insurance, hull insurance and commercial property insurance witnessed shrinking premium income. Sluggish exports and increasing credit risks led to a decrease of 4 percent in premium of credit and guarantee insurance. Meanwhile, increasingly intensive market competition led to the rising combined ratio of property insurance companies, which has reached 99.5 percent, a y-o-y increase of 0.9 percentage point, and the comprehensive expense ratio was up by 1.3 percentage points. Although property insurance companies achieved a y-o-y 9.6 percent growth of investment returns, their annual pre-tax profits dropped by 26.4 percent, standing at RMB 57.6 billion yuan (Figure 5.4).

Figure 5.4 Underwriting Performance and Pre-tax Profits of the Property Insurance Sector

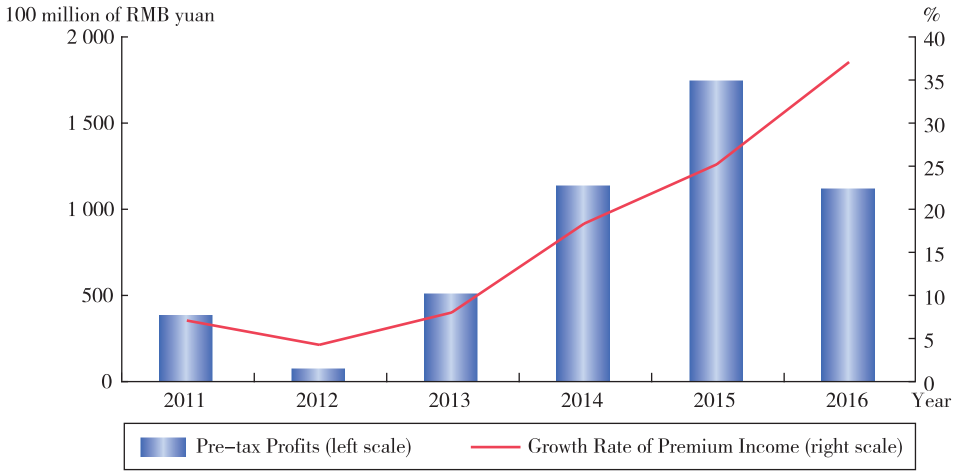


Source: The CIRC.

3. Premium of personal insurance grew fast and operational profits dropped

In 2016, the premium income of personal insurance companies registered RMB 2.17 trillion yuan, up by 36.8 percent y-o-y, which was 11.8 percentage points higher than that of the previous year. Influenced by the volatility in stock prices earlier that year and sluggish market interest rates across the year, investment returns of personal insurance sector dropped significantly compared to those of last year, marked by an annual investment returns of RMB 513.7 billion yuan and a y-o-y decrease of 8.1 percent. As adjustment of liability costs lagged behind the downturn of investment returns by a large margin, some personal insurance companies found a ROI lower than product settlement rate, leading to spread losses. Meanwhile, the dropping risk-free rate exacerbated the pressure on personal insurance companies to deal with withdrawal of reserves, causing diminishing profitability of the entire sector. The annual pre-tax profits of personal insurance companies recorded RMB 110.4 billion yuan, down by 36.5 percent y-o-y (Figure 5.5).

Figure 5.5 Pre-tax Profits and Growth Rate of Premium Income of Personal Insurance Companies



Source: The CIRC.

4. Income of a few personal insurance companies from insurance products with short- and medium-term duration dropped rapidly and liquidity risks deserved close attention

In 2016, the incremental amount in the policyholders' investment contracts with personal insurance companies reached RMB 1.2 trillion yuan, which mainly came from products with short- and medium-term duration, accounting for 34.2 percent of the written premiums[①]. Nearly 85 percent of the amount concentrated in 15 companies, and products with short- and medium-term duration of certain companies took up more than 90 percent of total written premiums. Since March 2016, the regulatory authorities released a series of rules to regulate the development of products with short- and medium-term duration and to control size of sale, which led to rapid decline of income of companies relying heavily on those products. In addition, personal insurance companies were still faced with pressure from maturity payments and surrender. In 2016, maturity payments grew by more than 30 percent. And the surrender rate was 5.61 percent, which was 0.36 percentage point lower y-o-y, but still

① Written premiums refer to all premiums received from the policies underwritten by insurers, which are prior to the significant insurance risk and separating of hybrid contracts. Written premiums equal to the sum of premium income, the increase amount in the policyholders' investment contracts, and the incremental amount in the separate accounts of investment-linked insurance.

above the 5 percent standard set by regulators. All the above-mentioned factors led to the increase of liquidity risks of a few personal insurance companies.

5. Non-government capital invested in the insurance sector increased and market exit mechanism needed reinforcement

In recent years, the initiative of non-governmental capital to engage in the insurance sector kept growing. In 2016, there were altogether 20 companies approved to be established (including 2 asset management companies), a record high in recent years, and in January 2017, another five companies were approved. The participation of non-governmental capital in the insurance sector would strengthen the capacity of the sector, promote insurance development and improve market systems. However, a few non-governmental capital institutions, after investment in insurance sector, pursued aggressive development, expanded irrationally, ignored the law of market development, tried to expand asset size by lowering prices and used insurance capital to engage in capital operation, which not only led to low premium sufficiency, high investment risks, fast depletion of capital and insolvency, but also disturbed market order and increased risks of the whole sector. In 2016, the insurance regulatory authority turned down applications of 7 companies and promoted to establish the insurance M&A fund. But currently, rules related to market exit of insurance companies are dispersed in many laws and regulations and remain to be more systemic and operable. It is necessary to further improve the market exit mechanism for insurance companies.

6. Structure of the property insurance market remained stable and competition of the personal insurance market became more intense

In 2016, the market share of the five largest property insurance companies in terms of premium income and the Herfindahl-Hirschman Index (HHI) [①] for the property insurance sector were 73.7 percent and 0.170 respectively, a decrease of 1 percentage point and 0.001, and the ranking of the five largest companies remained unchanged. As for personal insurance sector, market share of the five largest personal insurance companies in terms of premium income and HHI were 49.3 percent and 0.079 respectively, a decrease of 6.4 percentage points and 0.015. Market share of the five largest personal insurance companies in terms of written premiums was 47.8 percent, 0.06 percentage point higher y-o-y, and HHI was 0.067 which was the same as that of the previous year. In the personal insurance sector, both the name list and the

① HHI is the sum of squares of every institution’s market share in the sector. The higher the HHI goes, the more concentrated the market is.

ranking of the five largest companies changed, measured by premiums or written premiums, as a new company ascended to the top 5 and the ranking of 3 companies changed.

7. Growth of complaints slowed and consumer protection remained to be strengthened

In 2016, the insurance regulator received about 32,000 effective complaints, up by 5.4 percent but the growth rate slowed down by 2.9 percentage points y-o-y. Complaints over property insurance companies stood at 1.08 per RMB 100 million yuan of premium and 0.01 per 10,000 policies, a decrease of 0.67 and 0.03 respectively. Complaints over personal insurance companies stood at 0.43 per RMB 100 million yuan of premium and 0.12 per 10,000 policies, a decrease of 0.54 and 0.09 respectively. Among complaints related to property insurance, disputes over claims/payments accounted for 3/4 of the total, in which auto insurance took up the largest share. Among complaints over personal insurance, disputes over underwriting, claims /payments took up the largest proportion.

III. Outlook

2017 is an important year for the implementation of the *13th Five-Year Plan for the Development of the Insurance Sector* and for deepening the supply-side structural reforms. The insurance sector should always adhere to its mission as protection provider, and the regulator should always stick to its mission as supervisor, put risk prevention and control on a more important position, make risk control measures more targeted and effective, and promote the sound and healthy operation of the insurance market.

1. The insurance sector should adhere to its protection function and optimize insurance supply structure and quality

The insurance sector should adapt to the macro environment of economic transformation and upgrading, enhance its market position centered on risk coverage, strengthen innovation of protection products and services, optimize insurance supply structure, serve the national strategy of poverty alleviation and contribute to the real economy. Measures should be taken to promote the regulated and sound operation of critical illness insurance and improve its business quality and pooling level, innovate and develop various types of commercial pension and health insurance products, raise the replacement ratio of commercial pension and promote the establishment of a multi-tiered old-age security system. It is important to promote the innovative pilot that integrates technology with insurance and provide enterprises with risk coverage to support proprietary innovation and technological upgrading, steadily open up the market for short-term export credit insurance, and enhance support to exports of areas including high-end machinery manufacturing and aerospace development. The development of liability insurance for areas such as environmental pollution, production safety, medical security and campus security will be promoted. The plan for earthquake catastrophe insurance will be fully implemented, to promote the release of the administrative methods for earmarked reserve of the insurance, incorporate catastrophe insurance into national comprehensive risk prevention and mitigation system and expand the coverage of catastrophe insurance.

2. Efforts will be made to accelerate transformation of operational model and improve risk management

It is essential to establish reasonable development idea and model, reduce reliance on products with short- and medium-term duration, ensure the usage of insurance funds investing in fixed income assets as primary while non-fixed income assets as supplementary, and make equity investment focus on financial investment as primary while strategic investment as supplementary. Sound corporate governance and internal control mechanism featuring clear boundary between rights and responsibilities as well as effective check-and-balances should be built, and responsibilities of major shareholders should be strengthened to make corporate governance more scientific and effective. Measures will also be taken to enhance the awareness of restraint against capital, costs and risks, strengthen the establishment of the comprehensive risk management system, and build up a coordinating mechanism for product development and investment operation. Based on investment capacity and market situation, insurance companies should formulate prudent and sound product pricing strategy, lower expectation of ROI and try to ensure that assets and liabilities match with each other in terms of terms, returns, risks and liquidity.

3. Measures will be taken to deepen the market-oriented reform and promote sustainable development of the insurance sector

Reform of insurance clauses and tariffs will be promoted in an orderly manner, to expand the scope of business over which insurance companies have pricing power, and build a multi-tiered commercial auto insurance product system where demonstrative clauses play a major role and innovative clauses serve as supplement. The market-oriented reform of personal insurance tariffs will be further deepened to promote reform of pricing mechanism of accident insurance, and the reform of insurance fund utilization will also forge ahead to support innovative utilization of insurance funds, and encourage friendly investors so as to serve China's economic upgrading and industrial restructuring, to promote development of the real economy and to promote supply-side reforms including cutting overcapacity and debt-to-equity swaps. The insurance sector will conduct reform of the market system, expand pilots in areas such as mutual insurance, internet insurance and captive insurance, enhance the diversification and differentiation of insurance products, optimize business structure and regional distribution of the insurance market, and explore to establish small-and-micro insurance institutions and city-wide insurance institutions. The establishment of a multi-tiered market exit mechanism will be enhanced to make market restraint play a bigger role.

4. Efforts will be enhanced to strengthen regulation and safeguard the bottom line of preventing systemic risks

The regulators will upgrade and enhance regulation over solvency, improve regulatory standards for the three pillars, enhance capital restraint, and examine activities such as fraudulent capital injection and capital replenishment. Regulation of corporate governance will improve, to specify qualifications of shareholders, make regulation of associated transactions stricter, strengthen accountability, realize penetrating regulation and guard against cross-transmission of risks. Regulators will also improve the tiered and categorized regulation of personal insurance business, promote the implementation of new standards for embedded value, enhance regulation of pricing interest rates and settlement rates of personal insurance, reduce liability costs and effective guard against risks of interest rate spread losses. The establishment of a regulatory system of insurance asset and liability management should be accelerated, to classify and adjust major asset categories and proportions more reasonably, strengthen regulation of equity and stock investment and raise the standards for overseas investment capacity. In terms of regulating and binding the activities of persons acting in concert of insurance companies, the development of cross-market asset management products and the leveraged buyout, it is important to enhance regulation and coordination, build up regulatory synergy, prevent regulatory arbitrage and guard against systemic risks.

Chapter VI

Financial Market

In 2016, China's financial market maintained stable performance. The market kept expanding in size with increasingly diversified participants. The infrastructure building moved forward steadily while the opening-up made remarkable progress. The financial market played an important role in supporting supply-side reforms and satisfying the financing demands of the real economy.

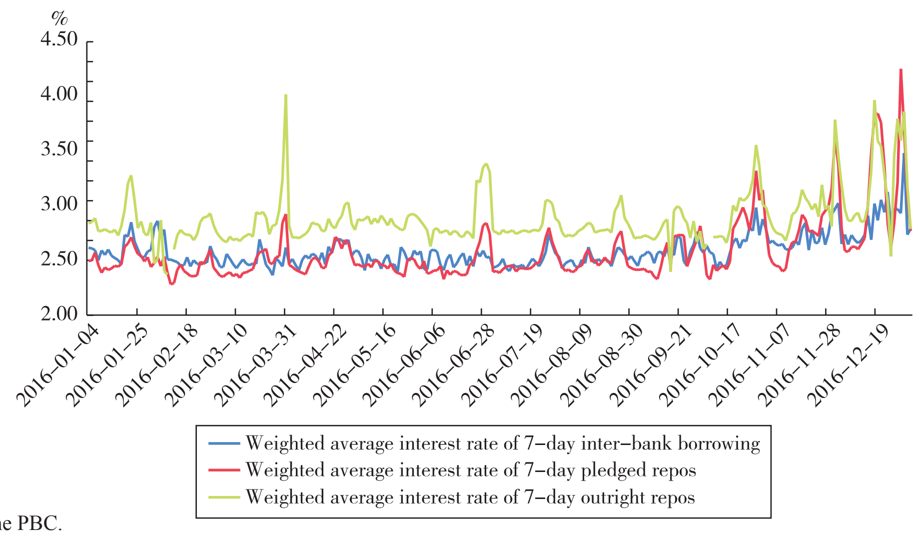
I. Market Overview

1. Money Market

Turnover in the money market hit another historical high though its growth slowed down. In 2016, trading was active in the money market. Turnover of inter-bank borrowing and repos registered RMB 697 trillion yuan, an increase of 33.6 percent y-o-y, which was 65.5 percentage points lower compared with 2015. In particular, turnover of inter-bank borrowing grew by 49.4 percent y-o-y to RMB 95.9 trillion yuan, turnover of pledged repos rose by 31.4 percent y-o-y to RMB 568.3 trillion yuan, and turnover of outright repos increased by 30.3 percent y-o-y to RMB 33 trillion yuan. Turnover of inter-bank borrowing with maturities of no longer than 7 days reached RMB 93.25 trillion yuan, accounting for 97.23 percent of total inter-bank borrowing, which was 1.16 percentage points higher than 2015; turnover of pledged repos with maturities of no longer than seven days stood at RMB 547.99 trillion yuan, accounting for 96.43 percent of the total, which was 0.17 percentage point higher than 2015.

Money market rates were more volatile and key interest rates rose. In the first three quarters of 2016, money market rates mainly fluctuated within a narrow range. The interest rate of 7-day pledged repos fluctuated around 2.5 percent. From the last ten days in October, key money market interest rates started to rise at an accelerated pace. In December, the monthly weighted average interest rate of pledged repos in the inter-bank money market reached 2.56 percent, up 61 basis points y-o-y (Figure 6.1).

Figure 6.1 Money Market Rates in 2016



Source: The PBC.

2. Foreign Exchange Market

Trading was brisk in the foreign exchange market and more foreign currencies were allowed to trade directly against the RMB. In 2016, turnover in the inter-bank foreign exchange market increased by 24.12 percent y-o-y to USD 16.97 trillion. Among this, turnover in the RMB foreign exchange market registered USD 16.85 trillion, increasing by 24.36 percent y-o-y; turnover of foreign currency pairs reached USD 115.944 billion, declining by 3.55 percent y-o-y. Broken down by product, turnover of spot transactions totaled USD 6.01 trillion, an increase of 21.76 percent y-o-y; turnover of foreign exchange derivatives stood at USD 10.96 trillion, up 25.45 percent y-o-y. Foreign currencies against which the RMB could trade directly increased further. Throughout the year, the direct trading of the RMB against the South African rand, South Korean won, Saudi Arabian riyal, United Arab Emirates dirham, Canadian dollar, Hungarian forint, Danish krone, Polish zloty, Mexican peso, Swedish krona, Turkish lira and Norwegian krone was launched.

3. Bond Market

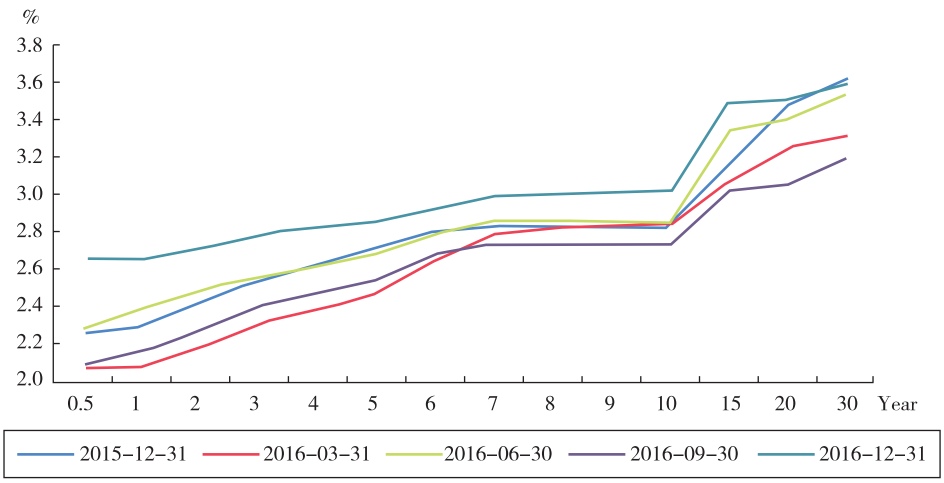
Turnover of spot bonds surged y-o-y and bond indices went up. In 2016, turnover of spot bonds in the inter-bank market recorded RMB 127.1 trillion yuan, and the daily average trading volume registered RMB 506.3 billion yuan, an increase of 45.4 percent y-o-y. Turnover of spot bonds on exchanges reported RMB 5.3 trillion yuan, up 54.7 percent y-o-y. At end-2016, the inter-bank bond index quoted 174.44 points, rising by 1.9 percent compared with the beginning of the year; the government bond index of the exchange market quoted 159.79 points, increasing by 3.31 percent compared with the beginning of the year.

The bond market weakened following initial strength while the entire yield curve shifted upward. In 2016, the bond market became more volatile and the yield curve of government bonds moved upward. At end-2016, the yields of 1-year, 3-year, 5-year, 7-year and 10-year government bonds increased by 35, 24, 15, 16 and 19 basis points respectively compared with end-2015. During the whole year, the change of bond yields could be divided into four stages. From the beginning of the year to early April, the government bond yield curve steepened as the short end came down while the long end went up with fluctuations. From mid-April to early June, the entire yield curve shifted upward, especially at the short end. From mid-June to early October, yields declined steadily with the intermediate and long-term bond yields going down significantly. Bond yields rose notably in the last ten days of October and at an accelerated pace in the last ten days of November. The yield of 10-year government bonds rose to 3.37 percent and the yield of 10-year bonds issued by the China Development Bank touched 3.93 percent, both of which were peaks within the year. The government bond futures hit loss limit for many times (Figure 6.2).

Market investors were more diverse and the participation of foreign institutions

broadened. In 2016, the eligibility standard of institutional investors for the inter-bank bond market was clearly defined, and the scope of investors was broadened further. At end-2016, there were 14 127 participants of various types in the inter-bank bond market, increasing by 4 491 compared with end-2015. Among these, there were 2 329 domestically incorporated institutions, which was 235 more y-o-y; 11 391 domestic non-corporate institutional investors, rising by 4 151 compared with end-2015; 407 foreign institutional investors, which was 105 more than that at end-2015.

Figure 6.2 Government Bond Yield Curve in the Inter-bank Bond Market in 2016

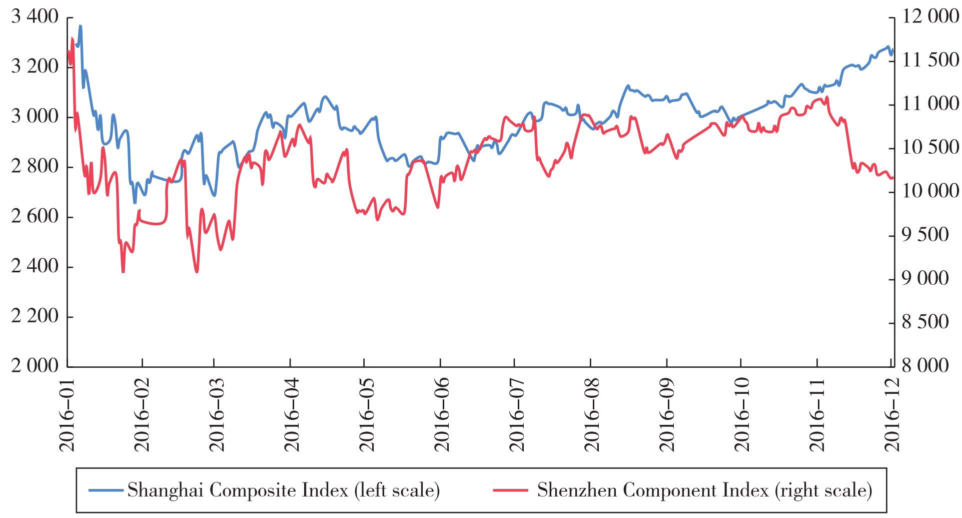


Source: The PBC.

4. Stock Market

The stock market stabilized following large fluctuation at the beginning of the year. In January 2016, the Shanghai and Shenzhen stock exchanges introduced the circuit breaker mechanism. However, due to the inherent defects, the mechanism was triggered twice within the first week of its adoption, causing the stock market to plummet. From January 4th to 29th, 2016, the Shanghai Composite Index declined by 16.95 percent, and the Shenzhen Component Index dropped by 25.64 percent. Thereafter the stock market stabilized and rebounded. At end-2016, the Shanghai Composite Index closed at 3 103.64 points, down 12.3 percent y-o-y; the Shenzhen Component Index ended at 10 177 points, down 19.6 percent y-o-y.

Figure 6.3　Shanghai Composite Index and Shenzhen Component Index in 2016



Source: Wind.

Vitality of trading in the stock market declined notably. In 2016, total turnover of the Shanghai and Shenzhen stock exchanges registered RMB 127.4 trillion yuan, and the daily average trading volume was RMB 522.1 billion yuan, down 50.1 percent y-o-y. Turnover ratio of the Shanghai Stock Exchange and Shenzhen Stock Exchange dropped by 167.59 and 406.36 percentage points respectively, indicating that the vitality of market trading declined significantly.

5. Futures and Option Market

Turnover of the futures market grew rapidly whereas turnover of stock index futures declined significantly due to policy constraints. At end-2016, there were 52 types of futures and option products in domestic market, among which, there were 46 commodity futures, 5 financial futures and 1 financial option. Throughout the year, total trading volume in domestic futures market rose by 15.71 percent y-o-y to 4.138 billion board lots whereas total turnover declined 64.69 percent y-o-y to RMB 195.63 trillion yuan. In particular, trading volume of commodity futures increased by 27.34 percent to 4.119 billion board lots, accounting for 99.56 percent of the total; turnover of commodity futures grew by 30.17 percent y-o-y to RMB 177.42 trillion yuan, accounting for 90.69 percent of the total. Trading volume of financial futures declined by 94.62 percent y-o-y to 18 million board lots, accounting for 0.44 percent of the total; turnover of financial futures decreased by 95.64 percent y-o-y to RMB 18.22 trillion yuan, accounting for 9.31 percent of the total. Compared with the previous year, trading volume of rebar, iron ore, coking coal, coke, and 10-year government bond futures contracts registered more remarkable growth.

Price of commodity futures increased

sharply whereas price of financial futures was stable. In 2016, as commodity prices bottomed out, demand increased and the supply-side structural reform unfolded, the price of domestic commodity futures rose significantly. At end-2016, China's commodity futures index closed at 1340.58 points, up 51.34 percent y-o-y; the agricultural commodity futures index closed at 892.87 points, increasing by 20.61 percent y-o-y; the industrial product futures index rose by 60.89 percent y-o-y to 1 862.65 points. The price of stock index futures stabilized after the initial plummet, fitting well with the trend in the spot market. At end-2016, major contracts of Shanghai Stock Exchange 50 A-Share Index futures closed at 2 286.90 points, down 5.53 percent y-o-y; major contracts of Shanghai Shenzhen 300 Stock Index futures ended at 3 310.08 points, which was 11.28 percent lower y-o-y; major contracts of CSI 500 Index futures declined by 17.78 percent y-o-y to 6 263.63 points. Major contracts of 5-year government bond futures ended at RMB 98.555 yuan, declining by 2.13 yuan y-o-y; major contracts of 10-year government bond futures closed at RMB 96.145 yuan, which was 3.890 yuan lower than that at end-2015.

The stock option market was stable. In 2016, the market for Shanghai Stock Exchange (SSE) 50 ETF options grew steadily. Throughout the year, the daily average trading volume registered about 324100 contracts with a monthly growth rate of 9.74 percent, the daily average face value traded reached RMB 7.234 billion yuan with a monthly growth rate of 8.56 percent, the daily average open interest recorded 948 600 contracts with a monthly growth rate of 10.98 percent, and the daily average premium turnover registered RMB 177 million yuan with a monthly growth rate of 4.2 percent. The distribution of investors was balanced in the option market. Institutional investors accounted for 56.71 percent in trading and 47.88 percent in open interest while individual investors accounted for 43.29 percent in trading and 52.12 percent in open interest. In the option market, the vertical spread and the horizontal spread left small room for arbitrage, and the pricing was basically reasonable. In 2016, the correlation between futures and spot prices in the SSE 50 EFT option market was 96.91 percent. Return on vertical spread arbitrage posted 0.25 percent, return on horizontal spread arbitrage registered 0.14 percent and return on parity arbitrage averaged 1.83 percent.

6. Commercial Paper Market

Interest rates in the commercial paper market fell first and then went up. In 2016, cumulative commercial paper acceptance by financial institutions reached RMB 84.5 trillion yuan, declining by 17.2 percent y-o-y; outstanding acceptance at the year-end stood at RMB 5.5 trillion yuan, increasing by 19.6 percent y-o-y. The growth of commercial paper financing slowed down with total amount increasing by RMB 894.6 billion yuan throughout the year, which was RMB 768.4 billion yuan less than that in 2015. At end-2016, the balance of commercial paper financing accounted for 5.1 percent of all loans, which was 0.2 percentage point higher y-o-y. In the first three quarters of 2016, as the liquidity in the banking system was reasonable and adequate and money market rates dropped, interest rates in commercial paper market was stable with a slight decline. In the fourth quarter, due to the increasingly frequent risk events in commercial paper businesses, the tightened regulation and the fluctuation of the money market, the balance between commercial paper supply and demand changed and the market interest rates went up.

7. RMB Interest Rate Derivatives Market

Trading volume of RMB interest rate derivatives continued to increase. In 2016, the RMB interest rate swap market saw 87 849 transactions, increasing by 35.5 percent y-o-y; total nominal principal increased by 19.9 percent y-o-y to RMB 9.92 trillion yuan. In terms of term structure, the swaps with maturities of one year or less traded most actively with a nominal principal of RMB 7.87 trillion yuan, accounting for 79.3 percent of the total. The reference rates for the floating end of the RMB interest rate swaps mainly comprised 7-day repo fixing rate and Shibor. The nominal principal of interest rate swaps that were linked with these two reference rates accounted for 85.9 percent and 13.8 percent respectively of the total. Throughout the year, there were 8 standard bond forward transactions with a turnover of RMB 100 million yuan; 8 standard interest rate derivatives transactions with a turnover of RMB 800 million yuan.

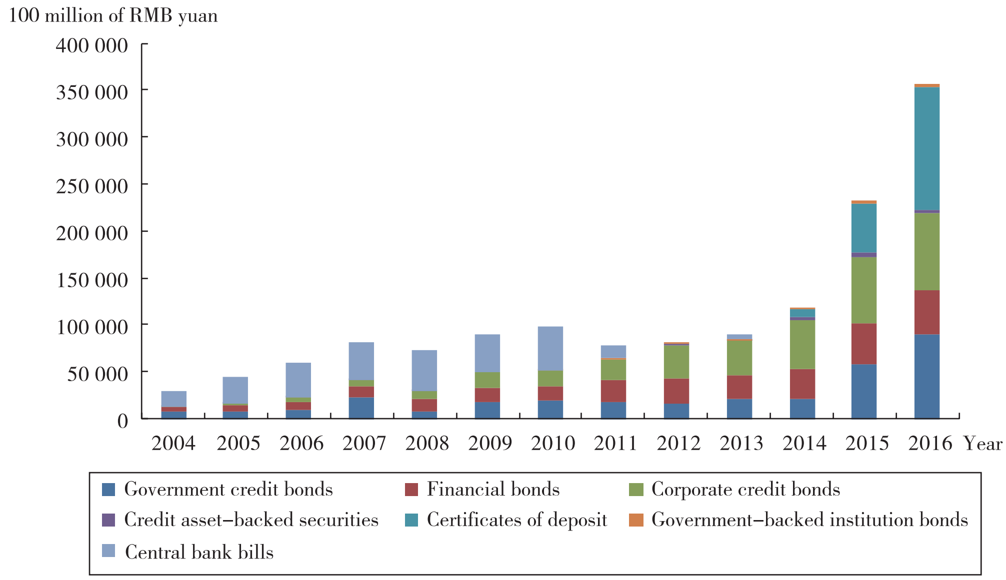
8. Gold Market

Gold price retreated after initial surge and trading volume kept growing rapidly. In 2016, gold price rebounded first and then dropped again. After hitting USD 1366.25 per ounce at the highest and USD 1 077.00 per ounce at the lowest, international gold price ended the year at USD 1 159.10 per ounce, up 9.12 percent y-o-y. The price of Au9999 on Shanghai Gold Exchange fluctuated in the range of RMB 181.2 yuan to RMB 300 yuan per gram throughout the year, and finally closed at RMB 263.9 yuan per gram, which was 18.42 percent higher y-o-y. In 2016, trading volume of gold on Shanghai Gold Exchange totaled 48 700 tons, increasing by 42.88 percent y-o-y; turnover stood at RMB 13.02 trillion yuan, up 62.58 percent y-o-y. Turnover of the international board on Shanghai Gold Exchange declined by 4.33 percent y-o-y to RMB 1.10 trillion yuan. The trading volume of international members accounted for 40 percent of the total trading volume at the international board, which was 22 percentage points higher y-o-y.

II. Overview of Market Financing

Bond issuance kept growing though its growth slowed down in the fourth quarter. In 2016, the issuance of RMB-denominated bonds in the bond market registered RMB 35.6 trillion yuan, up 55.5 percent y-o-y. Total bonds under custody at the year-end stood at RMB 63.8 trillion yuan, which was 30.8 percent higher y-o-y. Issuers in China's inter-bank bond market included the Ministry of Finance, China Development Bank, policy banks, China Railway, commercial banks, non-bank financial institutions, international development institutions, domestic and foreign non-financial enterprises, foreign financial institutions and foreign governments. Bond products and credit tiers were further diversified (Figure 6.4).

Figure 6.4 Issuance of Major Bonds in the Bond Market in Recent Years



Sources: The China Central Depository & Clearing Co. Ltd., Shanghai Clearing House.

In 2016, supply of local government bonds and certificates of deposit (CDs) grew rapidly. The issuance of local government bonds reached RMB 6 trillion yuan, up 58 percent y-o-y; the issuance of CDs registered RMB 13 trillion yuan, which was 1.4 times of the issuance in 2015. The issuance of corporate credit bonds grew steadily. In particular, the issuance of debt financing instruments by non-financial enterprises declined by 5.5 percent y-o-y to RMB 5.14 trillion yuan, the issuance of corporate bonds surged by 203 percent y-o-y to RMB 2.34 trillion yuan, and the issuance of enterprise bonds increased by 45.6 percent y-o-y to RMB 732.6 billion yuan(Table 6.1).

Table 6.1 Issuance of Major Bonds in 2016

Bond Type	Issuance (100 million of RMB yuan)	Y–o–y growth (%)
Central government bonds	30 545	45.6
Local government bonds	60 458	58
Central bank bills	0	—
Financial bonds	182 152	78.4

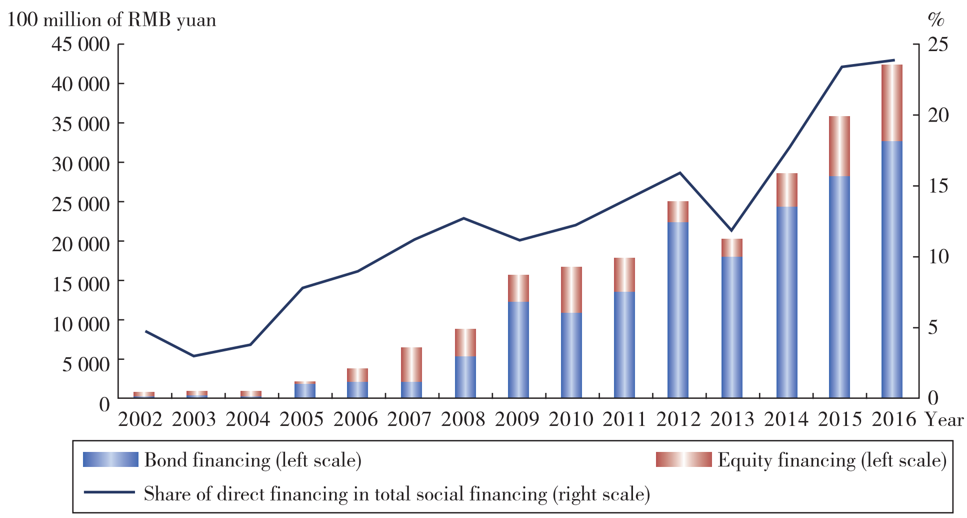
Continue

Bond Type	Issuance (100 million of RMB yuan)	Y–o–y growth (%)
Among which: Bonds issued by China Development Bank and policy banks	33 571	28.9
CDs	129 731	144.7
Corporate credit bonds	82 242	22.4
Among which: Debt financing instruments issued by non-financial enterprises	51 358	-5.5
Enterprise bonds	7 326	45.6
Corporate bonds	23 372	203.2
International institution bonds	412	258.3
Total	355 892	55.5

Sources: The MOF, the PBC, the NDRC, the CSRC, China Central Depository & Clearing Co. Ltd..

Equity financing was basically stable. In 2016, 227 enterprises completed IPOs, seven more compared with the previous year. The money raised through IPOs totaled RMB 157.829 billion yuan, decreasing by RMB 8.296 billion yuan y-o-y. According to statistics from Wind, a total of 623 listed companies completed secondary offering, raising RMB 776.447 billion yuan (excluding capital injection), which was 40.37 percent higher y-o-y (Figure 6.5).

Figure 6.5 Direct Financing by Non-financial Enterprises and Its Proportion in Total Social Financing (2002-2016)



Source: The PBC.

III. Market Infrastructure Building

1. The yield curve of government bonds was improved

Efforts were made to increase the varieties of government bonds with different maturities. Short-term government bonds were issued more frequently. Government bond yields of key maturities and at the short end were disclosed while the long end of government yield curve was improved further. The PBC and the Ministry of Finance disclosed yields of 30-year government bonds for the first time. The supporting mechanism for market making in government bonds was established. With instruments such as purchase and sales, the Ministry of Finance could support market makers in making market for newly issued government bonds of key maturities in the inter-bank bond market. The operation to support market making for government bonds was conducted with reference to government bond yield curve and priced in a public and market manner, i.e. with a single price, which would facilitate the building of government bond yield curve that could reflect the balance between market supply and demand.

2. The development of the inter-bank bond market was actively promoted

Firstly, the administration of access to the bond market was strengthened. The eligibility of institutional investors was clarified and the scope of investors was widened. The procedures of registration, account opening and network connection were improved. Business inspection was conducted in accordance with law. The responsibility of intermediaries and self-regulatory organizations in monitoring and self-management was emphasized. Secondly, the administration system of market makers was improved. The *Guidelines on Market Making Business in the Inter-bank Bond Market* and the *Evaluation Indicator System of Market Making Business in the Inter-bank Bond Market* were amended and implemented. Thirdly, the *Administrative Measures on OTC Businesses in the National Inter-bank Bond Market* was issued, which allowed a wider spectrum of institutions to conduct OTC bond businesses, further enriched bond products, and established regulations for the transaction, custody and settlement of OTC bonds. Fourthly, the *Notice on Issues Related to Improvement of the Issuance of Financial Bonds by Development and Policy Banks* was issued, which further simplified the issuance procedure of policy financial bonds and enriched the methods of issuance. Fifthly, the pre-issuance trading was launched in the inter-bank bond market so as to promote market price discovery. Sixthly, the administrative review for entering national inter-bank borrowing market was canceled. Criteria for market oversight both during and after the handling of businesses were improved. Detailed regulations for business operation were formulated. Business operation procedures for market access, network connection, quota adjustment and information disclosure were refined.

3. Product innovation was boosted vigorously

Firstly, measures were taken to encourage financial institutions and enterprises to issue green bonds so as to facilitate the development of green economy and ecological civilization. In 2016, green bond issuance registered RMB 202.09 billion yuan. Secondly, channels for financing poverty alleviation were widened and new ways of providing finance to poor areas were invented. Special financial bonds for poverty alleviation via relocation and the first social impact bond for poverty alleviation were issued, raising RMB 67.6 billion yuan. The role of financial market in targeted poverty alleviation was brought into play. Thirdly, efforts were made to study how to improve credit risk mitigation instruments. Credit default swaps and credit-linked notes were launched.

4. The regulation of the commercial paper market was strengthened

Risk events in the commercial paper market have become more common since 2015. In order to strengthen regulation, the PBC and the CBRC jointly issued the *Notice on Strengthening Commercial Paper Market Regulation and Promoting Its Healthy Development*, which reinforced the internal control and management of financial institutions, strengthened regulation for commercial papers trading, and stepped up risk inspection and supervision. Meanwhile, based on the actual situation of commercial paper market, the PBC enhanced the top-down design of the market, and improved institutional mechanism and infrastructure building. In December 2016, the *Administrative Measures on Commercial Paper Trading* was issued, which canceled trade authenticity review in commercial paper discount, expanded the scope of participants of commercial paper trading, and established comprehensive regulation for financial institutions in trading commercial papers. This would help gradually establish an intensive market structure mainly composed of legal entities, and augment the risk prevention capacity of market participants. The national commercial paper trading platform came online and Shanghai Commercial Paper Exchange was set up, which would facilitate information aggregation, transaction, registration and custody, clearing and settlement of all papers and electronic commercial papers, and would achieve the whole process monitoring for all transactions of market participants. Consequently, it would improve market transparency and trading efficiency, promote the regulation and development of the commercial paper market in terms of technology and institutional building, prevent illegal behaviors such as repeated sales of one single paper and off-balance transactions, and mitigate operational risks.

5. The reform and development of multi-layered capital market made new progress

Measures were taken to deepen the reform of the National Equities Exchange and Quotations System for Small and Medium Enterprises (namely the New Third Board), which included the introduction of market stratification, launching the pilot of market making by private equities, expanding the scope of market makers and initiating the pilot of preferred stocks. In 2016, the New Third Board saw over 10,000 companies listed, completed 2 603 private placements and raised RMB 139.1 billion yuan. Meanwhile, efforts were also made to promote the regulation and development of regional equity markets. A study was conducted on the mechanism of cooperation and connection between the New Third Board and regional equity markets. Currently, there were 40 regional equity markets with about 15 900 listed companies, 56 100 companies on display and a total financing of RMB 689.6 billion yuan. In January 2017, the *Notice of the General Office of the State Council on Regulating and Developing Regional Equity Markets* was issued, which clearly defined the principles and the positioning for regional equity market development and would generate positive impact on the construction of the multi-layered capital market.

6. The two-way opening up of the capital market was pushed forward steadily

Opening up of the bond market was pushed forward steadily. The scope of Panda bond issuers and the issuance size were expanded further. The SDR bonds were issued successfully. The spectrum of foreign institutional investors was widened. Besides, the mainland and Hong Kong stock markets were further connected. The pilot of the Shenzhen-Hong Kong Stock Connect was launched officially, and the Shanghai-Hong Kong Stock Connect was improved by abolishing the total quota limit. Furthermore, the opening up of financial sector towards Hong Kong and Macau was broadened. The supplementary agreements of the *Closer Economic Partnership Arrangement* (CEPA) were implemented. Two joint-venture securities companies and one joint-venture fund management company were approved and set up. In addition, exchanges made a new step in going global. China Europe International Exchange operated smoothly, and successfully acquired some equity of the Pakistan Stock Exchange.

Box 9 Further Opening up of the Bond Market

In recent years, with the gradual increase of the RMB use across borders as well as internationally, the opening up of China's bond market has been moving forward steadily.

In terms of issuance, in 2005 the PBC and the Ministry of Finance jointly issued the *Interim Administrative Measures on the Issuance of RMB-denominated Bonds by International Development Institutions*, allowing international development institutions to issue RMB-denominated bonds in China. The International Finance Corporation and the Asian Development Bank were the first to issue RMB-denominated bonds in China's inter-bank bond market, raising RMB 4 billion yuan. In 2013, the channel for foreign non-financial institutions to issue RMB-denominated bonds in the inter-bank bond market was introduced. Daimler AG issued RMB-denominated debt financing instruments, raising RMB 15 billion yuan. In September 2015, HSBC and Bank of China (Hong Kong) also issued RMB-denominated bonds in the inter-bank bond market. Thereafter, the government of British Columbia in Canada, the South Korean government and the Polish government gained the approval to issue RMB-denominated bonds in the inter-bank bond market. By end-2016, foreign issuers in China's bond market had already comprised foreign non-financial enterprises, financial institutions, international development institutions and foreign governments, and total issuance of Panda bonds reached RMB 63.1 billion yuan. In August 2016, the World Bank successfully issued the first tranche of SDR-denominated bonds in the inter-bank bond market, adding a new product category to China's bond market. This would promote the opening up and development of China's bond market, expand the use of SDR, and reinforce the stability of the international monetary system.

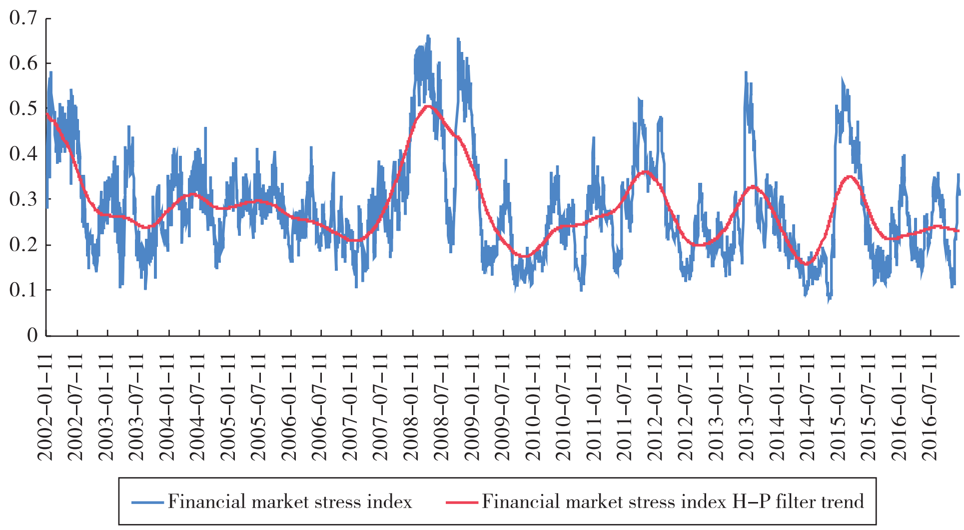
In terms of trading, the inter-bank bond market has attracted an increasingly wide spectrum of foreign institutional investors with an expanding scope of investment. In recent years, the PBC has allowed eligible foreign central banks and monetary authorities, sovereign wealth funds, international financial organizations, foreign RMB clearing banks and participating banks, foreign insurance institutions, RQFII and QFII to enter the inter-bank bond market for a variety of businesses such as spot trading and repurchase. Following the expansion of opening up towards central banks and similar institutions in July 2015, the PBC further widened the scope of foreign investors to include all types of foreign financial institutions that were legally incorporated and the investment products they issued, as well as medium- and long-term institutional investors such as pension funds. By end-2016, 407 foreign institutions had entered the inter-bank bond market, adding 105 compared with end-2015.

During the next stage, the PBC will continue to push forward the opening up of the bond market steadily. According to the general plan for RMB internationalization and capital account convertibility, the PBC will enhance coordination and planning, and stand firmly behind the principle that opening up should be done in a gradual and controllable manner with efficiency and safety equally emphasized. The PBC will encourage foreign institutions to issue bonds in China and domestic institutions to issue bonds abroad, and will greatly facilitate the investment of foreign institutional investors in the inter-bank bond market.

IV. Soundness Assessment

In 2016, China's financial market was stable in general. At the beginning of January 2016, the A-share market introduced the circuit breaker mechanism. This triggered a large decline in the A-share market within a short period of time, which then spread to other financial markets. As a result, the financial market stress index surged, but came down afterwards. However, at end-2016, due to the increasing volatility of bond and foreign exchange markets, the financial market stress index escalated again. Throughout the year, the financial market stress index was generally at moderate and low levels, though it did rise significantly at some points (Figure 6.6).

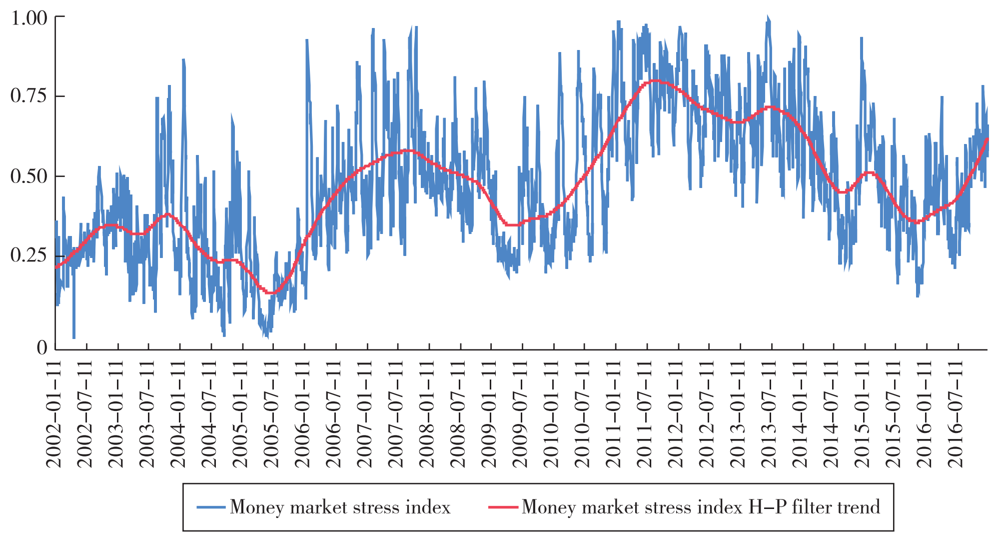
Figure 6.6 Financial Market Stress Index, 2002-2016



Source: The PBC.

Key money market rates were basically stable though they became more volatile in the second half of 2016, and the market stress increased. In 2016, the aggregate liquidity in the money market was reasonable and adequate with approximately balanced supply and demand. Key money market rates were stable in general, though they fluctuated upward in the second half of the year. At end-2016, the overnight pledged repo interest rate, weighted average interest rate of 7-day pledged repos and 3-month Shibor were 2.14 percent, 2.71 percent and 3.27 percent respectively, up 6.9, 24.9 and 18.7 basis points compared with the beginning of the year. In terms of market stress index, as major trading products in the money market became more volatile in the second half of 2016, the market stress was on a upward trend throughout the year, remaining at a moderately high level, which was generally higher than that in 2015 (Figure 6.7).

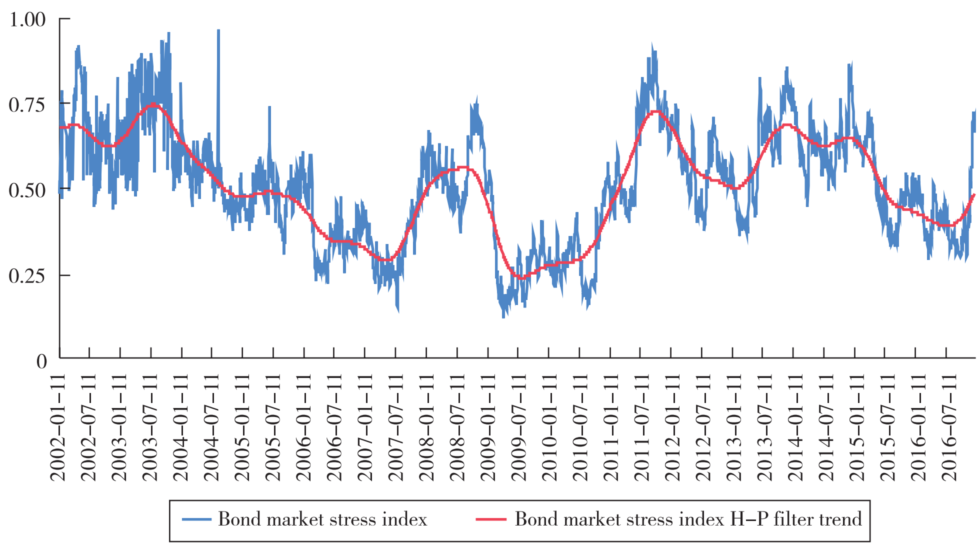
Figure 6.7 Money Market Stress Index, 2002-2016



Source: The PBC.

Bond market yields surged at end-2016, and the market stress increased rapidly. All three components of the bond market stress index, namely interest rate risk, pessimistic expectation of institutional investors and credit risk, were stable at relatively low levels in the first half of 2016, whereas interest rate risk and pessimistic expectation of institutional investors escalated towards the end of the year. As a result, the bond market stress index rose rapidly as well and hovered around relatively high levels at the year-end. More specially, due to the interest rate hike by the Federal Reserve, the volatility of money market rates and the liquidity risk in the bond market caused by the weak internal control in some financial institutions, yields in the bond market rose at end-2016; the yields of key government bonds such as 1-year, 5-year and 10-year became more volatile, and the interest rate risk in the bond market increased. The yield to maturity curve of government bonds flattened throughout the year. The daily average term spread between 10-year and 1-year government bonds was 58.49 basis points, 23.52 basis points lower than the average of 82 basis points in the previous year. The pessimistic expectation of institutional investors for economic outlook worsened compared with 2015. The spread between the 1-year and 5-year AA-rated medium-term notes and government bonds of the same maturities stood at 121.4 and 146.5 basis points respectively, declining by 58.1 and 57.1 basis points y-o-y. The narrowing spread between the AA-rated medium-term notes and government bonds of the same maturities (credit risk premium) indicated that the credit risk in the bond market declined slightly. However, it should be noted that the above-mentioned credit risk premium in the bond market might have included expectation of rigid redemption, therefore credit risk in the bond market might have be underestimated (Figure 6.8).

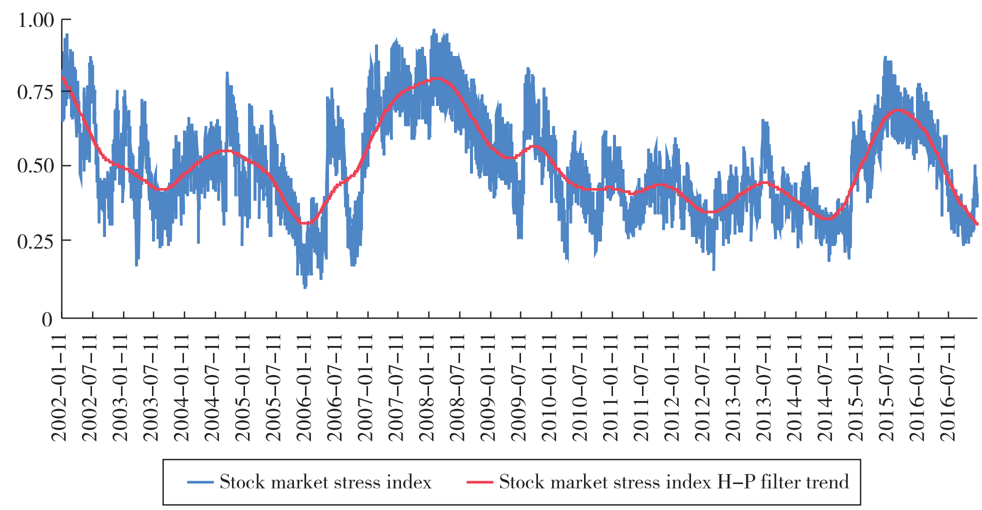
Figure 6.8 Bond Market Stress Index, 2002-2016



Source: The PBC.

The stock market stabilized after the large fluctuation at the beginning of the year, and the market stress presented a downward trend throughout the year. At the beginning of 2016, the A-share market introduced the circuit breaker mechanism. However, during the four trading days from January 4th to 7th, the circuit break was triggered twice, leading to the early market closure on January 4th and 7th. Shanghai Stock Exchange, Shenzhen Stock Exchange and China Financial Futures Exchange announced that the circuit breaker mechanism would be suspended from January 8th, 2016. The A-share market stabilized following the initial dramatic decline. In January alone, the Shanghai Composite Index declined by 16.95 percent, and Shenzhen Component Index dropped by 18.33 percent. From February to the year-end, the two indices rebounded by 15.43 percent and 9.17 percent respectively. In terms of the stock market stress index, the volatility risk in A-share market started at a high level in early 2016, then continued with a tendency of declining, and kept low in the second half of the year; the valuation risk was at moderate and low levels all through the year, and valuation across different boards diverged significantly where large-cap and blue-chip stocks were valued significantly lower than stocks at the SME board and Growth Enterprise Board (GEB). At end-2016, the rolling price-to-earnings ratios of all AB shares, Shanghai Shenzhen 300, SME board and GEB stood at 21.83, 12.66, 57.44 and 79.78 times; and their respective price-to-book ratios reached 2.14, 1.51, 4.77 and 6.46 times. Throughout the year, the pessimistic expectation of investors in A-share market remained high. In general, the A-share market stress index trended downwards following the rapid increase at the beginning of the year. It rebounded towards the end of the year and finished 2016 at a moderate level (Figure 6.9).

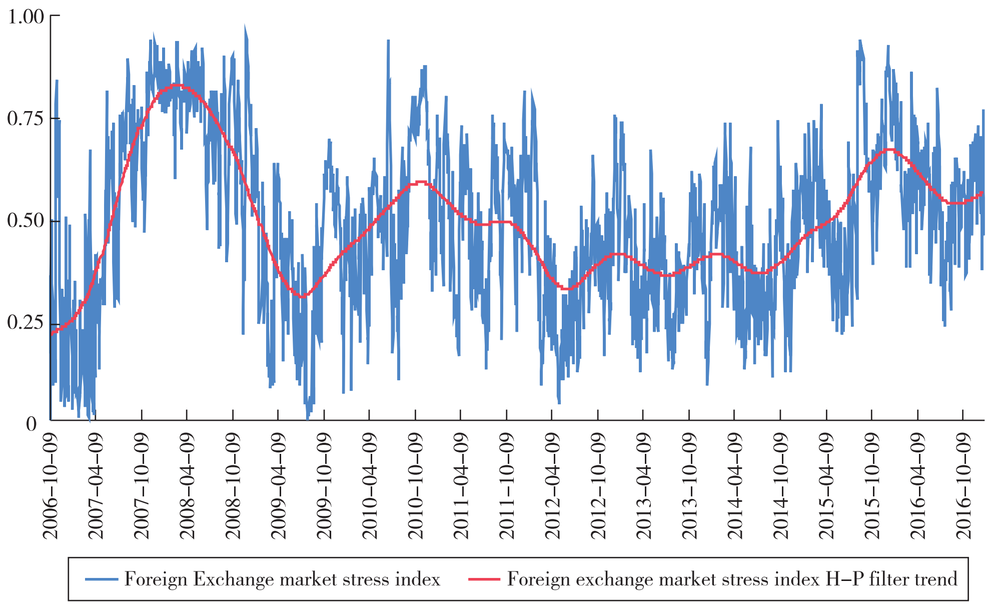
Figure 6.9 Stock Market Stress Index, 2002-2016



Source: The PBC.

The RMB depreciated slightly against the U.S. dollar, and the foreign exchange market stress index was elevated in the second half of 2016 but still below the previous year. In 2016, the RMB depreciated moderately against the U.S. dollar. The exchange rate became more flexible with notable two-way volatility. The RMB exchange rate against a basket of currencies kept basically stable, and the expectation of RMB exchange rate was generally well anchored. At end-2016, the RMB exchange rate against the U.S. dollar closed at RMB 6.945 yuan per U.S. dollar in the onshore market, depreciating by 4 513 basis points or 6.95 percent y-o-y; the RMB exchange rate against the U.S. dollar closed at RMB 6.9761 yuan per U.S. dollar in Hong Kong, depreciating by 4 075 basis points or 6.2 percent y-o-y. In the second half of 2016, the volatility of the spot RMB exchange rate against the U.S. dollar increased significantly, indicating a rise of volatility risk in the foreign exchange market. Throughout the year, due to supply and demand factors, the divergence between onshore and offshore exchange rates widened. In general, the foreign exchange market stress rose rapidly to an elevated level in the second half of 2016, but still was slightly lower than the previous year (Figure 6.10).

Figure 6.10 Foreign Exchange Market Stress Index, 2002-2016



Source: The PBC.

V. Outlook

IN 2017, according to the arrangement of the CPC Central Committee and the State Council and the basic principle of serving supply-side reforms and real economy, efforts will be made continuously to further push forward interest rate liberalization, improve institutional arrangements and promote the regulation and development of the financial market so that it can continue to play a positive role in stabilizing economic growth, boosting economic restructuring, adjustment, transition and upgrading, and preventing financial risks.

Interest rate liberalization will be advanced further. The efficiency of financial resource allocation will be enhanced and the financial regulation mechanism will be improved. With deepening the financial market as a start, further steps will be taken to foster benchmark interest rates, and ameliorate the government bond yield curve, so as to improve the market-based interest rate formation mechanism. Efforts will be made to explore interest rate corridor mechanism, enhance the capacity of macro control with interest rates, and smooth the transmission from central bank policy rates to the financial market and the real economy. Financial institutions will be urged to reinforce internal control, strengthen their own capacity to price independently and rationally, and improve risk management. Oversight will be tightened over the irrational pricing behaviors of financial institutions. The self-regulatory mechanism of market interest rate pricing will be given an important role. Effective measures will be adopted to regulate interest rate pricing and safeguard the fair pricing.

The market-based reform and opening up of the money market will be advanced continuously. Efforts will be made to facilitate financial institutions accessing to the inter-bank borrowing market. The construction of market self-regulatory mechanism and market transparency will be enhanced and the pricing mechanism will be improved so as to vitalize the money market. Steps will be taken to establish and improve the mechanism of oversight both during and after the handling of businesses, to regulate the operations of financial institutions in the money market, to promote the smooth and healthy development of the market, and to prevent market risks effectively. Administrative measures in the inter-bank borrowing market will be reformed for the better. The market structure will be improved by refining administrative measures for terms and quotas so as to make trading structure more reasonable. The opening up of the money market will be widened further. More foreign institutional investors will be allowed to conduct bond repurchase according to market development at the appropriate time.

The infrastructure construction and macroprudential management in the bond market will be enhanced. Efforts will be made to promote administrative coordination in the bond market and boost regulatory collaboration across ministries. The role of the bond market in boosting direct financing, preventing and mitigating financial risks, and improving resource allocation will be tapped earnestly while ensuring the safety, efficiency and general stability of the market. Product innovation and institutional building in the bond market will be fostered firmly in line with the demand of the real economy. Commercial banks will be encouraged to develop new capital replenishment instruments. The administration of financial bond issuance and the build-up of information disclosure system will be further improved. Measures will be taken to encourage commercial banks to develop OTC bond businesses actively. Attempts will be made to publish a detailed regulation for OTC businesses. Risk prevention in the bond market will be reinforced. The credit default risks in the bond market will be prevented actively and be resolved effectively. Steps will also be taken to improve macroprudential management in the bond market, to consistently ensure regulatory coordination, and to promote the healthy and regulated development of the market.

The opening up of the bond market will be widened continuously. In line with the general arrangement for RMB internationalization and capital account convertibility, efforts will be made to advance the opening up of the inter-bank bond market in a comprehensive and steady manner. Continuous support will be given to various entities issuing bonds in China. Steps will be taken to facilitate foreign institutions to participate in the inter-bank bond market. Accounting, auditing and other complementary polices regarding the inter-bank bond market will be further clarified. Cross-border cooperation on market infrastructure will be pushed forward steadily. Greater convenience will be provided for the investment by foreign institutional investors. Besides, work will continue to be done to push for the inclusion of China’s bond market into major international bond indices so that the bond market can play a better and positive role in expanding inflows.

The construction of the multi-layered capital market will be pushed ahead steadily. Efforts will be made to further enlarge and strengthen the main-board market, improve the IPO system, expand equity financing, and optimize the financing structure of the capital market by developing cost-constrained equity financing instruments such as convertible bonds and preferred stocks. The market-based M&A, reorganization and exit mechanism will be ameliorated, giving full play to the capital market as the main channel for M&A and reorganization. Support will be given to enterprises in consolidating resources through M&A and reorganization and to industries in transformation and upgrading. Reforms in the New Third Board will be deepened further. Stratified management will be improved so as to connect reforms in issuance, trading, investor access and regulation, provide differentiated institutional arrangements to a variety of enterprises and boost market initiative. Measures will be taken to encourage the regulated development of regional equity markets. Uniform rules for businesses and oversight of regional equity markets will be formulated promptly. Guidance will be provided to local governments in strengthening and improving routine regulation. The role of regional equity markets in meeting the demands of regional micro, small and medium-sized enterprises for financing and share transfer will be brought to full play.

The development of the foreign exchange market will be accelerated. In line with the principle that finance shall serve the real economy, exchange rate management services will be provided to import and export enterprises with real demands. Support will be given to the use of RMB in cross-border trade and investment. The direct trading of RMB against other currencies will be promoted so as to better serve the cross-border use of RMB. Close attention will be paid to the impact of international situation on capital flows. The macroprudential management of cross-border capital flows will be improved.

The regulated and healthy development of the gold market will be enhanced. The product system in the gold market will be improved. The role of the gold market in supporting real economy will be tapped earnestly. The infrastructure in the gold market will be reinforced. The market making system in the inquiry market will be improved. A benchmark system for intermediate and forward gold prices will be built. Efforts will be made to accelerate the establishment of a central counterparty clearing mechanism and to strengthen the construction of the technological system in the gold market so as to upgrade the services provided by China's gold market. The opening-up strategy for the gold market will be advanced continuously. The international board on Shanghai Gold Exchange will be improved, and the role of RMB-denominated Shanghai Gold Benchmark Price will be exploited actively, which will boost China's influence in the international gold market. Measures will be taken to strengthen financial institutions' risk management for gold market businesses, and to prevent market risks.

The development of futures and derivatives market will be pushed forward steadily. Continuous work will be done to thoroughly investigate the feasibility of introducing crude oil futures and to make active preparation for that. Refined sugar options and soybean meal options will be launched at the proper time. The introduction of other new futures products will also be promoted continuously. The interim restraint measures for stock index futures will be abolished gradually at the right time. Efforts will be made to actively develop the government bond futures market, to enrich investor structure, and to lay a solid foundation for the government bond yield curve that can reflect market supply and demand. Meanwhile, the product categories of ETF options will be enriched and preparatory work will be done continuously for the launching of stock index options.

The regulation and development of local exchanges will be promoted. All local exchanges will be urged to rectify and regulate themselves in line with the *Decision of the State Council on Cleaning up and Rectifying All Types of Exchanges to Effectively Prevent Financial Risks* and the *Implementation Opinions of the General Office of the State Council on Cleaning up and Rectifying All Types of Exchanges*. Punishment will be tightened for exchanges and operators suspected of illegal operation, and illegal and criminal activities will be punished severely according to the law. Efforts will be made to establish and improve a long-term mechanism for the sustainable and healthy development of local exchanges. Policy guidance and oversight will be strengthened so as to help local exchanges build the concept of serving real economy and to prevent speculation.

Chapter VII

Financial Infrastructure

In 2016, the building of financial infrastructure in China made further achievements, with improved payment, clearing and settlement system, gradually upgraded financial laws and regulations, optimized accounting standards, significant improvement of the credit information market and social credit system, more progress in anti-money laundering, outstanding headways in financial consumer protection and overall improvement of financial services, which underpinned the sound operation of the financial system.

I. The Payment, Clearing and Settlement System

1. Institutional building continued to improve

Progress was made in building the legal framework. First, the *Administrative Measures for Bank Card Clearing Institutions* was issued in order to improve the basic legal institutional arrangement for opening up the market and market entry. Second, the *Opinions on Promoting the Healthy Development of the Bank Card Clearing Market* was issued, which laid a solid foundation for the development and innovative upgrades of the payment market . Third, the *Notice on Issuing the Administrative Measures on the Categorized Rating of Non-bank Payment Institutions* was promulgated, aiming to improve the categorized rating system of non-bank payment institutions. Fourth, the *Measures on Rewarding the Tip-offs against the Illegal Payment and Settlement Activities* was issued and the Payment and Clearing Association of China established the platform for tip-offs. Fifth, the *Measures for Settlement of Domestic Letters of Credit* was revised to meet the financing and payment demand of enterprises and promote the rapid and sound development of domestic trade.

Payment infrastructure was improved. First, the functions of the payment system were improved and the plan for the functional upgrade of the High Value Payment System （HVPS）and prolonging its operation hours was under consideration. Second, the online payment and clearing platform for non-bank payment institutions was in preparation in order to provide unified and public clearing services. Third, the 4 rounds of application of the comprehensive front-end subsystem of the Accounting Data Centralized System (ACS) was completed and 2608 regional and foreign-funded banks went online nationwide. Fourth, the development of the RMB Cross-border Inter-bank Payment System (CIPS) was promoted and more participants were incorporated into the CIPS. By the end of 2016, participants in the first phase of CIPS included 28 domestic and foreign direct participants, 512 domestic and foreign indirect participants from 78 jurisdictions, covering approximately all the jurisdictions engaged in RMB businesses. In 2016, payment systems of all types in China operated in a safe and stable manner. A total of 59.287 billion transactions with a value of RMB 5114.51 trillion yuan were processed by various payment systems in China, increasing by 26.29 percent and 16.70 percent y-o-y respectively. The number and value of transactions processed by payment systems of the PBC stood at 8.009 billion transactions and RMB 3821.35 trillion yuan, rising by 33.58 percent and 21.88 percent y-o-y respectively, among which a total of 4.453 billion transactions with a worth of RMB 37.46 trillion yuan were processed by the Internet Banking Payment System (IBPS), up by 50.16 percent and 34.96 percent respectively. Businesses of clearing institutions including China Union Pay, Clearing Center for City Commercial Banks and Rural Credit Banks Funds Clearing Center continued to expand. RMB CIPS functioned in a stable manner.

Businesses of CCPs progressed steadily. First, the business scope was expanded. The Shanghai Clearing House Co., Ltd. started the central clearing business for RMB foreign exchange options, becoming the first clearing institution in the world to provide central clearing service for OTC foreign exchange options. RMB Electrolytic Copper Swap and Shanghai Carbon Quota Forward were included in the central clearing service of the OTC commodity derivatives market. Second, the business systems kept upgrading. In December 2016, the new generation of settlement system of China Financial Futures Exchange (CFFEX) went online, which comprehensively supported multi-product, multi-account and multi-currency business scenarios and flexible margin and commission models. CFFEX improved the scalability, security and usability through innovations such as isolation of clearing core, member-based clearing and visible settlement, etc. On July 15, 2016, Shanghai Futures Exchange issued new settlement regulations and modified the warehouse warrant system accordingly; started the business of converting negotiable securities into margin in real-time, which relieved the members' funding pressures and improved the efficiency of the margin.

Securities settlement systems operated stably. The securities depository and settlement business of the China Central Depository & Clearing Co., Ltd., the Shanghai Clearing House Co., Ltd., and the China Securities Depository and Clearing Co., Ltd. (China Clear) continued to increase. The bond depository value in the inter-bank market (inter-bank certificates of deposit excluded) rose by 25.53 percent y-o-y to RMB 56.30 trillion yuan, among which RMB 8.13 trillion yuan was deposited with the Shanghai Clearing House Co., Ltd. Total value of settlement for spot bond trading, bond lending and bond repos rose by 42.67 percent y-o-y to RMB 963.22 trillion yuan.

International communication and cooperation on payment and settlement were further deepened. First, we fully leveraged international platforms such as the CPMI, EMEAP, SEACEN, ASEAN 10+3 and the China-Europe bilateral meetings to strengthen exchanges on international payment and settlement fronts, promoting convergence with international practices and enhancing China's say in global payment and settlement industry. Second, we facilitated the implementation of *the Principles for Financial Market Infrastructures* (PFMI), and completed the regulatory review on domestic financial market infrastructure.

2. Outlook

In the next stage, a safer and more efficient national payment system will be put in place, so that the payment system could better bolster economic and social development. First, efforts will be made to improve the legal and institutional framework for payment and settlement to lay a solid foundation for the sound and efficient operation of the payment system. Second, we will constantly improve the regulatory mechanism for the payment service market and ensure its smooth operation. Third, we will promote payment, clearing and settlement infrastructure construction in a stable manner to further improve the functions of payment, clearing and settlement. Fourth, we will continue the implementation of PFMI and build up the macroprudential regulatory framework for financial market infrastructures. Fifth, we will enhance international communication on payment systems and deepen participation in relevant international affairs.

Box 10 Opening up the Bank Card Clearing Market in a Stable and Orderly Fashion

In recent years, the bank card business in China has been expanding rapidly. By the end of 2016, financial institutions had issued 6.125 billion bank cards, and conducted 115.474 billion transactions, with transaction volume standing at RMB 741.81 trillion yuan. Faced with the rapid, diversified and innovative development of bank card business, the quality and efficiency of bank card clearing services must be constantly improved.

To further deepen financial reforms and improve the market-based payment services, the State Council promulgated *the Decision on the Market Entry Management of Bank Card Clearing Institutions* in April, 2015. This marked the comprehensive opening up of the bank card clearing market to all domestic and foreign market participants. In June 2016, the PBC and the CBRC released *the Administrative Measures for Bank Card Clearing Institutions* as the detailed complementary regulation for the market entry by bank card clearing institutions. The Measures clarified the market entry mechanism for bank card clearing institutions, the specific preconditions and procedures for the preparation, opening up and change of institutional profile, as well as the qualification requirements for board directors and senior management. As some bank card clearing institutions have started some of the cross-border foreign currency bank card clearing business, the

Measures stipulated that foreign institutions only providing foreign currency clearing services for cross-border transactions are not required to set up clearing institutions in China in principle; however, they should follow the regulatory requirements and fulfill reporting obligations. If the services provided by such institutions significantly affect the sound operation of domestic clearing system and the public confidence on payment system, they shall set up branches in China and apply for market entry.

Promoting the opening up of the bank card clearing market is one of the measures to deepen the financial sector reform. The establishment and improvement of institutional arrangements in our bank card clearing market will attract more market participants. In the future, we will build up a bank card clearing market with diversified participants, form a market-oriented environment to facilitate the competition of multiple bank card service providers, provide differentiated and diversified bank card clearing services for customers from all sectors, constantly improve the structure and promote the sound development of the bank card service industry. Meanwhile, the gradual establishment of the market-oriented mechanism in the bank card clearing market will provide better payment services for financial consumers, by launching more personalized bank card payment products to customers and card holders, creating a safe and user-friendly payment environment, meet the increasingly diversified payment demands, facilitate customers' convenience of consumption and improve their life quality.

II. Legal Environment

1.The legal system governing the financial sector further improved

New laws and regulations were made. First, in order to safeguard national and public security, the *Cyber Security Law of the People's Republic of China* was passed, establishing the protection and evaluation system for key information infrastructures. The *Law of the People's Republic of China on the Administration of Activities of Overseas Non-governmental Organizations in the Mainland of China* was approved to regulate overseas nongovernmental organizations, their representative offices and Chinese partners in the opening and utilization of accounts, in order to strengthen supervision on anti-money laundering and counter financing of terrorism. Second, the *Decision of the State Council on Amending Certain Administrative Regulations* was passed so as to streamline administration, delegate powers and retain control over significant matters, improve services and remove ex-ante approval for certain issues. As for the securities market, certain regulations were amended to eliminate the approval procedure to improve the flexibility of securities exchanges in utilizing risk funds, and remove the approval procedures for futures exchanges and firms regarding some of their business operations. As for the insurance market, regulations were amended to lift the restrictions on the reinsurance business of foreign-funded insurance companies, allowing foreign-funded insurers to cede business to and receive ceded business from related firms and to eliminate the approval procedure for insurance companies in conducting agricultural insurance business. Third, the *National Social Security Fund Regulation* was approved, further regulating the collection, utilization, management, operation and supervision of the fund to ensure its security and appreciation.

Important documents were promulgated. The *Opinions of the CPC Central Committee and the State Council on Deepening the Reform of Investment and Financing System* was promulgated to further transform government functions, establish and improve the new investment and financing system featuring independent decisions by the enterprises, unclogged financing channels, proper transformation and standardization of government functions, effective macro-control and sound legal protection. The *Opinions of the State Council on Reducing Enterprise Leverage in a Proactive and Prudent Way* was released to actively and prudently reduce corporate leverage through multiple channels and underpin supply-side structural reforms. The *Notice of the General Office of the State Council on Issuing the Implementation Plan for the Dedicated Risk Clearance in Internet Finance* was published to enforce stringent market access and strengthen the supervision of flow of funds. The *Notice of the State Council on Comprehensively Implementing the Pilot Programs of Business Tax-to-VAT Reform*, the *Notice of the Ministry of Finance and the State Administration of Taxation on Comprehensively Implementing the Pilot Programs of Business Tax-to-VAT Reform* were promulgated. Starting from May 1, 2016, pilot programs of business tax-to-VAT reform were implemented nationwide to ensure the full coverage of VAT in all industries and sectors. Based on the principle of parallel transfer of tax burden, the business tax at 5 percent of business turnover would be replaced by the VAT at 6 percent of the added value for the financial sector. The *Guideline of the State Council on Establishing and Improving the Joint System for Incentivizing Good Credit and Penalizing Discredit and Accelerating the Build-up of the Social Credit System* was released to improve the social credit system and create an equitable and honest market environment.

More judicial interpretations were released. The Supreme People's Court published the *Regulations on Issues about the Adjudication of Independent Guarantee Cases,* which unified the rules on effect of independent guarantee transaction domestically and internationally, clarified the independence and the documentation nature of the independent guarantee, strictly defined fraudulent scenarios and determination criteria, and standardized the procedures for termination of payment. The *Opinions on Comprehensively Promoting the Docking Mechanism for Insurance Dispute Litigation and Mediation* was issued, standardizing the docking mechanism for insurance dispute litigation and mediation through platform building, operational procedure standardization, etc.

New rules and measures were issued. The PBC issued regulations to standardize the management of bank card clearing institutions, lower the reporting threshold of RMB high value cash transactions from RMB 200,000 yuan to RMB 50,000 yuan, and incorporate natural persons' remitting no less than USD 10,000 abroad through cash or account transfer into the high-value transaction reporting scope. The regulatory authorities issued regulations in order to strengthen the management of the information intermediary business of online lending, insurance fund investing indirectly in infrastructure construction, Securities Investor Protection Fund, equity incentives in listed companies, investor suitability for securities and futures, risk control indicators for securities firms, significant asset restructuring of listed companies, the Futures Investor Security Fund, etc., and clarify the administrative measures on the transaction connectivity between mainland and Hong Kong stock exchanges.

2. Outlook

In 2017, to achieve the objective of comprehensively deepening financial reform and opening-up, and improve the financial market system, we will continue to improve the legal system of the financial sector so as to support the real economy, promote financial product innovation and contribute to the financial regulatory reform. We will accelerate the revision of the *Law of the People's Bank of China,* the *Law on Commercial Banks*, the *Law on Banking Regulation and Supervision*, the *Law on Securities*, the *Law on Insurance* and *Provisional Regulations on Cash Management,* and promote the formulation of a series of laws and regulations, including the *Law on Futures*, the *Regulations on Non-deposit Taking Lending Institutions,* the *Administrative Measures on Financial Statistics,* the *Regulations on Management of Financing Guarantee Companies,* the *Provisional Regulations on Management of Private Equity Investment Funds,* the *Regulations on Management of Listed Companies,* the *Regulations on Trust Companies,* and the *Regulations on Earthquake Catastrophe Insurance,* etc.

III. Accounting Standards

1. Further progress was made in building the accounting standard system

First, plans for accounting reform and development were formulated, and the *Overview of the 13th Five-Year Plan for the Accounting Reform and Development* was issued. Second, the system of government accounting standards was improved. Four specific government accounting standards, namely standards on inventory, investment, fixed assets and intangible assets were issued.

The consultative drafts of guidelines on the implementation of accounting standards of public infrastructures, government material reserves and fixed assets were promulgated. Third, the corporate accounting standards for financial firms were revised, soliciting public opinions on 4 consultative standards, namely recognition and measurement of financial instruments (revised), transfer of financial assets (revised), hedging accounting (revised), and presentation of financial instruments (revised). In coordination with the requirement of the supply-side reforms, the *Rules on Standardizing the Accounting Standards for Related Issues of Reducing overcapacity, Destocking, Deleveraging, Cutting costs and Shoring up the Weak Spots* was released. Fourth, the guiding system for management accounting was improved by issuing the *Basic Guidelines on Management Accounting* and soliciting public opinions on 22 consultative guidelines on management accounting including the strategic management. Fifth, the *Guideline on Comprehensively Promoting the Internal Control Mechanism of Administrative and Public Institutions* was promulgated.

2. Outlook

First, we will advance the implementation of the *Overview of the 13th Five-Year Plan for the Accounting Reform and Development*. Second, we will push forward the comprehensive convergence of our corporate accounting standards with the IFRS standards. Third, we will improve the government accounting system and formulate detailed standards and guidelines for implementation. Fourth, we will improve the corporate accounting standards system, and revise and improve relevant accounting standards in a timely manner. Fifth, we will strengthen the guiding system for management accounting and promote the application of management accounting. Sixth, we will increase the use of information technology in accounting practices.

IV. Credit Environment

1. Constant progress has been made in the credit information sector and social credit system development

The plan for credit information market sector development was formulated to promote the timely establishment of a social credit system covering all social sectors. Based on comprehensive investigation and researches, we are formulating the top-level design and overall planning for the development of the credit information sector and drafting the *Establishing and Improving the Social Credit System that Covers All Social Sectors : Overall Plan for China's Credit Information Sector Development*. Aiming at preventing financial risks and protecting the information owners' rights and interests, the Plan will formulate a distinct and scientific development plan for the credit information sector from the perspective of optimizing the market structure, strengthening the regulatory mechanism and improving the service quality.

The coverage of the credit information system was expanded to regulate the development of credit information sector.

We provided non-banking financial institutions like securities companies, insurance firms, micro-lending companies and financing guarantee firms with access to the national basic database of financial credit information, promoted the collection of non-financial information in an orderly fashion, expanded the coverage of the database and studied the feasibility of non-financial institutions' access to the database. By the end of 2016, the database had collected information from 910 million natural persons, 22.1 million enterprises and other organizations. Meanwhile, 5.06 billion pieces of non-financial credit information were collected as well. The PBC stepped up regulation on the access to personal credit information market, and penalized illegal and irregular activities in order to protect the information owner's rights and interests. Supervision on institutions with access to the basic database of financial credit information was strengthened to require such institutions to establish and improve internal control and accountability mechanism, standardize data reporting and utilization and enhance protection for the information owners' rights and interests. The annual on-site inspection of credit information business was carried out, imposing 1046 administrative penalties against the search and utilization of personal information in violation of the regulations and collecting RMB 8.91 million yuan in fines. The PBC conducted comprehensive verification on the authenticity of the registration materials of enterprise credit information agencies and credit rating agencies, and cancelled the registration of credit information agencies which conducted no related business in the past 6 months. By the end of 2016, the number of registered enterprise credit information agencies decreased from 143 to 136 nationwide. It also improved the registration management for the rating agencies, enhanced rating quality test based on default rates, promoted rating for micro-lending companies and financing guarantee firms, and explored the long-term market-based mechanism. By end-2016, a total of 92 credit rating legal entities and 72 branches were registered. In 2016, 25,150 credit rating businesses were completed, 6,169 of which bond market ratings and 19,981 of which credit market ratings. Measures were taken to actively protect the information owners' rights and interests. A total of 209 complaints were accepted and all cases were solved.

Promoting the development of micro, small- and medium-sized enterprises and the rural credit system. In cooperation with the local governments, the PBC linked the development of micro, small- and medium-sized enterprise credit system with the "entrepreneurship and innovation" initiative, and linked the development of rural credit system with targeted poverty relief program in order to tackle the financing difficulties for micro, small- and medium-sized enterprises and rural households in terms of low accessibility, high costs, slow speed and significant credit risks. By end-2016, the PBC had replenished and perfected the credit information of 2.6114 million micro, small- and medium-sized enterprises which conducted no lending and borrowing activities with banks before, and established credit records for 172 million rural households. As a result, the total number of micro, small- and medium-sized enterprises and rural households receiving loan support from banks reached 471.6 thousand and 92.48 million respectively and outstanding loans reached RMB 10.5 trillion yuan and 2.7 trillion yuan, up by 5.3 percent and 9.3 percent respectively.

New progress was made in the building of credit information regulatory framework. The management framework of foreign-funded credit information agencies was clarified. Foreign-funded credit information agencies were granted national treatments, and the market access conditions and management standards for domestic and foreign-funded credit information agencies were unified. The *Administrative Measures for the Registration of Credit Information Agencies* was issued, which formed a unified and complete registration management system through unifying the requirements and standards for registration acceptance and review, and establishing a dynamic registration management system featuring both registration approval and cancellation.

Promoting the development of social credit system and creating a sound credit environment. Constant efforts were made to improve the Inter-Ministerial Conference for the Development of Social Credit System and perfect the related rules and regulations. The disclosure, sharing and utilization of administrative law enforcement information of government agencies were promoted. The building of regional credit systems was advanced, with the plan for 32 cities to conduct pilot programs for building social credit systems approved, and related evaluation and inspection for the implementation carried out .

Publicity campaigns on credit information culture were launched to raise the credit awareness of the society. The PBC organized publicity campaigns to disseminate credit information knowledge on a regular basis, including the "Credit Record Day", publicity campaign on major festivals, the publicity campaigns held in government agencies, communities, rural areas, enterprises and the campus. According to incomplete statistics, in 2016, more than 60,000 publicity campaigns on credit information culture were launched, over 159,000 financial branches, 380 credit information agencies and 8.3 million individuals participated, more than 2,800 news media covered the events and more than 82.1 million copies of publicity materials were distributed. The educational campaign on credit and honesty culture was proactively promoted, and credit information education from the perspective of both professional training and universal education was pushed forward. A publicity and educational system covering universities, middle schools and primary schools was established. A total of 2,867 credit information cultural events were launched in schools and institutes, covering more than 10 million students; 96 books on credit information education were compiled for universities, middle schools and primary schools.

2. Outlook

In the next stage, we will strengthen credit information regulation, promote the building of the credit information system covering the whole society, establish a long-term mechanism for preventing and controlling information leak, trading and illegal utilization, protect the rights and interests of information owners and market entities, and strictly regulate the development of the credit rating industry. We will vigorously propel the building of the social credit system and establish micro, small- and medium-sized enterprise and rural credit systems so as to improve the social credit environment. We will further improve the laws and regulations on credit information to improve credit information management, and enhance publicity and education to raise the credit awareness of the society.

V. Anti-money Laundering

1. AML capacities continued to improve

Efforts were made to actively promote the fourth round of AML mutual evaluation under the FATF framework. According to FATF standards and mutual evaluation practices of other jurisdictions, the PBC required the members of the AML inter-ministerial conference, certain non-financial industrial associations and obligatory organizations to conduct self-evaluation so as to comprehensively identify our progress and deficiencies on AML and CFT. The *Risk Evaluation Framework for China's Money Laundering and Terrorism Financing (2016)* was formulated.

Risk-based AML regulation and management was strengthened. The *Administrative Measures on the Reporting of High-value and Suspicious Transactions by Financial Institutions* was revised and the *Provisional Benchmark for AML Administrative Penalties* was issued. Relevant authorities completed the categorized rating on obligatory organizations and the renewal of payment institutions, and conducted AML inspections on some of the financial institutions. Compared with 2015, the frequencies and penalty amount of the AML inspections in 2016 were significantly higher, and the AML regulation for obligatory organizations was remarkably more stringent.

AML investigation continued. A significant increase was seen in the number of investigation cases, clues transferred, cases providing help to investigative authorities as well as cases started and solved with assistance of clues transferred. Evaluation of money laundering patterns and risk warnings was enhanced, special risk warnings against frequent criminal cases such as illegal fund-raising, telecommunication fraud and underground banks were issued, and the pilot monitoring model against the flow-back of terrorism financing was established. Special campaigns on combating illicit money transfer using offshore companies and underground banks and campaigns to combat illegal behaviors such as tax deceit in export business and over-issuance of VAT invoices were also carried out, with significant achievements.

Further international cooperation on AML has been carried out. The PBC fully leveraged the international and regional AML organizations and platforms such as FATF, EAG and APG, strengthened researches on key AML and CFT issues and international rules, and promoted the fruitful AML multilateral cooperation. The PBC signed the regulatory MOU on AML and CFT with the Russian central bank, conduced strategic dialogue on AML and CFT with the U.S., and signed MOUs on the exchange and communication of financial intelligence with relevant authorities in 7 countries including Australia.

2. Outlook

In the next step, we will comprehensively promote the fourth round of FATF AML mutual evaluation, focus on key areas, improve AML rules and regulations, strengthen risk-based regulation of legal entities, conduct AML investigations focusing on national key initiatives and deepen AML international cooperation.

VI. Financial Consumer Protection

1. Significant progress has been made in financial consumer protection

The framework of financial consumer protection has been constantly improved. The PBC implemented the *Guidance on Strengthening the Financial Consumer Protection* issued by the General Office of the State Council, accelerated the establishment and improvement of the rules and regulations on financial consumer protection, and formulated and promulgated the *Implementation Measures of the People's Bank of China on Financial Consumer Protection*.

Financial inclusion was conducted in an orderly fashion. The PBC formulated the *Scheme of Responsibility Division for the Plan on Promoting the Development of Financial Inclusion (2016-2020)*, and actively encouraged local governments to issue development plans and guidance for financial inclusion development so as to guide the development of regional financial inclusion. Based on the key G20 achievements, the PBC built up the financial inclusion indicator system and relevant statistical system.

Box 11 Promoting the Development of Digital Financial Inclusion

According to the definition put forward by the 2016 white paper *Global Standard-Setting Bodies and Financial Inclusion: the Evolving Landscape* issued by the G20

Global Partnership for Financial Inclusion (GPFI), digital financial inclusion refers to all services that leverage digital financial services to promote financial inclusion. In recent years, digital financial inclusion has witnessed rapid progress around the world and gradually received more attention from countries and jurisdictions. The current progress of digital financial inclusion in China is also well recognized globally.

In 2016, the *G20 High-Level Principles for Digital Financial Inclusion* (hereafter referred to as the *High-Level Principles*) was issued, becoming the first high-level guiding document in this front and an important link in the top-level design in global digital financial inclusion. During its G20 rotating presidency, China directly engaged in the formulation of the principles and played a critical role in the process. The *High-Level Principles* is composed of 8 principles (66 examples on key actions). First, promote a digital approach to financial inclusion; Second, balance innovation and risk to achieve digital financial inclusion; Third, provide an enabling and proportionate legal and regulatory framework for digital financial inclusion; Fourth, expand the digital financial services infrastructure ecosystem; Fifth, establish responsible digital financial practices to protect consumers; Sixth, strengthen digital and financial literacy and awareness; Seventh, facilitate customer identification for digital financial services; Eighth, track digital financial inclusion progress.

The achievement of the G20 in financial inclusion will be of great significance to the development of financial inclusion in the member jurisdictions in the future. The G20 encourages all members to take concrete actions and formulate action plans in accordance with respective national circumstances, so as to promote the global progress of financial inclusion. Based on the *High-Level Principles*, all jurisdictions are able to build up a sound policy framework for digital financial inclusion, step up financial infrastructure construction, and strike a reasonable balance between financial innovation and risks through effective and appropriate regulation, so as to protect financial consumers' rights and interests. The financial industry can formulate more detailed technical standards to promote the globalization and standardization of FinTech products and the healthy development of the Internet finance industry.

Supervision, inspection and evaluation progressed steadily. Cross-regional supervision and inspection on financial consumer protection were carried out with heightened preciseness and timeliness. The evaluation of institutions for financial consumer protection was implemented and the pilot programs for relevant evaluation was deepened.

Significant achievements were made in educating financial consumers. The PBC organized the initiative on the "Financial Consumers' Rights and Interests Day", with the theme of "Rights, Responsibilities and Risks". The PBC also launched the 2016 "Financial Knowledge Dissemination Month", and established the financial literacy survey mechanism for financial consumers. Efforts were also made on financial knowledge to be incorporated into the national education system, and the update of *Financial Knowledge Dissemination Textbook* has already begun.

The acceptance and handling of financial consumer complaints became increasingly standardized. The hotline for financial consumer protection (12363) operated soundly. 18,689 financial consumer complaints were accepted in 2016 and 16,954 were solved, accounting for 90.72 percent of all the complaints. The *Analysis Report and Typical Cases on the Acceptance and Handling of the Financial Consumer Complaints by the PBC* was issued quarterly. The Information Management System for Financial Consumer Protection operated smoothly, which ensured the digitization and standardization of the distribution and transfer of financial consumers complaints. The pilot programs for the third-party handling mechanism for financial consumption disputes (non-litigation) were deepened, and the pilot programs for the implementation of categorization standards for financial consumers complaints attained expected objectives.

2. Outlook

For the next step, we will further improve the legal system for financial consumer protection, and promulgate the *Regulations for the Implementation of the Law on Protection of Consumer Rights and Interests*. We will continue to organize financial consumer education campaigns represented by the "Financial Knowledge Dissemination Month" and the "Financial Consumers' Rights and Interests Day", and make preparation for the 2017 national survey on the financial literacy of consumers. We will formulate specific policies and measures for the *Plan on Promoting the Development of Financial Inclusion (2016-2020)*, and promote the implementation of the 2016 GPFI initiatives. We will carry out supervision and inspection on financial consumer protection, revise and improve the evaluation indicator system for financial consumer protection carried out by financial institutions, and improve the disclosure mechanism of publicizing typical cases of and regulatory information on financial consumer protection. We will also improve the service quality and efficiency of the "12363" financial consumer protection hotline.

Chapter Ⅷ

Macroprudential Regulation

In 2016, international community continuously improved the macroprudential policy framework and promoted the implementation of macroprudential policy tools. Based on the international experiences, China continued to enhance macroprudential regulation, improved the financial regulatory coordination mechanism, strengthened the assessment and monitoring of systemic risks, expanded the macroprudential policy toolkit, and effectively guaranteed the bottom line of allowing no systemic risks to emerge.

I. International Developments on Macroprudential Regulation

1. Building more resilient financial institutions

Further improving the policy framework. In 2016, The Basel Ⅲ package of reforms made by BCBS was further pushed forward in line with the principles of simplicity, comparability and risk sensitivity. Several reforms have made progress, including the revision of capital requirement of market risk, the revision of leverage framework, the issuance of the supervisory framework of interest rate risk in the banking book, and the development of the simple, comparable and transparent capital requirement on securitization. To make a better balance among simplicity, comparability and risk sensitivity, BCBS is now making efforts on reforms including the measurement of credit risk and operational risk, the additional leverage ratio requirement of the G-SIBs, capital floor requirement and the pillar 3 disclosure requirements, etc.

Promoting the implementation of Basel Ⅲ. BCBS published in October 2016 a progress report on implementation, which illustrates that all of the 27 BCBS members have implemented the Basel Ⅲ risk-based capital requirement and liquidity coverage ratio requirement, 26 members have published countercyclical capital buffer requirements, 25 members have established or are developing regulatory framework on D-SIBs, and all the G-SIB home jurisdictions① have published regulatory requirements on G-SIBs. Meanwhile, members are faced with challenges in finishing part of the reforms in time, such as measuring counterparty credit risk and capital requirement for CCPs exposures. To promote the consistent implementation of Basel Ⅲ, BCBS carried out the RCAP for Argentina, Korea, Indonesia, Japan, Russia and Turkey. As of the end-2016, all of the BCBS members had participated in the RCAP on risk-based capital requirement.

2. Strengthening the supervision on SIFIs

Updating the list of G-SIBs. In November 2016, the FSB updated the list of G-SIBs

① G-SIB home jurisdictions include China, U.S., France, Germany, Italy, Netherlands, Spain, U.K., Japan, Switzerland and Sweden.

based on the end-2015 data. Thirty banks were designated as G-SIBs (Table 8.1) and the total number of G-SIBs remained the same as that in 2015. Citigroup moved from Bucket 3 to Bucket 4; Bank of America moved from Bucket 2 to Bucket 3; ICBC and Wells Fargo moved from Bucket 1 to Bucket 2; HSBC moved from Bucket 4 to Bucket 3; Barclays moved from Bucket 3 to Bucket 2; Morgan Stanley moved from Bucket 2 to Bucket 1. ICBC, ABC, BOC and CCB were still in the list but with much higher scores. Total assets of Chinese banking sector kept increasing against the backdrop of global slow recovery and weak performance of banking sector. In addition, the inter-bank business, and bond issuance and brokerage expanded significantly in 2015 in China, which contributed to the increase of the relevant scores and lifted our G-SIBs to higher rankings. The G-SIBs designated in November 2014 have begun to implement higher capital requirements since January 1, 2016, and the designated G-SIBs in the annual updated list in every November will be subject to higher capital requirements as from January 14 months later.

Table 8.1 The Updated List of G-SIBs

Bucket (Higher Capital Buffer Requirements)	G-SIBs in alphabetical order within each bucket
5 (3.5%)	(Empty)
4 (2.5%)	Citigroup JP Morgan Chase
3 (2.0%)	Bank of America BNP Paribas Deutsche Bank HSBC
2 (1.5%)	Barclays Credit Suisse Goldman Sachs Industrial and Commercial Bank of China Limited Mitsubishi UFJ FG Wells Fargo
1 (1.0%)	Agricultural Bank of China Bank of China Bank of New York Mellon China Construction Bank Groupe BPCE Group Crédit Agricole ING Bank Mizuho FG Morgan Stanley

Continue

Bucket (Higher Capital Buffer Requirements)	G-SIBs in alphabetical order within each bucket
1 （1.0%）	Nordea Royal Bank of Scotland Santander Société Générale Standard Chartered State Street Sumitomo Mitsui FG UBS Unicredit Group

Source: *2016 List of Global Systemically Important Banks* by the FSB, Nov. 2016.

Updating the list of G-SIIs. The FSB, together with IAIS, published the first list of G-SIIs in July 2013, in which 9 insurance companies including Ping An Group were designated as G-SIIs. Since 2014, the FSB has updated the list every November. The FSB updated the list in November 2016 based on the end-2015 data. Nine insurance companies were designated as G-SIIs, the same with those in 2015 (Table 8.2). Besides, IAIS revised the assessment methodology of G-SIIs in June 2016 and the new methodology has been applied in the 2016 assessment.

Table 8.2 The Updated List of G-SIIs

Aegon N.V.
Allianz SE
American International Group, Inc.
Aviva plc
Axa S.A.
Melife, Inc.
Ping An Insurance (Group) Company of China, Ltd.
Prudential Financial, Inc.
Prudential plc

Source: *2016 List of Global Systemically Important Insurers* by the FSB, Nov. 2016.

Box 12 Revision of the G-SII Assessment Methodology

In July 2013, the IAIS published the assessment methodology for G-SIIs and decided to review the methodology every three years. In June 2016, the IAIS published *Global Systemically Important Insurers: Updated Assessment Methodology,* which revised the 2013 Methodology from several aspects.

Adjusting the indicator category. The 2013 Methodology classified five categories to assess and designate G-SIIs, namely size, global activity, interconnectedness, Non-traditional/Non-insurance (NTNI) activities and substitutability, etc. While in the practice of assessment, stakeholders indicated that the definition of NTNI activities is a little bit obscure, and there existed some overlap between the categories of NTNI activities and interconnectedness. The IAIS proposed that if its macroeconomic exposure is too large, an insurer might be easier to transmit the negative shocks to other financial institutions or financial markets through the counterparty channel, so that the systemic risks may thus rise. In addition, it may cause financial market turbulence and then interrupt the key functioning of financial markets if an insurer fire sales its assets for urgent liquidity demand, which may also result in systemic risks. The IAIS regarded the products and business that could cause material macroeconomic risks and liquidity risks through exposure or asset liquidation channels as important indictors for assessing G-SIIs. Thus, the IAIS developed a new asset liquidation category, divided the interconnectedness category into two subcategories, namely counterparty exposure and macroeconomic exposure, and reallocated the indicators previously belonging to NTNI activities to the assert liquidation category and macroeconomic exposure subcategory within the interconnectedness category. After this revision, the 2016 Methodology consists of five categories, namely size, global activity, interconnectedness, asset liquidation and substitutability.

Adjusting the calculation of indicators. Compared with the 2013 Methodology, the 2016 Methodology was revised in both selection and calculation of the indicators. First, given the reality of data reliability, the IAIS would no longer use the indicator of derivatives trading (excluding hedging and replication), and move intra-group commitments and large exposures from the quantitative assessment to the next phase. Second, the IAIS would use the absolute reference values instead of relative scores to calculate three indicators, namely derivatives trading (CDS or similar derivatives instrument protection sold), financial guarantees and reinsurance. There are 17 indicators in the 2016 Methodology compared with 20 indicators in 2013, so that some indicators now have higher weights.

Adjusting the assessment process. In order to promote the scientific and transparent nature of assessment, the IAIS further refined and expanded the assessment process from three phases to five phases. Phase I is the annual data collection phase. The IAIS collects data from insurers that meet at least one of the two criteria, i.e. total assets of more than USD 60 billion and a ratio of premiums from jurisdictions outside the home jurisdiction to total premiums of 5% or more; or total assets of more than USD 200 billion and a ratio of premiums from jurisdictions outside the home jurisdiction to total premiums greater than 0%. Phase II is the scoring and threshold determination phase. A quantitative threshold is set by means of statistics and analysis based on the scores of sample institutions. Those insurers with scores higher than the threshold would enter the next phase. Phase III is the prospective G-SII discovery phase. Comprehensively considering the heterogeneity of structures, products, exposures and global activities within the insurance industry, and differences in data quality reported across insurers and across jurisdictions, phase III will focus on the quantitative and qualitative information that are not involved in the indicators and previous phases. Phase IV is to exchange with prospective G-SIIs and relevant supervisors. The IAIS will determine the preliminary G-SII list, share with the prospective G-SIIs the assessment results of the first three phases and offer them an opportunity to exchange views with the IAIS about the assessment process. Phase V is to submit the G-SII list to the FSB (Table 8-3).

Table 8-3 Changes of Indicators and Weights in the G-SII Assessment Methodology

	The 2013 Methodology		The 2016 Methodology	
Indicator	Category	Weight	Category	Weight
Total Assets	Size（5%）	2.5%	Unchanged	
Total Revenues		2.5%		
Revenues derived outside of home country	Global activity（5%）	2.5%		
Number of Countries		2.5%		

Continue

<table>
<tr><th></th><th colspan="2">The 2013 Methodology</th><th colspan="3">The 2016 Methodology</th></tr>
<tr><th>Indicator</th><th>Category</th><th>Weight</th><th colspan="2">Category</th><th>Weight</th></tr>
<tr><td>Intra-financial assets</td><td rowspan="7">Interconne-ctedness (40%)</td><td>5.7%</td><td rowspan="4">Interconne-ctedness</td><td rowspan="4">Counterparty exposure</td><td>6.7%</td></tr>
<tr><td>Intra-financial liabilities</td><td>5.7%</td><td>6.7%</td></tr>
<tr><td>Reinsurance</td><td>5.7%</td><td>6.7%</td></tr>
<tr><td>Derivatives</td><td>5.7%</td><td>6.7%</td></tr>
<tr><td>Large exposures</td><td>5.7%</td><td colspan="3">Deleted. Considered in Phase III</td></tr>
<tr><td>Turnover</td><td>5.7%</td><td colspan="2" rowspan="2">Asset liquidation</td><td>6.7%</td></tr>
<tr><td>Level 3 assets[①]</td><td>5.7%</td><td>6.7%</td></tr>
<tr><td>Financial guarantees</td><td rowspan="8">NTNI activities (NTNI, 45%)</td><td>6.4%</td><td rowspan="3">Interconne-ctedness</td><td rowspan="3">Macroeco-nomic exposure</td><td>7.5%</td></tr>
<tr><td>Minimum guarantees on variable products</td><td>6.4%</td><td>7.5%</td></tr>
<tr><td>Derivatives Trading (CDS, etc)</td><td>6.4%</td><td>7.5%</td></tr>
<tr><td>Non-policy holder liabilities and non-insurance revenues</td><td>6.4%</td><td colspan="2" rowspan="3">Asset liquidation</td><td>7.5%</td></tr>
<tr><td>Short term funding</td><td>6.4%</td><td>7.5%</td></tr>
<tr><td>Liability liquidity</td><td>6.4%</td><td>7.5%</td></tr>
<tr><td>Intra-group commitments</td><td>6.4%</td><td colspan="3">Deleted. Considered in Phase III</td></tr>
<tr><td>Derivatives trading (excluding hedging and replication)</td><td>Not used</td><td colspan="3">Deleted</td></tr>
<tr><td>Premiums for specific business lines</td><td>Substituta-bility (5%)</td><td>5%</td><td colspan="3">Unchanged</td></tr>
</table>

Note: Level 1 assets are those whose prices could be observed in active markets and need not to be adjusted. Level 2 assets are those traded in inactive markets but with prices calculated by models. Level 3 assets are those with opaque valuation approaches and techniques. This indicator first calculates level 3 assets and then calculates its ratio to the total of level 1, 2 and 3 assets.

3.Promoting effective resolution regime

Implementing the TLAC requirements steadily. Since the publishing of TLAC requirements by the FSB in 2015, most G-SIB home jurisdictions released TLAC implementation proposals or consultative documents. From January 2015 to August

2016, the total global TLAC instrument issuance amounted USD 623 billion, among which common stocks recorded USD 19 billion, other Tier 1 capital recorded USD 104 billion, Tier 2 capital recorded USD 117 billion and senior debt recorded USD 383 billion. The major issuance currencies include USD, EUR and JPY, accounting for 50 percent, 22 percent and 13 percent, respectively.

Promoting the effective resolution regime for G-SIFIs. CMGs of all the G-SIBs carried out the second round of RAPs in 2016. The outcomes of RAPs indicated that, great progress had been made in many aspects of G-SIB resolution reforms, but there still remained a lot to do in areas of sufficiency of funding and liquidity during resolution, implementation of the bail-in mechanism, information management system and the continuous access to FMIs during resolution, etc. Authorities of G-SIB home jurisdictions will carry out the third round of RAPs in 2017, mainly focusing on the TLAC instrument issuance and adherence to the temporary stay protocol by the ISDA. In 2016, all the G-SIIs have completed the first round of RAPs. The outcomes of the RAPs indicated that, G-SII home jurisdictions and major host jurisdictions generally lacked comprehensive resolution powers and tools required by the *Key Attributes for Effective Resolution Regimes* (*Key Attributes* for short). The analysis of the key functions of G-SIIs had made slow progress. The resolution strategies needed further refinement, with better feasibility and more effective ex-ante coordination framework. It should be further clarified under what conditions should the policy holder protection be the funding source of resolution.

Promoting the implementation of the *Key Attributes*. The FSB carried out the second thematic peer review on implementation of the *Key Attributes* in 2016. The review indicated that, since 2012, member countries had made a great progress in resolution powers and tools, and the scale and condition for the use of resolution powers had changed a lot. However, resolution plan requirements were still missing in some jurisdictions, and only a few members had the banking resolution regime in line with the *Key Attributes*. The bail-in tools and temporary stay on early termination rights in financial contracts are the most widely missing tools in banking resolution. Little progress had been made in insurance sector resolution, and only part of members had initiated the relevant reforms. In 2016, the FSB, together with the CPMI, IADI, IAIS, IOSCO, IMF and World Bank, developed and improved the *Key Attributes Assessment Methodology for the Banking Sector*. This methodology will be applied in the FSAP by the IMF and World Bank.

4.Providing resilient market-based financing sources

Continuously monitoring the shadow banking system. In May 2017, the FSB published the *Global Shadow Banking Monitoring Report 2016* based on the end-2015 data, covering 28 jurisdictions including all the 24 FSB members and Belgium, Cayman Islands, Chile and Ireland, representing over

80 percent of the global GDP. Based on the broad measure, Monitoring Universe of Non-bank Financial Intermediation (MUNFI) grew to USD 149 trillion by the end of 2015, accounting for about 48 percent of total financial assets in participating jurisdictions. Based on the narrow measure, shadow banking in 27 jurisdictions (excluding China)[①] amounted to USD 34 trillion, accounting for 69 percent of GDP and 13 percent of total financial assets in corresponding jurisdictions, and the 6 largest jurisdictions accounted for over 80 percent. Among advanced economies in the north America, Asia and Europe, the U.S. has the largest shadow banking system which accounted for 40 percent of the total scale, with Cayman Islands, Japan and Ireland following.

Addressing asset management structural vulnerabilities. Recently, the FSB indicated that there exist five structural vulnerabilities in the asset management sector, namely liquidity mismatch, leverage within investment funds, operational risk and challenges in transferring investment mandates in stressed conditions, securities lending activities of asset managers and funds, and potential vulnerabilities of pension funds and sovereign wealth funds. In January 2017, the FSB published policy recommendations to address the above vulnerabilities. The FSB proposed to promote data reporting and information disclosure, develop consistent measures of leverage, enhance relevant supervisory guidance, develop liquidity risk management tools, carry out stress tests and establish business continuity plans.

5.Promoting reforms of OTC derivatives markets

Progress continued to be made in reforming global OTC derivatives markets in 2016. Generally speaking, among 24 jurisdictions, trade reporting and higher capital requirements on non-centrally cleared derivatives are best implemented. Almost all jurisdictions have in force the relevant requirements, covering over 90 percent of transactions in their markets, while there still exist some legal obstacles in reporting to and accessing data from trade repositories in some jurisdictions. Frameworks of central clearing are in place for 14 member jurisdictions. Implementation of frameworks of margin requirements of non-centrally cleared derivatives is less progressed, with only half of the jurisdictions accomplishing in time by anticipation. Implementation of frameworks of exchange or electronic platform trading falls far behind the timetable, with only 11 member jurisdictions in force while others do not plan to implement in the near future. In terms of cross-border corporation, the EU commission and CFTC developed a unified regulatory framework for CCPs which were active both in Europe and the U.S.

① China did not participate in the narrow measure assessment.

6. Strengthening reforms of central counterparties

IOSCO, CPMI and FSB have been working on enhancing the resilience, recovery planning and resolvability of CCPs. In terms of enhancing resilience and recovery planning, IOSCO and CPMI have assessed the implementation of the *Principles for Financial Market Infrastructures* (PFMI) in August 2016 and published a consultative document on how to better implement PFMI. IOSCO and CPMI will continue to analyze the feasibility to carry out supervisory stress tests of CCPs. In terms of improving resolvability, based on a stocktaking work about the existing CCP resolution plans, the FSB published the consultative document of *Essential Aspects of CCP Resolution Planning* in August 2016, in which detailed requirements were clarified about resolution objectives, resolution powers, loss allocation, funding sources and cross-border coordination. The FSB also published the *Guidance on CCP Resolution and Resolution Planning—Consultative Document* in February 2017, to further clarify key issues that authorities should take into consideration when establishing CCP resolution frameworks so as to unify standards in different jurisdictions. In addition, the Study Group on Central Clearing Interdependencies (SGCCI) established by the BCBS, CPMI, FSB and IOSCO continued to work on interdependencies between CCPs and their major clearing members and the potential systemic influence. SGCCI has completed the data collection from major global CCPs and the International Data Hub at the BIS.

7. Reducing misconduct risk

The FSB continued to work on reducing misconduct risk and promoting market confidence in 2016. First, the FSB worked to improve incentives to reduce misconduct. In terms of compensation, the FSB would develop by end-2017 a supplementary guidance, which would supplement the *Principles and Implementation Standards for Sound Compensation Practices* with respect to the link between compensation and conduct. Meanwhile, the FSB are working on consistent national reporting and data collection about the use of compensation tools against misconduct. In terms of corporate governance, the Working Group on Governance Framework established by the FSB conducted a stocktake of various efforts underway by international bodies, national authorities, industry associations and firms to strengthen governance frameworks to address misconduct risk. Second, relevant organizations took measures to improve global standards of conduct in fixed income, currency and commodities (FICC) markets. IOSCO is developing a detailed regulatory toolkit to guide good conduct. BIS is developing global standards of conduct in the foreign exchange market and the phase I document has been published. All the work above will be accomplished by end-2017. Third, efforts were made to reform major benchmarks. IOSCO will finalize guidance for benchmark administrators on the content of their statements of compliance with the *Principles for Financial Benchmarks*. Inter-bank Offered Rate (IBOR) administrators further improved the interest rate forming mechanism to enhance the role of real trading data. The FSB continued to monitor the progress of benchmark interest rate reform and will publish in 2017 a monitoring report.

8. Others

First, the IMF, FSB and BIS jointly published the *Elements of Effective Macroprudential Policies: Lessons from International Experience*, which will guide member jurisdictions to establish and improve their macroprudential policy frameworks. Second, the FSB has generally accomplished the work on enhancing information disclosure in the banking sector. Eighty-two percent of banks have implemented the relevant policy recommendations on improving disclosure quality of data about risk management, capital adequacy, liquidity risk and credit risk. Third, the analysis and regulation of Fintech have been enhanced. The FSB developed an analytical framework for Fintech and established a dedicated working group to assess and monitor the financial stability implications from Fintech. Fourth, the FSB established the Correspondent Banking Coordination Group (CBCG) to analyze the decline in global correspondent banking relationships, and to address any potential threats to economic growth, financial inclusion, anti-money laundering andcombating the financing of terrorism. Fifth, the global LEI system is well functioning. By the end of 2016, 29 jurisdictions had been authorized to issue LEIs and over 480,000 entities had received their LEIs.

Box 13 IMF, FSB and BIS Jointly Published the *Elements of Effective Macroprudential Policies: Lessons from International Experience*

After the recent global financial crisis, the international community realized that the previous financial regulatory system mainly focused on the resilience of individual institutions instead of preventing financial risks from accumulation and transition in an systemic and countercyclical perspective. Thus major jurisdictions began to reform domestic financial regulatory systems and enhance macroprudential regulation. During its presidency of G20 in 2016, China required the IMF, FSB and BIS to stocktake essential aspects and good practices of national macroprudential policies. Against this backdrop, the *Elements of Effective Macroprudential Policies: Lessons from International Experience* was published by the three institutions, which carried out a comprehensive study on macroprudential policy scope, objectives, institutional arrangements and policy tools, and provided a guidance for jurisdictions to establish and improve their macroprudential policy frameworks.

I. The Definition and Objectives of Macroprudential Policy

The report indicates that Macroprudential policy is defined as the use of primarily prudential tools to limit systemic risk, namely, the risk of widespread disruption to the provision of financial services that is caused by an impairment of all or parts of the financial system, and which can cause serious negative consequences for the real economy. Systemic risk is generally recognized as having two dimensions: vulnerabilities related to the build-up of risks over time ("time dimension"), and vulnerabilities from interconnectedness and the associated distribution of risk within the financial system at any given point in time ("cross-sectional" or "structural" dimension).

Macroprudential policy pursues the following objectives: (1) increase the resilience of the financial system to aggregate shocks by building and releasing buffers; (2) contain the build-up of systemic vulnerabilities over time by reducing procyclical feedback between asset prices and credit and containing unsustainable increases in leverage, debt stocks, and volatile funding; and (3) control structural vulnerabilities within the financial system that arise through interlinkages and the critical role of individual intermediaries in key markets that can render individual institutions "too-big-to-fail".

II. The Institutional Arrangements of Macroprudential Policy

Mandate and governance. Considerable differences across countries suggest that there is no "one-size-fits-all" approach for the institutional arrangements of macroprudential policy. Notwithstanding this, a number of countries have come to the conclusion that effective macroprudential policy is well-served by providing the relevant authorities with a clear mandate that sets out well-defined objectives as well as adequate powers. In many jurisdictions, the central bank plays an important role, in order to harness its expertise, incentives to take action, and independence. This can be achieved in a variety of ways, such as making the central bank board (or governor) the decision-making body, having the governor chair the policymaking committee, providing the central bank with a clearly defined role to provide its proposals for policy action to the attention of the decision-making body, or assigning it a leading role in the regulation and supervision of designated SIFIs. A dedicated financial stability unit within the central bank or standing macroprudential policymaking committee, which can be charged with the analysis of systemic risks and the preparation of proposals for policy responses, can support the macroprudential policy process.

Powers for relevant authorities. In order to ensure the effectiveness of policy implementation, macroprudential policy authorities should be provided with adequate powers. Such powers include: obtaining information from other authorities to fill data gaps; influencing the activation and calibration of regulatory constraints; influencing the designation of individual institutions as systemically important; and initiating changes in the regulatory perimeter, etc. The strength of such powers can vary into three degrees. First, hard powers, giving policymakers direct control over macroprudential tools or the ability to direct other regulatory authorities. Hard powers can effectively avoid frictions of policy implementation. Second, semi-hard powers, enabling policymakers to make formal recommendations to other regulatory authorities, coupled with a 'comply or explain' mechanism. Semi-hard powers can increase the chance of action being taken, while at the same time maintaining the operational independence of the recipient authority. Third, soft powers, enabling policymakers to express an opinion, or warning, or a recommendation. Soft powers alone are unlikely to be sufficient to ensure effectiveness and should be supplemented by other powers.

III. Operational Considerations of Macroprudential Policy

Analyzing and monitoring systemic risk. The analysis and monitoring of systemic risk should focus on two dimensions. To assess the build-up of risks from the time dimension, authorities are typically examining a number of areas, including: economy-wide vulnerabilities from an excessive growth in total credit or asset prices; sectoral vulnerabilities arising from specific sectors; and systemic risks from a build-up of maturity and foreign currency mismatches in the financial sector. To assess vulnerabilities from the structural dimension, risks from linkages within and across key classes of intermediaries and market infrastructures at a given time are being monitored, as well as the impact of the failure of any of these institutions on the system as a whole. A number of indicators are used to comprehensively assess systemic risks, and macroprudential stress tests can also provide policy recommendations, complementing the use of early warning indicators.

Establishing macroprudential policy tools. Macroprudential policy tools are also categorized into two dimensions in correspondence with risks. In the time dimension, such tools usually require financial institutions to build up buffers as systemic risk accumulates in order for them to be drawn down in times of stress. Such tools include broad-based capital tools such as dynamic provisioning requirements and the countercyclical capital buffer (CCyB), asset-side tools such as capital requirements and caps on the share of exposures to specific sectors, and liquidity-related tools such as reserves requirements, Liquidity Coverage Ratio (LCR), core funding ratios and caps on the loan-to-deposit ratio, etc. In the structural dimension, such tools could improve the resilience of SIFIs and reduce the interconnectedness within the financial system. Such tools include designation of and higher loss absorbency and resolvability requirements for systemically important banks and insurers; enhancing the resilience of financial market infrastructures and the recovery and resolution plan requirements.

IV. Three Main Institutional Models of Macroprudential Policy Frameworks

Based on the stocktaking work, the document concluded three institutional models for macroprudential policymaking. First, the main macroprudential mandate is assigned to the central bank, with its Board or Governor making macroprudential decisions. If supervisory authorities are independent from the central bank, an interagency coordination mechanism should be established with the Ministry of Finance involved. Second, the main macroprudential mandate is assigned to a dedicated committee within the central bank structure. This setup can help counter the potential risks of dual mandates of the monetary and macroprudential policy for the central bank. It also allows for separate regulatory and supervisory authorities and external experts to participate in the decision-making committee. Third, the main macroprudential mandate is assigned to an interagency committee outside the central bank, to make decisions and implement macroprudential policies through coordinating policy action, facilitating information sharing and analyzing systemic risk.

II. Major Jurisdictions' Progress in Macroprudential Policies

1. United States

Monitoring and assessment of systemic risks. The Financial Stability Oversight Council (FSOC) published its annual report in June 2016. The report indicates that, against the backdrop of slow world economic recovery, surplus supply of product markets, appreciation of USD and the spillover effects of monetary policies of foreign countries, there exist some potential risks in its financial system. The essential risks include: cyber safety that could influence the key functions of the financial system; risks in terms of liquidity, leverage and resolvability for asset management products; risks in terms of capital adequacy, liquidity and resolvability of large financial institutions; increasing interconnectedness of CCPs and their clearing members; less stable wholesale funding market; over reliance by market participants on reference rates like LIBOR; insufficient financial market data collection and interagency information sharing; lag of legislation for housing finance; market participants' over reliance on short-term financing due to the domestic and foreign low interest rate environment for a long time, and the higher leverage and risks as a result; the use of auto-trading system by some institutions in the fixed income market, which could undermine financial stability.

Countercyclical capital requirements. The Federal Reserve Board (FRB) published in September 2016 the implementation framework of Basel III CCyB policy. As an annex to Regulation Q (12 CFR part 217), CCyB framework applies for all banking financial institutions that are subject to the advanced approaches capital rules with total assets over USD 250 billion or foreign exposures over USD 10 billion. The FRB assesses the financial risks by a variety of means and then sets and calibrates the CCyB standard. Unless specifically mentioned, the CCyB amount will drop to 0 percent 12 months after its application. In 2016, the FRB also tightened the stress test standard for large banks which were subject to the CCyB requirement.

Regulation on SIFIs. In March 2016, the FRB proposed to address issues about large credit exposures to a single counterparty of banking financial institutions. In May 2016, the FRB proposed to make some adjustment to financial contracts of domestic G-SIBs and domestic operations of foreign G-SIBs, to prevent from contract termination and asset fire sales by forbidding counterparties to exit from the contracts within 48 hours since the triggering of bankruptcy. In December 2016, the FRB published a new rule to require domestic G-SIBs and domestic operations of foreign G-SIBs to keep adequate long-term debt, which could be converted into equity during resolution, and to meet the TLAC requirement as well since 2019. In addition, six authorities including the FRB and Office of the Comptroller of the Currency (OCC) jointly drafted a new rule on compensation for the Wall Street. According to the new rule, large financial institutions should delay the bonus to their senior management for 4 years and claw back the paid bonus if their senior management's activity infringed the right of institutions or investors.

2. United Kingdom

Making macroprudential policies. The Financial Policy Committee (FPC) suggested that major instability in the U.K. financial system arised from the upcoming influence of the Brexit in 2016, which even added uncertainty to global and U.K. economic prospective. Significant risks emerged in the real estate market, deficit in current account reached its historical high level, GBP depreciated by 12 percent since the Brexit, and the leverage seemed a little bit high in the household sector. Due to the above risks, the FPC announced in July to lower the CCyB standard to 0 from 0.5 percent in March and decided to maintain this level until mid-2017. Meanwhile, in order to avoid capital hoarding and credit contraction from banks, the FPC proposed that the Prudential Regulation Agency (PRA) lower the supervisory capital buffer requirements. Other policy recommendations from the FPC included: to remove the deposit reserves from the calculation of bank leverage; and give insurers some flexibility when applying PRA's new rules on solvency.

Conducting banking sector stress tests. BoE conducted the third stress test to the banking sector in March 2016 with the participating large banks accounting for 80 percent of total loans. The test was designed under the newly published *BoE's Approach to Stress Testing the UK Banking System* in October 2015, with more severe scenarios. In the severe scenario, the total system-wide losses are estimated to be GBP 44 billion, five times the net losses of the global financial crisis. The tire 1 capital adequacy ratios of 7 banks drop to 8.4 percent, higher than the level of 7.4 percent in 2014 and 2015. Generally speaking, banks with more foreign and corporate business suffer more, while Lloyds Banking Group, Nationwide Building Society and Santander UK, which operate mainly in domestic markets, are less shocked. In addition, BoE tested the capital adequacy ratios according to the Hurdle rate framework. The test result indicates that there emerges huge capital gap in Royal Bank of Scotland Group, Barclays and Standard Chartered, which should improve their capital positions by all means.

3. European Union

Monitoring and assessment of systemic risks. The European Systemic Risk Board (ESRB) published its annual risk monitoring report. The report suggests that, due to the continued global low interest rate environment and geopolitical uncertainties, there exist four potential financial risks in Europe: the relatively low market liquidity amplifies the repricing of risk premia in global financial markets; the balance sheets of the banking and insurance sector remain weak; the indebtedness of the public, corporate and household sector may further deteriorate; and the continuous expansion of shadow banking may shock the financial system potentially.

The decision making and implementation of macroprudential policies. The ESRB guided its members to implement CCyB policies. Members are required to calculate on a quarterly basis the deviation of credit/GDP gap from its long-term trend and set and disclose the CCyB standard based on the calculation. The CCyB standard should be further calibrated based on domestic systemic risks. The ECB could set higher CCyB standard than members if necessary. The mutual recognition of EU CCyB regulation applies to all EU members and the cap level is set to 2.5 percent. The ESRB defines non-EU countries to which the EU banks' risk-weighted assets, total assets or default exposures account for more than 1 percent of the total as material third countries. The same mutual recognition standard applies to material third countries.

Publishing macroprudential bulletin. The ECB published the Macroprudential Bulletin, issue 1, in March 2016, which introduced its macroprudential mandate under the Single Supervisory Mechanism (SSM), the objectives, implementation channels, policy tools and governance framework, as well as macroprudential analytical techniques like the assessment model of the lending standards of household loans and the bank early warning model, etc. In October, ECB published its Macroprudential Bulletin, issue 2, which reported the progress of macroprudential policies in the euro area in several areas, such as the macroprudential effects of stress tests for systemically important banks, the analysis and tools of macroprudential policies, supervision on high frequency and dark pool trading, etc.

Monitoring the shadow banking system. The ESRB published its first EU shadow banking monitoring report in July 2016. The report indicates that the EU shadow banking had been growing fast in recent years to EUR 37 trillion by end-2015, accounting for 36 percent of total assets of the EU financial sector and 250 percent of EU GDP. Shadow banking in the euro area recorded EUR 28 trillion, up by 27 percent than end-2012. The fast growth of shadow banking increased the financial leverage, added to the financial risks of interconnectedness, and some potential vulnerabilities emerged from hedge funds, real estate market funds and money market funds.

Conducting banking sector stress tests. The European Banking Authority (EBA) conducted stress tests to 51 banks from 15 countries (37 banks supervised by the SSM and 14 banks from the European Economic Area including Denmark and the U.K.) based on the scenarios of ESRB. The result indicates that in the severe scenario, the capital adequacy ratio of sample banks would lose 3.4 percentage points in 2018 compared to that of 2015, the aggregate leverage ratio would drop from 5.2 percent to 4.2 percent, the capital loss would amount to EUR 226 billion, the maximum credit losses would amount to EUR 349 billion and the leverage ratio would fall below 3 percent in 7 banks.

III. China’s Practice in Macroprudential Regulation

There is an enriched scope of macroprudential policy framework. According to the research by the IMF, FSB and BIS, this concept involves both the appropriate institutional arrangements and the analysis and monitoring of systemic risks, as well as a variety of macroprudential policy tools. China is now in a period of economic structural adjustment and upgrading alongside with structural conflicts, so it is necessary to establish a financial regulatory framework which fits for the development of the modern financial market and to enhance the role of macroprudential policies. China thus continues to improve the macroprudential policy framework, promote the institutional arrangement of interagency corporation, enhance the monitoring and identification of risks, and effectively implement and calibrate policy tools, so as to safeguard financial stability from all the dimensions and throughout all the procedures, and to hold on to the bottom line of allowing no systemic risks to emerge.

1. Constantly improving the Joint Ministerial Conference on Financial Regulatory Coordination Mechanism

In 2016, the Joint Ministerial Conference on Financial Regulatory Coordination (Joint Conference in short) continued to push forward the coordination of financial regulatory policies, measures and actions, promote the collaboration and effectiveness of financial supervision, and play an active role in addressing systemic risks and encouraging the financial sector to better serve the real economy. First, the Joint Conference pushed forward the research on the cross-market risk assessment framework, improved the risk information sharing mechanism among financial regulatory authorities and promoted the work on consistent supervision of FMIs and the establishment of comprehensive financial statistics. Second, the Joint Conference pushed forward the regulation of cross-sector and cross-market development of insurance companies, and enhanced the supervision on universal life insurance, investment in shares of listed companies and cross-border investment by insurance companies. Third, the Joint Conference improved the regulatory coordination on investment by industrial enterprises into financial activities, carried out researches on the regulatory arrangement of financial holding companies established by industrial enterprises and studied to establish the regulatory rules for financial holding companies. Fourth, it promoted and regulated the development of emerging financial business, pushed forward the draft of more normative asset management product standards and rules, helped to draft the *Implementation Plan for the Dedicated Risk Clearance in Internet Finance*, and promoted the establishment of the entrance criteria and daily regulatory framework that fit for the characteristics of Internet finance. Fifth, it made efforts to enhance the financial disciplines, clarify the regulatory mandate for private wealth management activities, further regulate OTC margin financing, reduce leverage financing, enhance the management of local exchanges, and require commercial banks and third-party payment institutions to conduct business with local exchanges in line with relevant regulations.

Next, the Joint Conference will continue to implement the decisions of the CPC Committee and the State Council, adhere to the general principle of making progress while maintaining stability, and give mitigation of financial risks much more significance. The Joint Conference will continue to enhance the monitoring and early warning of cross-market financial risks, promote the policy coordination and action corporation of the risk mitigation in key areas, and improve the capacity to resolve financial risks. In addition, the Joint Conference will focus on the decision of the CPC Committee and the State Council on the coordinated supervision of SIFIs, financial holding companies and financial market infrastructures and establishment of comprehensive financial statistics, and push forward the establishment of a financial regulatory framework which fits for the development of the modern financial market and the financial integrated operation.

2. Strengthening monitoring and assessment of systemic risks

Continuous efforts were made in promoting the on-site inspection and risk assessment of banking, securities, insurance and non-financial institutions with financing functions. Financial stability stress tests were conducted for commercial banks and securities firms with more participating institutions. Risk monitoring and study in key areas and severe problems were enhanced, and studies on issues of NPL ratio rebounding and weak profitability of banks, asset management activities, equity crowd funding, private equity and investment of insurance funds were carried out. The PBC also continued to improve the risk monitoring mechanism of large problem enterprises, addressed material risk events in a timely manner, and promoted the judgment of macroeconomic perspective, local financial risks and trends of specific industries.

3. Effectively using and improving macroprudential policy tools

Efforts were continued to improve the resolution regime of G-SIFIs. ICBC, ABC, BOC, CCB and Ping An Insurance (Group), which have been designated as G-SIFIs by the FSB, have established the CMGs and developed and renewed their RRPs annually. Ping An Insurance (Group) and ABC have completed the first round of RAPs, while ICBC and BOC have accomplished the second round. CCB will conduct its first RAP in 2017.

The Macroprudential Assessment (MPA) system functioned well. In order to further improve the macroprudential policy framework, the PBC upgraded the dynamic adjustment mechanism on differentiated reserve ratio to MPA, taking into account capital and leveraging, assets and liabilities, liquidity, pricing behavior, asset quality, cross-border risk exposure and the implementation of credit policies, to improve the self-discipline of banking financial institutions. Due to the well functioning of MPA, money and credit supply maintained a stable growth, banking financial institutions generally operated resiliently, and the objectives of MPA were preliminarily achieved. Besides the implementation of MPA, the PBC improved the structure and weights of relevant indicators and calibrated some parameters. The previous indicator "external liabilities" was replaced by "cross-border risk exposure" accompanied with some sub-indicators, so as to fit for the frequent cross-border capital flows. Off-balance sheet wealth management products were included in broad credit for the first time in the first quarter of 2017, so as to guide financial institutions to better mange their off-balance sheet risks.

The PBC continued to improve the macroprudential policy framework for foreign exchange flows and cross-border

capital flows. In order to implement the decision of the third Plenary Session of the 18th CPC Central Committee on establishing and improving the macroprudential policy framework for external liabilities and capital flows, the PBC established a preliminary macroprudential policy framework for foreign exchange and cross-border capital flows. First, the full-coverage of the macroprudential policy framework for cross-border financing was established and improved. Enterprises and financial institutions could carry out cross-border financing business within the caps decided on the basis of their own capital conditions. The PBC could adjust the above financing activities countercyclically based on the need of macro control. Second, macroprudential measures were applied to FX future transactions, which introduced the reserve requirement of 20 percent of nominal amount (including options and swaps). Third, domestic financial institutions were required to set aside reserves at the normal reserve requirement ratio for deposits of overseas financial institutions, so as to promote the resilient operation of overseas financial institutions.

The countercyclical adjustment of real estate market was further enhanced. First, measures were taken to improve the city-specific housing credit policies. On February 1, 2016, the PBC and CBRC jointly published the *Notice on Adjustment to the Individual Housing Credit Policy*, which stimulated that the minimum down payment rates in non-purchase restriction cities were lowered while unchanged in purchase restriction cities. Since March, several cities adjusted their housing credit policies for times to raise the minimum down payment rates, so as to address the overwhelming increase of house prices. So far, the minimum down payment rates for the first house in these cities are above 30 percent, rates for the second house are generally above 50 percent, and even above 70 or 80 percent in several cities. Second, commercial banks were encouraged to improve their credit structure and credit approval. OTC financing activities like "loans for down payment" in real estate market have been included into the dedicated risk clearance in Internet Finance. Meanwhile, commercial banks were required to strictly implement the differentiated housing credit policies and enhance the credit approval procers, so as to avoid malign competition in price and "loans for down payment". Third, the capital inflows to the real estate market were better monitored and regulated. Capital inflows from trust, wealth management, bond, asset management and insurance funds to the real estate market were intensively regulated to avoid excessive or irregular capital inflows, so as to guide more funds to flow into the real economy.

Special Topic Ⅰ

Promoting Regulated and Healthy Development of the Wealth Management Sector in China

Since the emergence of China's first publicly offered fund in 1991 and the first banking wealth management product (WMP) in 2004, the wealth management sector has experienced rapid development and increasing size of business, which contributed to the development of direct financing market, the expansion of investment channels for the public, the improvement of operational models of financial institutions and supporting the financing needs of real economy. However, problems caused by differentiated rules and embedded products have also emerged, which requires market regulation and top-level design to integrate macro-prudential administration and micro-prudential regulation, to integrate institutional regulation and functional regulation, to unify regulatory standards for same type of products and to guard against cross-sector and cross-market transmission of risks.

I. Development of Wealth Management Business

Wealth management business refers to a kind of financial services where institutions, entrusted by investors, invest and manage the trusted assets of the investors. Wealth management institutions exercise due diligence for the benefits of the investors and charge management fees accordingly, and the investors are liable for any risks or returns on their own. Since the reform and opening up, China has witnessed rapid economic development, expanding residents' wealth and growing size of the high-net-worth group, resulting in increasing demand for wealth maintenance and accumulation and for diversified investment options. There has been growing demand of enterprises for direct financing, and financial institutions are increasingly required to reform their single business structure and profit model. It is fair to say that wealth management business effectively connects investment with financing, and its fast development reflects the common demands of the residents, the enterprises and the financial institutions.

In the course of the development of wealth management sector, various regulators improved relevant rules. Since the second half of 2012, institutions of the securities, fund, futures and insurance sectors have witnessed rapid growth of wealth management businesses, and cross-sector cooperation on wealth management among various types of institutions has become increasingly close, marking the emergence of "an era of grand wealth management" in China. By the end of 2016, the size of in- and off-balance sheet WMPs of banks stood at RMB 5.9 trillion yuan and RMB 23.1 trillion yuan respectively; the size of entrusted funds of trust companies registered RMB 17.5 trillion yuan; the size of publicly offered funds, private equity funds, as well as asset management plans (AMPs) of securities companies, funds and their subsidiaries, and insurance asset management companies reached RMB 9.2 trillion yuan, RMB 10.2 trillion yuan, RMB 17.6 trillion yuan, RMB 16.9 trillion yuan and RMB 1.7 trillion yuan respectively. After eliminating the portion that is cross-held, the overall size of wealth management business of all sectors combined totaled more than RMB 60 trillion yuan.

II. Practices of Wealth Management

Major business types and cooperation models include the following.

1. Business types

Commercial banks. Because of the wide sale channels and sticky customers , banking WMPs account for the largest share in total wealth management business. The business models include the following. The first one is the proprietary model where banks invest money raised by issuing WMPs directly in deposit products, monetary market tools, bonds and other assets or portfolios. The second model is that banks purchase products of other financial institutions, namely investing funds raised by issuing WMPs in assets such as bonds and equities by purchasing WMPs of other banks, trust plans, AMPs of securities companies, insurance asset managemnet companies and fund companies. The third model is to invest relying on other financial institutions, namely banks investing money raised from issuing WMPs in WMPs of other financial institutions, and the banks provide and manage investment projects, take investment risks and enjoy investment returns while the channel institutions collect management fees. And the fourth is an outsourcing model where banks entrust money raised from issuing WMPs to trust companies, securities companies, fund companies and other financial institutions for investment after the two sides agree on certain returns, and the entrusted institutions manage daily investments or act as investment consultants. The outsourcing model takes up a large share of business in some small- and medium-sized banks that are lack of investment capacities.

Trust companies. Trust companies, entrusted by investors, issue trust plans and manage and operate trusted monetary funds for the benefits of investors or for a specific purpose. The business models include the following. The first is the single trust model where a trust company is entrusted by a single investor and manage and utilize the funds separately, on investor’s will, in accordance with the management measures specified by the investor (for specific purpose) or management measures specified by the trust company on behalf of the investor (for non-specific purpose). The second is the collective trust model where the trustee company combines assets entrusted by two or more investors into a pool and manage, utilize or handle the funds in the name of the trustees. Collective fund trust is a typical product that is actively managed by trust companies. The third one is the umbrella trust model where a trust product contains two or more sub-trusts of different kinds from which investors can choose one or more to form a portfolio based on their investment preferences. For example, banking WMPs subscribe to the senior tranche of the trust plan’s beneficiary right while other clients subscribe to subordinate tranches, and subscribers to subordinate tranches may be composed of multiple subsidiary components.

Securities companies. The business models include the following. The first is collective AMPs where money can be raised from no more than 200 investors with a minimum investment amount of RMB 1 million yuan each, and the money is usually invested into all kinds of standardized securities and AMPs issued by other financial institutions. The second is targeted AMPs where money is raised from a single investor and the investment scope is ascertained jointly by the securities company and the investor. Such a model is aimed at providing customized products to targeted customers and usually serves as an investment channel because of its flexibility in investment scope. The third is special AMPs, which are often applied in asset securitization business where the securities company establishes a special AMP to purchase the underlying assets that need to be securitized, and the AMP works as a special purpose vehicle (SPV) that initiates the securitization, and shares of the plan are traded at exchanges.

Funds and subsidiaries. Wealth management business of fund companies targets at standardized securities with public nature. In 2012, the CSRC allowed fund companies to operate AMPs that are of private nature and that can be invested in non-standardized securities by setting up subsidiaries. The business models include the following. The first is the public fund model where the fund company issues beneficiary certificates to public non-specific investors or to cumulatively more than 200 specific investors. Based on investment scope, the funds can be further classified into equity investment funds, bond investment bonds, hybrid funds, money market funds, QDII funds, etc.. Such funds are regulated by the *Law on Securities Investment Funds*. The second is the specific investor-targeted product of fund companies, which is privately offered for particular customers. The fund company raises money from specific customers or accepts entrusted properties from specific customers to act as an asset manager, and invests entrusted assets in cash, bank deposits and other standardized securities. The third is the specific investor-targeted product of fund subsidiaries, which is a kind of wealth management business for specific customers offered by subsidiaries of fund companies. Such business is of private nature with flexible investment scope including “equity, creditor’s rights and other property rights transferred not through securities exchanges”, which covers almost all standardized and non-standardized assets.

Futures companies. Wealth management business of futures companies include AMPs for a single investor and those for specific multiple investors, in which the minimum investment for a single investor should be no less than RMB 1 million yuan. Rules for wealth management business for specific multiple investors are still being formulated by the CSRC. The investment scope includes financial derivatives such as futures and options, equity, bonds, securities investment funds, collective AMPs, central bank notes, short-term commercial papers, asset-backed securities, etc..

Insurance institutions. Insurance asset management companies, while entrusted by parent insurance companies and other insurance companies to manage third-party funds and corporate annuities, issue AMPs to raise funds. Such products mainly include bond investment plans, asset supporting plans, equity investment plans, portfolio products, etc.. The issuance scope is limited to qualified institutional investors, and the products may be issued to a specific single investor or to multiple investors collectively.

Non-financial institutions. Managers of privately offered funds, as non-financial institutions, raise funds from qualified investors through non-public channels to set up private funds that can be divided into two categories: the first one invests in unlisted equities to earn spread profits between the primary and secondary markets, which is called the private equity fund; and the second one is dedicated to investing in the secondary market, which is called the private securities investment fund. Meanwhile, with the development of mobile internet, big data, cloud computing and other information technologies, non-financial institutions, such as internet companies and investment consulting companies, have also started to offer wealth management services to the public. Internet-based WMPs such as Yu'E Bao are growing rapidly because of the low investment threshold, high returns and instant redemption.

2. Major cooperation models

Because there are differences in regulatory standards for different sectors such as those regarding investment scope, capital provisions and tranche leverage, there has emerged a business model where financial institutions cooperate to create multiple embedded products.

Inter-bank WMPs. This refers to when banks purchase WMPs from each other. Inter-bank WMPs is a kind of wholesale business, and therefore have shorter term, higher returns and lower issuance costs. Moreover, banks that purchase inter-bank WMPs with their own money tend to be more flexible on risk-based capital provisions, which helps to reduce capital occupation. Therefore, small banks with limited investment capacity tend to purchase WMPs of large banks to expand size of WMPs and enjoy guaranteed returns.

Cooperation between banks and trust companies. In the first place, banks entrusted money from WMPs to trust plans and directed the latter to provide the money to specific borrowers. After regulation became tightened, banking WMPs turned to trust beneficiary rights or had AMPs of securities companies embedded into banking WMPs, or used trust plans to purchase bank loans with banks promising to repurchase the assets at expiration with premium. Banks may also commission trust companies to use the funds of WMPs to bid for new shares, invest in beneficiary rights of stocks with sale restrictions or invest in equity returns.

Cooperation between banks and securities companies and between banks and fund companies. Banks use funds of WMPs to invest in beneficiary rights to loans or notes of their own via AMPs of securities companies or fund companies so as to move the loan assets out of the balance sheets. Banks also indirectly invest in the secondary market or engage in private equity placement by purchasing the senior tranche of AMPs issued by securities companies or fund companies.

Cooperation between banks and insurance institutions. Banks deposit funds into another bank in the form of term deposit or agreement deposit by purchasing insurance AMPs or directly entrusting others to invest, so as to turn inter-bank deposits into general deposits to expand source of funds and size of loans. Banks may also commission insurance asset management companies to operate capital and invest funds of WMPs in insurance AMPs or products of other financial institutions, in the course of which WMPs of trust companies, fund subsidiaries and other financial institutions are embedded.

Cooperation among banks, trust companies, securities companies, fund companies and insurance institutions. Apart from cooperation between two sectors, there are wealth management businesses that involve institutions from multiple sectors, including channel business for entrusted loans (trust loans) involving banks, securities companies and trust companies, outsourcing businesses involving banks, trust companies, securities companies and fund companies, businesses of stock-pledged repurchase provided by banks, trust companies, securities companies and fund companies, tailored channel business conducted by banks, trust companies, securities companies and fund companies, equity investment business involving banks, (securities companies), insurance institutions and fund companies, etc..

III. Issues Deserving Close Attention

1. Liquidity risks of capital pool

Wealth management institutions invest low-cost and short-term funds in bonds or equity projects with longer maturity via rolling issuance, collective operation, term mismatch and separate pricing, so as to seek maximized profits. Payments at expiration rely on the consecutive issuance of the products, and difficulties in raising more funds may lead to liquidity shortage, which may transmit to other wealth management institutions of the same product chain. For embedded products that amplify leverage, liquidity risks may easily spread. At the asset end, there also exists such portfolio where a single product is invested in many types of assets, and some portfolios have complex composition that is far from transparent.

2. Multiple embedding of products leads to risk contagion

Banking WMPs have large source of funds but are only allowed to directly invest in bonds. Investment of banking WMPs in equities is limited and tranched products are prohibited. Some banks, not willing to give up high-quality projects, turn to AMPs of trust, securities, fund and insurance institutions as channels to invest the funds in equity products. Embedded products usually have complex structures and obscure underlying assets, which means that if a risk incident occurs, the risks will spread to all participating institutions, increase the possibility of risk contagion and enhance market volatility. WMPs with multiple layers of embedding usually contain complex legal relations, and in cases where the trusting institution does not perform active management and the channel institution lacks enough due diligence capacity, the two sides may blame the other party when losses occur. Moreover, risks should not be neglected in cases where some non-financial institutions that are not effectively regulated, such as internet platforms and private wealth management companies, cooperate with financial institutions to provide embedded products.

3. Insufficient regulation of shadow banking

Bank loans are regulated with strict capital adequacy ratio requirements, limits on investment areas and desirability lending management, so banks realize “off-balance sheet issuance of loans” through off-balance sheet WMPs and other types of AMPs. Features of shadow banking exist in off-balance sheet WMPs and products invested in non-standard creditor assets under cooperation of banks and trust companies, banks and securities companies and banks and fund companies as well as investments of insurance institutions that are equity investments on surface but credit investments by nature. Such business is of low transparency and is easy to evade regulatory requirements for loans. Moreover, part of the money is invested in prohibited areas and most of the money is not yet covered by statistics of the TSF.

4. Rigid redemption makes risks stay in the financial system

Wealth management business mainly involves trust relationship or commission relationship. Some businesses may have obscure legal relationships but they are by nature creditor-debtor relationship, therefore liable to implicit rigid redemption. For example, some WMPs use proprietary funds or money from the pool to ensure expected returns and are not able to keep separated from the asset and liability business of their own. Rigid redemption not only makes risks accumulate in the financial system but also raises the risk-free returns, which distorts prices of money, hinders efficiency of the financial market to allocate resources and fueled moral hazard risks.

5. Some non-financial institutions conduct wealth management business regardless of orders and regulation

There have emerged some risks and problems concerning the wealth management businesses of some non-financial institutions. For example, some non-financial institutions split online the WMPs that are privately issued offline and sell them to non-specific general investors; promote products to investors who do not have the proper risk identification capacity, or do not apply sufficient technical measures to identify clients; conduct fraudulent and misleading promotion, and do not disclose investment risks sufficiently; and do not take measures such as fund custody to ensure the safety of investors' money, and some even turn their business into illegal fund-raising.

IV. Promoting the Regulated and Healthy Development of Wealth Management Business

To address the acute risks and problems emerging during the rapid development of wealth management sector, it is important to keep problem-oriented and have a definite target in view, and establish an effective wealth management regulatory mechanism starting with addressing the differences in the regulation of WMPs of the same type.

1. Unify standards and rules in a classified manner and gradually eradicate arbitrage

To mitigate risks of shadow banking, it is important to build up a macroprudential policy framework for wealth management business, improve policy tools and strengthen macro, countercyclical and cross-market monitoring, evaluation and adjustment. Meanwhile, to respond to differences in regulatory standards under the separate regulatory mechanism, it is necessary to enhance functional and penetrating regulation. Same standards should be applied to same type of products to eliminate arbitrage and to contain risk spread caused by embedded products.

2. Guide the wealth management sector to return to its mission and eliminate rigid redemption in an orderly manner

Efforts should be made to guide the wealth management sector to return to its original mandate of "being entrusted by clients to manage their wealth". Returns and risks as a consequence of investment should be borne by the investors and the trusting party only charges management fees. Wealth management institutions should not make promises about payback of principal or returns. It is important to strengthen practices of investor suitability and investor education, and enhance investors' awareness of the fact that "the product seller conducts due diligence and the buyer bears profits and losses". Risk insulation between wealth management business and proprietary business should be strengthened to make sure that the trustee performs their responsibilities. Issuance of products with expected returns should be gradually reduced to promote the transformation to products measured by net asset value, so that changes of fair value of the assets can reflect risks of the underlying assets in a timely manner.

3. Enhance liquidity risk prevention and contain leverage ratio

Measures should be taken to strengthen separate management, separate ledger and independent accounting so that the product maturity is matched with term duration of invested assets. Financial institutions should be encouraged to establish subsidiaries with legal person status to conduct wealth management business. They should set up independent account management and custody mechanism, and build up buffers among different WMPs and between proprietary funds and trusted funds. Requirements on the leverage ratio of same products should be unified to control leverage of the stock market and bond market and guard against asset bubbles.

4. Eliminate multiple embedding and contain channel business

All types of financial institutions should have equal access to the wealth management market and enjoy fair treatment. It is important to restrict multiple embedding of products, strengthen the responsibility of trusted institutions to conduct active wealth management, and prevent trusted institutions from providing channel business for the trusting institutions with the purpose of evading regulatory requirements such as restrictions on investment scope and leverage. Allow, to a reasonable degree, the operation model that is based on active management and is focused on asset allocation and portfolio management.

5. Strengthen regulation of "non-standard" business and prevent risks of shadow banking

Efforts will be made to enhance regulation of "non-standard" business of banks, incorporate off-balance sheet WMPs of banks into the scope of broad credit, and guide financial institutions to strengthen risk management of off-balance sheet businesses. The transfer of banking credit assets and beneficiary rights should be regulated. Banks should also control and gradually reduce the size of investment in "non-standard" assets, and enhance pre-investment due diligence, risk examination and post-investment risk management.

6. Establish the comprehensive statistics system to provide foundation for penetrating regulation

To address the fragmented statistics of wealth management business, it is important to accelerate the establishment of a comprehensive statistics system featuring full coverage, unified standards and shared information that is able to collect the basic information, the offering information, the asset-liability information and the termination information of every single product. Based on this, penetrating identification of underlying assets and final investors can be realized to give a full picture of the entire sector in a timely and accurate manner and to reflect the actual risk situation of the industry.

Special Topic II

The Market-oriented Risk Resolution Mechanism of the Deposit Insurance System

As one of the three key pillar components of the modern financial safety net and the important operating platform for dealing with crisis and resolution of financial vulnerabilities, the deposit insurance system is positioned as the substantial defense line in mitigation and orderly resolution of financial risks. The *Decisions on Some Major Issues Concerning Comprehensively Deepening Reforms* adopted at the Third Plenary Session of the 18th CPC Central Committee required establishing the deposit insurance system and further enhancing the market-oriented market exit regime for financial institutions. Since the enactment of the *Deposit Insurance Regulations of China* in 2015, the implementation of the deposit insurance system has been smoothly carried out, which helps to give an increasingly important role for deposit insurance in the prevention and resolution of financial risks gradually. According to the guidance issued by the 2016 Central Economic Work Conference, which required attaching more importance to the prevention of financial risks and making determination to deal with a couple of vulnerabilities, the managing authority of the deposit insurance system endeavored to further improve the system's role in risk identification and resolution, so as to further enhance its importance in forming the market-oriented risk resolution regime.

I. Experiences and lessons in the risk resolution practices from both international and domestic views

1. Implementing the deposit insurer's prompt corrective and effective resolution mandates in the prevention and resolution of financial risks

The key of financial risk management lies in the sound institutional arrangement to efficiently identify, manage and reduce vulnerabilities, so as to take timely measures against financial risks. It has taken a long time for jurisdictions around the world to explore and summarize the effective way to deal with financial risks. In the U.S. Savings and Loan Crisis in 1980s, the Resolution Trust Corporation was established as the special resolution vehicle to collect non-performing assets of the troubled Savings and Loan Associations. Finally, with the cost of the crisis amounting to USD 150 billion, the insurer for the industry, namely the Federal Savings & Loan Insurance Corporation went bankrupt and the fund under its management was fully depleted. Against such background, as the response to the lessons of the crisis, the legislation in 1991 in U.S. required reforming the original institutional arrangement, including introducing the risk-based premium system and the Prompt Corrective Action (PCA) mechanism, which empowered the deposit insurer appropriate supervisory mandates to apply risk ratings to banks as the basis of determining the risk-based premium as well as taking prompt corrective actions depending on the categorization of problem banks according to their different risk profile. More specifically, the deposit insurer may impose intervention or restriction measures against the troubled financial institutions according to their capital shortage conditions, including restricting transactions with affiliates or asset growth and requiring capital replenishment as well as ordering the financial institutions to correct the risky behaviors within certain time limit. If the capital of a bank would be most likely depleted, the deposit insurer may take over the bank in a timely manner to maintain the safety of deposits, reduce the potential losses of the deposit insurance fund, and contain the potential financial crisis. As illustrated by practices, the prompt corrective and resolution mandates by the deposit insurer played an important role in enhancing the U.S. banking sector's capital strength and risk management capacity as well as promoting the overall regulatory efficiency.

Currently, more and more deposit insurers around the world began to be empowered with mandates of early identification of risks and correction of problem banks' behaviors. According to the International Association of Deposit Insurers (IADI), ensuring the deposit insurers' prompt correction mandates against problem banks will help to generate certain pressure on regulators, reduce or prevent regulatory forbearance, and promote the overall regulatory quality and efficiency. Drawing lessens and experiences both domestically and internationally, when introducing the deposit insurance system into China, the authorities made it clear that the deposit insurer can not be mandated only as the paybox and should be equipped with appropriate prompt corrective actions for the purpose of early identification and timely intervention against problem banks, which should be realized in the appropriate division of labor between the regulator and deposit insurer so that both safety net players assume different focuses in responsibilities and make joint efforts in promoting the effectiveness of the financial safety net.

2. It has been demonstrated by the 2008 global financial crisis that the deposit insurance system's risk resolution mandate should be strengthened towards building the market-oriented exit regime for financial institutions

The 2008 global financial crisis was the most realistic test on the effectiveness of the current deposit insurance system. There had been 525 bank failures in the U.S. during the crisis as of the end of 2016. However, the relatively mature and effective deposit insurance system in the U.S. successfully coped with different-sized bank failures using various market-oriented resolution methods including purchase and assumption, bridge banks, subject to the least-cost rule for deposit insurance funds. The effective operation of the deposit insurance system in the U.S. successfully dealt with failures of banks of different size, including Citi Bank, Washington Mutual, Indymac, etc., minimized resolution costs, maintained the public's confidence in the financial sector and safeguarded financial stability. Drawing on the successful experiences in the crisis, the resolution mandates of the Federal Deposit Insurance Corporation (FDIC) has been further expanded to systemically important non-bank financial institutions, making the deposit insurance system the effective resolution platform for the whole financial industry. Compared to the successful operation of the U.S. deposit insurance system, the "pay-box" type of deposit insurance systems in Europe played a limited role in dealing with crisis and maintaining the public's confidence since such system was only responsible for compensating depositors on the ex post basis. In such cases, the government had to rely on public funding to deal with the banking sector crisis, with such measures as government-led asset restructuring, disposing bad assets through the "bad bank plan", implementing nationalization, etc. The government-led financial assistance to financial institutions like Royal Bank of Scotland and Fortis Bank aroused wide public disputes which criticized on the negative consequences of such doing including harming the benefits of taxpayers, spoiling market discipline, leading to sovereign debt crisis risks and difficulties of the afterwards policy normalization.

When summarizing experiences of the 2008 financial crisis, the FSB indicated that the deposit insurance system should not only be the effective risk resolution platform for bank failures, but also a much more fundamental institutional arrangement in safeguarding financial stability. FSB also included the *Core Principles for Effective Deposit Insurance Systems* into the key standards for sound financial systems. According to the survey by IADI in 2013, the proportion of countries empowering the deposit insurers with resolution mandates has increased from 50 percent of the respondents in 2005 to 65 percent in 2011. The resolution tools that could be used by deposit insurers became more diversified, with 56 percent of members implementing "Purchase and Assumption" transactions, 53 percent of members providing financial assistance to troubled banks, 47 percent of members promoting M&A between troubled banks and healthy banks, 37 percent of members establishing bridge banks, as well as 50 percent of members managing the bank assets.

3. The risk resolution practices in China also illustrated that establishing the market-oriented risk resolution regime helps to prevent moral hazard and form the long-term mechanism of maintaining financial stability

There were two important periods of dealing with massive financial failures in history since 1980s in China. The first period was during 1997-2001, when the failures of a number of small- and medium-sized financial institutions broke out and the financial market order need to be rectified thoroughly. According to the State Council's *Notice on Deepening Financial Reforms, Rectifying Financial Market Order and Mitigating Financial Risks*, the PBC implemented the market exit for a number of vulnerable financial institutions through measures including mergers and acquisitions, restructuring, revoking the licenses, dissolution, closure, bankruptcy, etc. The second period was during 2003-2007, when the government took measures to close a large number of risky securities firms and trust investment companies, to enhance the long-term mechanism of risk mitigation. It also dealt with the risks of a couple of small- and medium-sized banks through revoking the licenses and temporary business suspension. During the process, the PBC made various efforts to replenish the capital of and provide liquidity support to problem financial institutions in support of their restructuring, and pay back or purchase personal liabilities to mitigate financial risks.

In general, the past practices help to accumulate experiences and form the basic policy framework of resolution in China. Meanwhile, it should be admitted that with the underdevelopment of the legal framework in prevention and resolution of financial risks at that time, especially in the context of no deposit insurance system established, the fundamental role of the market in resource allocation could not be brought into full play, and the risk management capacity of the financial sector as a whole was limited. Firstly, there was no prompt corrective mechanism in place to ensure early identification and resolution of risks, which always led to high resolution costs. Secondly, there was no formal depositor protection scheme to prevent run on banks. Thirdly, there was hardly any professional resolution platform that was market-oriented and the resolution process was inefficient. Fourthly, there was no benign mechanism of incentives and restrictions, which may lead to moral hazard.

II. Establishment of the deposit insurance system helps to further enhance the legal framework of market-oriented exit regime for financial institutions

1. It is the common practice around the world to rely on the effective deposit insurance system to form the market-oriented exit regime for banks

In terms of the relevant legal framework, a lot of countries rely on the deposit insurance system to form the market-oriented exit regime for banking institutions. Currently, major advanced jurisdictions utilize the deposit insurance system to take corrective actions, respond to risks, and deal with various public claims before the market exit of banking institutions. There are mainly three models of the market-oriented exit regime for banking institutions around the world.

For the first model, the deposit insurance legislation itself is actually the market-oriented exit regime, under which the deposit insurers lead the restructuring and resolution process of problem institutions, taking into account the prioritization of depositor protection in bank resolution. The United States is the typical example, where the *Federal Deposit Insurance Act* specifies the rules and methods for bank resolution and market exit, stipulating FDIC's role as the resolution authority for the banking sector as it can take over the problem banks under certain conditions and implement liquidation. For the second model, the deposit insurance legislation is the key component of the legal framework for the market-oriented exit regime for financial institutions. After dealing with depositor compensation and related social stability issues, the normal judicial process can be applied to market exit of insured problem banks. The typical examples are some EU members, Canada, Japan, Korea, Taiwan Province of China and Russia. In the case of Japan, the *Deposit Insurance Law* of Japan stipulates the major role of the deposit insurer in the resolution process of failed banks and takes it as the important platform for crisis management. For the third model, in those countries without the specific deposit insurance legislation, the corporate bankruptcy law completely applies to the banks, such as in Australia.

2. The deposit insurance system should play a leading role in the market-oriented exit regime for financial institutions to fully ensure the legitimate interests of depositors and promote resolution efficiency

In order to achieve early identification and prevention of financial risks, drawing on the successful international experiences, Article 7 of the *Deposit Insurance Regulations of China* stipulates that, the deposit insurer shall take prompt corrective actions and resolution measures in accordance with the provisions of the *Regulations*. In order to reduce losses to the deposit insurance fund and keep consistent with the current legal framework, Article 18 and 19 of the *Deposit Insurance Regulations of China* stipulate that, the deposit insurer shall be appointed the party to take over or liquidate failed banks and will be able to utilize the deposit insurance fund, subject to the least-cost principle, to exercise market-oriented resolution measures, such as the purchase and assumption transactions, to protect depositors efficiently, deal with financial failures quickly and effectively, and ensure the continuous operation of the banking industry and financial stability during the resolution process. The establishment of the deposit insurance system is an important step in improving the risk resolution and market-oriented exit regime for the financial sector. As the key institutional arrangement in depositor protection, and risk resolution and market-oriented exit regime for financial institutions, the efficient operation of the deposit insurance system will help to promote the efficiency of financial risk resolution and provide legal and institutional basis for the timely risk prevention and resolution in China.

Appendix

Statistics

Table 1 Selected Economic Indicators

Items	2012	2013	2014	2015	2016
Gross Domestic Product (RMB 100 million yuan)	540 367	595 244	643 974	679 052	744 127
Industrial Value Added	199 671	210 689	227 991	228 974	247 860
Fixed Asset Investment (RMB 100 million yuan)	374 695	447 074	512 761	562 000	606 466
Retail Sales of Consumer Goods (RMB 100 million yuan)	210 307	237 810	262 394	300 931	332 316
Exports & Imports（USD 100 million）	38 671	41 600	264 334	245 741	243 386
Exports	20 487	22 096	143 912	141 255	138 455
Imports	18 184	19 504	120 423	104 485	104 932
Balance	2 303	2 592	23 489	36 770	33 523
Foreign Direct Investment（USD 100 million）	1 117	1 176	1 196	1 263	1 260
Foreign Exchange Reserves (USD 100 million)	33 116	38 213	38 430	33 304	30 105
Consumer Price Index (previous year=100)	102.6	102.6	102.0	101.4	102.0
Fiscal Revenue (RMB 100 million yuan)	117 253.52	129 143	140 350	152 217	159 552
Fiscal Expenditure (RMB 100 million yuan)	125 952.97	139 744	151 662	175 768	187 841
Per Capita Urban Household Dispensable Income (RMB yuan)	24 565	26 955	28 844	31 195	33 616
Per Capita Rural Household Dispensable Income (RMB yuan)			10 489	11 422	12 363
Number of Employed Persons in Urban Areas (million)	371.0	382.4	393.1	404.1	414.3
Registered Unemployment Rate in Urban Areas (%)	4.1	4.05	4.09	4.05	4.02
Total Population (million)	1 354.0	1 360.7	1 367.8	1 374.6	1 382.7

Note: ① GDP from 2012 to 2015 is verified and final, and GDP in 2016 is preliminary.

② From 2016, the calculation methodology of the GDP has been revised by the National Bureau of Statistics of China, and the historical GDP data from 1952 to 2015 have been revised accordingly. The data in the table are after revision.

Source: Calculated on the basis of data from *China Statistical Year Book* and *Statistical Communique of The People's Republic of China on the National Economic and Social Development.*

Table 2 Selected Financial Indicators (1)

(Year-end Balance)

(RMB 100 million yuan)

Items	2012	2013	2014	2015	2016
Money & Quasi-money (M_2)	974 148.8	1 106 525.0	1 228 374.8	1 392 278.1	1 550 067
Money (M_1)	308 673.0	337 291.1	348 056.4	400 953.4	486 557
Currency in Circulation (M_0)	54 659.8	58 574.4	60 259.5	63 217.6	68 304
Total Deposits with Financial Institutions	917 368.1	1 043 846.9	1 138 644.6	1 357 021.6	1 505 864
Household Deposits	399 546.9	447 601.6	485 261.3	526 281.8	569 149
Non-financial Enterprise Deposits	327 444.9	361 555.2	378 333.8	430 247.4	502 178
Total Lending by Financial Institutions	629 906.6	718 961.5	816 770.0	939 540.2	1 066 040

Source: The PBC.

Table 3 Selected Financial Indicators(2)

(Growth Rates)

(percent)

Items	2012	2013	2014	2015	2016
Money & Quasi-money (M_2)	13.80	13.59	12.16	13.34	11.33
Money (M_1)	6.49	9.27	3.19	15.20	21.35
Currency in Circulation (M_0)	7.71	7.16	2.88	4.91	8.05
Total Deposits with Financial Institutions	13.34	13.76	9.08	12.44	10.97
Household Deposits	16.27	12.03	8.41	8.45	8.15
Non-financial Enterprise Deposits	7.89	10.43	4.64	13.72	16.72
Total Lending by Financial Institutions	14.96	14.14	13.60	14.30	13.46

Note: Growth rates have been adjusted to reflect recent changes in statistical coverage.

Source: The PBC.

Table 4 International Liquidity

(USD million)

Items	2012	2013	2014	2015	2016
Total Reserves (minus gold)	3 325 440	3 833 291	3 853 760	3 341 006	3 026 557
Special Drawing Rights (SDRs)	11 366	11 184	10 456	10 282	9 681
IMF Reserve Position	2 485	792	286	362	6 359
Foreign Exchange	3 311 589	3 821 315	3 843 018	3 330 362	3 010 517
Gold (1 million ounces)	33.89	33.89	33.89	56.66	59.24
Gold (national valuation)	9 815	9 815	9 815	60 191	67 878
Foreign Liabilities of Other Depository Companies	157 509	294 789	409 995	199 865	182 683

Note: The gold by the end of 2016 is market value, which cannot be compared with data of previous years.

Source: The PBC.

Table 5 Gold and Foreign Exchange Reserves

Year	Gold Reserves (10 thousand ounces)	Foreign Exchange Reserves (USD 100 million)	Change in Foreign Exchange Reserves (percent)
1998	1 267	1 449.6	3.6
1999	1 267	1 546.8	6.7
2000	1 267	1 655.7	7.0
2001	1 608	2 121.7	28.1
2002	1 929	2 864.1	35.0
2003	1 929	4 032.5	40.8
2004	1 929	6 099.3	51.3
2005	1 929	8 188.7	34.3
2006	1 929	10 663.4	30.2
2007	1 929	15 282.5	43.3
2008	1 929	19 460.3	27.3
2009	3 389	23 991.5	23.3
2010	3 389	28 473.4	18.7
2011	3 389	31 811.5	10.7
2012	3 389	33 115.9	4.1
2013	3 389	38 213.2	15.4
2014	3 389	38 430.2	0.6
2015	5 666	33 303.6	-13.3
2016	5 924	30 105.2	-9.6

Source: The PBC.

Table 6 Assets of China's Financial Sector

(December 31, 2016)

(RMB trillion yuan)

Type of Financial Institutions	Assets
Financial Sector	286.22
Central Bank	34.37
Banking Financial Institutions	232.25
Securities and Futures Financial Institutions	4.48
Insurance Financial Institutions	15.12

Note: Assets of securities and futures financial institutions refer to assets of securities and futures companies, with assets of clients excluded.

Source: Calculated by the Financial Stability Analysis Group of PBC.

Table 7 Depository Corporations Survey in 2016

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Net Foreign Assets	271 902.51	270 808.24	268 410.62	263 947.53
Domestic Credits	1 425 206.59	1 496 112.44	1 544 356.39	1 600 067.21
Claims on Government(net)	105 297.31	128 867.58	146 868.01	162 351.58
Claims on Non-financial Sectors	1 089 233.25	1 118 050.46	1 139 687.61	1 166 092.58
Claims on other Financial Sectors	230 676.03	249 194.40	257 800.77	271 623.05
Money & Quasi-money	1 446 198.03	1 490 491.83	1 516 360.50	1 550 066.67
Money	411 581.31	443 643.70	454 340.25	486 557.24
Currency in Circulation	64 651.21	62 818.89	65 068.62	68 303.87
Corporate Demand Deposits	346 930.10	380 824.81	389 271.63	418 253.37
Quasi-money	1 034 616.71	1 046 848.13	1 062 020.26	1 063 509.43
Corporate Time Deposits	300 623.37	301 673.99	315 077.15	307 989.61
Personal Deposits	586 855.68	587 548.66	598 880.53	603 504.20
Other Deposits	147 137.66	157 625.48	148 062.57	152 015.62
Deposits Excluded from Broad Money	38 640.09	39 130.29	40 162.25	44 874.49
Bonds	172 910.91	181 274.72	191 976.93	201 110.89
Paid-in Capital	44 207.92	44 560.14	45 562.81	47 166.59
Other Items(net)	-4 847.84	11 463.70	18 704.51	20 796.11

Source: The PBC.

Table 8 Balance Sheet of the Monetary Authority in 2016

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter 1	Quarter 2	Quarter 2	Quarter 4
Foreign Assets	246 545.30	245 223.59	238 943.29	229 795.77
Foreign Exchange	238 365.77	236 307.53	229 108.68	219 425.26
Monetary Gold	2 416.61	2 487.73	2 530.43	2 541.50
Other Foreign Asstes	5 762.92	6 428.33	7 304.17	7 829.01
Claims on Government	15 312.73	15 274.09	15 274.09	15 274.09
Of Which: Central Government	15 312.73	15 274.09	15 274.09	15 274.09
Claims on Other Depository Corporations	44 158.16	57 566.49	61 905.21	84 739.02
Claims on Other Financial Corporations	6 654.59	6 657.69	6 657.69	6 324.41
Claims on Non-financial Sector	72.10	74.74	71.69	81.03
Other Assets	13 473.58	13 345.56	12 098.46	7 497.26
Total Assets	**326 216.46**	**338 142.16**	**334 950.43**	**343 711.59**
Reserve Money	283 376.58	289 070.82	290 706.67	308 979.61
Currency Issue	71 352.51	69 030.85	71 920.48	74 884.44
Deposits of Other Depository Corporations	212 024.07	220 039.97	218 786.19	234 095.17
Deposits of Financial Corporations Excluded from Reserve Money	3 909.69	4 759.53	5 712.91	6 485.03
Bond Issue	6 572.00	6 572.00	764.00	500.00
Foreign Liabilities	3 827.75	3 881.51	3 786.76	3 195.07
Deposits of Government	27 338.77	31 797.32	29 920.44	25 062.70
Own Capital	219.75	219.75	219.75	219.75
Other Liabilities	971.93	1 841.23	3 839.89	-730.58
Total Liabilities	**326 216.46**	**338 142.16**	**334 950.43**	**343 711.59**

Source: The PBC.

Table 9 Balance Sheet of Other Depository Corporations in 2016

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	41 063.46	42 585.43	46 034.22	50 019.57
Reserve Assets	221 686.94	230 116.56	230 545.77	246 447.18
Deposits with Central Bank	214 985.66	223 904.60	223 693.91	239 866.61
Cash in Vault	6 701.27	6 211.96	6 851.86	6 580.57
Claims on Government	117 323.34	145 390.81	161 514.36	172 140.19
Of Which: Central Government	117 323.34	145 390.81	161 514.36	172 140.19
Claims on Central Bank	6 160.88	5 695.55	677.21	525.23
Claims on Other Depository Corporations	300 636.14	304 319.78	304 521.91	315 878.20
Claims on Other Financial Institutions	224 021.44	242 536.71	251 143.08	265 298.63
Claims on Non-financial Institutions	809 470.17	821 461.39	825 631.79	836 467.90
Claims on Other Resident Sectors	279 690.98	296 514.34	313 984.13	329 543.65
Other Assets	75 906.17	81 626.14	82 685.66	87 435.13
Total Assets	**2 075 959.53**	**2 170 246.70**	**2 216 738.13**	**2 303 755.70**
Liabilities to Non-financial Institutions and Households	1 314 172.28	1 356 212.53	1 387 791.35	1 420 678.69
Deposits Included in Broad Money	1 234 409.16	1 270 047.46	1 303 229.32	1 329 747.18
Corporate Demand Deposits	346 930.10	380 824.81	389 271.63	418 253.37
Corporate Time Deposits	300 623.37	301 673.99	315 077.15	307 989.61
Personal Deposits	586 855.68	587 548.66	598 880.53	603 504.20
Deposits Excluded from Broad Money	38 640.09	39 130.29	40 162.25	44 874.49
Transferable Deposits	11 354.26	11 064.60	12 078.45	14 028.43
Other Deposits	27 285.83	28 065.68	28 083.80	30 846.06
Other Liabilities	41 123.03	47 034.79	44 399.78	46 057.02
Liabilities to Central Bank	46 855.28	60 246.77	64 388.36	87 879.65
Liabilities to Other Depository Corporations	123 721.19	131 786.23	135 593.43	144 836.81
Liabilities to Other Financial Corporations	150 575.65	160 883.66	151 793.89	157 274.92
Of Which: Deposits Included in Broad Money	147 137.66	157 625.48	148 062.57	152 015.62
Foreign Liabilities	11 878.50	13 119.28	12 780.13	12 672.74
Bond Issue	172 910.91	181 274.72	191 976.93	201 110.89
Paid-in Capital	43 988.16	44 340.39	45 343.06	46 946.84
Other Liabilities	211 857.56	222 383.11	227 070.99	232 355.17
Total Liabilities	**2 075 959.53**	**2 170 246.70**	**2 216 738.13**	**2 303 755.70**

Source: The PBC.

Table 10 Balance Sheet of Chinese-funded Large Banks in 2016

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	24 543.32	24 979.54	26 959.07	28 224.02
Reserve Assets	119 903.53	120 200.02	122 195.23	126 353.55
Deposits with Central Bank	116 271.21	116 829.35	118 345.62	122 710.30
Cash in Vault	3 632.32	3 370.67	3 849.61	3 643.25
Claims on Government	75 559.71	93 249.80	103 001.20	110 144.47
Of Which: Central Government	75 559.71	93 249.80	103 001.20	110 144.47
Claims on Central Bank	5 909.69	5 399.56	656.09	500.33
Claims on Other Depository Corporations	126 253.41	126 138.32	120 417.51	116 794.94
Claims on Other Financial Corporations	49 824.29	53 321.01	53 858.12	57 488.73
Claims on Non-financial Corporations	434 838.21	440 332.74	440 415.75	442 329.72
Claims on Other Resident Sectors	149 575.96	158 545.98	167 363.88	174 812.05
Other Assets	41 925.63	45 920.22	45 765.91	46 962.09
Total Assets	**1 028 333.76**	**1 068 087.18**	**1 080 632.77**	**1 103 609.89**
Liabilities to Non-financial Institutions and Households	705 597.47	720 161.04	735 166.88	741 531.74
Deposits Included in Broad Money	647 669.74	656 317.86	672 722.82	676 781.19
Corporate Demand Deposits	177 794.96	191 171.54	195 468.13	200 970.93
Corporate Time Deposits	116 977.00	115 272.39	119 485.99	116 787.73
Personal Deposits	352 897.78	349 873.93	357 768.69	359 022.53
Deposits Excluded from Broad Money	20 066.48	20 836.22	21 682.87	23 882.77
Transferable Deposits	5 423.26	5 054.20	5 845.97	6 599.10
Other Deposits	14 643.22	15 782.02	15 836.89	17 283.67
Other Liabilities	37 861.25	43 006.96	40 761.19	40 867.77
Liabilities to Central Bank	26 001.40	34 153.19	34 937.91	45 262.48
Liabilities to Other Depository Corporations	21 770.90	28 312.05	30 442.12	31 388.41
Liabilities to Other Financial Corporations	55 160.28	60 110.44	52 331.67	54 179.29
Of Which: Deposits Included in Broad Money	54 070.57	59 098.67	51 248.85	52 951.96
Foreign Liabilities	4 873.52	4 989.68	5 323.35	5 355.66
Bond Issue	83 055.29	84 580.01	86 122.53	86 961.85
Paid-in Capital	20 632.41	20 607.96	20 728.35	20 848.90
Other Liabilities	111 242.47	115 172.81	115 579.96	118 081.57
Total Liabilities	**1 028 333.76**	**1 068 087.18**	**1 080 632.77**	**1 103 609.89**

Source: The PBC.

Table 11 Balance Sheet of Chinese-funded Medium-Sized Banks in 2016

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	13 500.87	14 612.85	16 238.87	18 574.46
Reserve Assets	42 456.57	45 166.18	42 925.46	45 696.20
Deposits with Central Bank	41 857.76	44 604.43	42 335.72	45 057.01
Cash in Vault	598.81	561.75	589.73	639.19
Claims on Government	23 357.49	30 845.15	34 957.05	36 915.26
Of Which: Central Government	23 357.49	30 845.15	34 957.05	36 915.26
Claims on Central Bank	123.50	122.00	0.00	0.00
Claims on Other Depository Corporations	58 283.25	61 050.49	61 245.90	63 915.31
Claims on Other Financial Corporations	85 589.46	91 619.47	94 665.63	102 136.95
Claims on Non-financial Corporations	187 591.85	189 252.79	190 044.51	193 236.87
Claims on Other Resident Sectors	58 653.37	63 433.97	68 856.80	74 314.09
Other Assets	14 428.09	14 605.98	15 062.53	15 322.79
Total Assets	**483 984.46**	**510 708.89**	**523 996.76**	**550 111.94**
Liabilities to Non-financial Institutions and Households	232 868.14	242 547.90	244 358.86	252 664.32
Deposits Included in Broad Money	218 408.62	228 096.85	230 536.18	236 599.56
Corporate Demand Deposits	77 981.09	88 156.92	87 843.66	98 436.64
Corporate Time Deposits	94 126.18	93 008.15	96 923.79	92 885.37
Personal Deposits	46 301.35	46 931.78	45 768.73	45 277.54
Deposits Excluded from Broad Money	12 969.10	12 393.62	12 101.37	13 738.14
Transferable Deposits	3 535.18	3 575.24	3 608.20	4 117.50
Other Deposits	9 433.93	8 818.38	8 493.17	9 620.64
Other Liabilities	1 490.41	2 057.44	1 721.32	2 326.62
Liabilities to Central Bank	15 942.60	19 910.37	22 649.34	31 769.20
Liabilities to Other Depository Corporations	40 638.73	40 663.27	43 836.20	49 315.13
Liabilities to Other Financial Corporations	66 473.79	70 036.51	66 760.63	68 878.21
Of Which: Deposits Included in Broad Money	65 426.03	69 064.48	65 694.47	67 153.00
Foreign Liabilities	2 233.24	3 512.31	3 338.24	3 414.16
Bond Issue	71 672.30	76 485.08	84 017.56	86 078.68
Paid-in Capital	4 461.44	4 510.51	4 777.45	5 233.07
Other Liabilities	49 694.22	53 042.94	54 258.47	52 759.18
Total Liabilities	**483 984.46**	**510 708.89**	**523 996.76**	**550 111.94**

Source: The PBC.

Table 12 Balance Sheet of Chinese-funded Small Banks in 2016

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	782.49	641.32	663.52	881.87
Reserve Assets	44 807.21	49 063.53	49 425.39	55 723.96
Deposits with Central Bank	43 150.64	47 502.17	47 738.48	54 019.42
Cash in Vault	1 656.57	1 561.36	1 686.91	1 704.54
Claims on Government	15 451.85	17 978.61	20 423.32	21 708.61
Of Which: Central Government	15 451.85	17 978.61	20 423.32	21 708.61
Claims on Central Bank	40.76	34.88	18.62	24.91
Claims on Other Depository Corporations	70 508.52	72 426.75	77 337.16	87 447.57
Claims on Other Financial Corporations	80 541.70	89 455.44	94 026.01	97 708.86
Claims on Non-financial Corporations	138 423.45	143 308.43	147 682.66	152 228.48
Claims on Other Resident Sectors	49 218.90	52 604.49	56 499.06	60 018.72
Other Assets	13 664.47	14 714.08	15 793.95	16 889.78
Total Assets	**413 439.35**	**440 227.52**	**461 869.70**	**492 632.74**
Liabilities to Non-financial Institutions and Households	269 326.94	286 479.35	301 089.36	314 329.36
Deposits Included in Broad Money	266 068.56	283 048.26	297 389.66	309 906.22
Corporate Demand Deposits	64 668.66	72 837.57	77 206.31	84 609.36
Corporate Time Deposits	67 014.05	69 884.71	72 970.40	72 679.52
Personal Deposits	134 385.84	140 325.99	147 212.95	152 617.34
Deposits Excluded from Broad Money	2 155.35	2 169.40	2 327.06	2 645.86
Transferable Deposits	415.17	403.89	450.69	600.43
Other Deposits	1 740.18	1 765.52	1 876.36	2 045.43
Other Liabilities	1 103.03	1 261.68	1 372.65	1 777.28
Liabilities to Central Bank	3 914.57	4 962.56	5 555.64	9 510.22
Liabilities to Other Depository Corporations	47 312.07	49 313.76	48 425.40	52 388.42
Liabilities to Other Financial Corporations	26 727.80	28 573.45	30 872.69	32 396.67
Of Which: Deposits Included in Broad Money	25 877.10	27 840.47	29 766.04	30 625.89
Foreign Liabilities	839.80	671.48	717.78	641.85
Bond Issue	17 633.80	19 779.69	21 393.53	27 607.65
Paid-in Capital	11 039.49	11 418.27	11 955.40	12 659.34
Other Liabilities	36 644.89	39 028.97	41 859.89	43 099.22
Total Liabilities	**413 439.35**	**440 227.52**	**461 869.70**	**492 632.74**

Source: The PBC.

Table 13 Balance Sheet of Foreign-funded Banks in 2016

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	1 983.64	2 066.16	1 898.73	2 070.88
Reserve Assets	2 868.53	3 107.26	3 584.13	4 059.87
Deposits with Central Bank	2 858.75	3 098.44	3 575.12	4 051.10
Cash in Vault	9.78	8.83	9.01	8.77
Claims on Government	1 686.78	1 945.95	1 807.48	1 958.02
Of Which: Central Government	1 686.78	1 945.95	1 807.48	1 958.02
Claims on Central Bank	86.93	138.09	2.50	0.00
Claims on Other Depository Corporations	4 683.10	4 684.07	5 293.65	5 697.53
Claims on Other Financial Corporations	2 545.12	2 454.08	2 469.24	2 738.25
Claims on Non-financial Corporations	10 316.01	10 251.69	9 832.20	10 254.49
Claims on Other Resident Sectors	1 002.26	1 023.02	1 040.37	1 081.24
Other Assets	1 019.13	1 637.62	1 586.83	3 809.46
Total Assets	**26 191.50**	**27 307.94**	**27 515.13**	**31 669.73**
Liabilities to Non-financial Institutions and Households	13 683.79	14 452.25	15 130.53	17 153.13
Deposits Included in Broad Money	10 314.51	10 781.15	11 472.63	12 731.07
Corporate Demand Deposits	2 989.85	3 471.74	3 198.54	4 425.12
Corporate Time Deposits	5 922.42	5 955.17	6 946.54	6 995.68
Personal Deposits	1 402.24	1 354.24	1 327.56	1 310.28
Deposits Excluded from Broad Money	2 810.99	3 047.44	3 199.60	3 477.52
Transferable Deposits	1 529.20	1 591.72	1 645.17	1 844.67
Other Deposits	1 281.79	1 455.73	1 554.42	1 632.85
Other Liabilities	558.29	623.66	458.30	944.54
Liabilities to Central Bank	34.32	179.79	274.37	167.80
Liabilities to Other Depository Corporations	2 484.40	2 313.15	2 473.75	2 610.92
Liabilities to Other Financial Corporations	1 631.85	1 448.80	1 247.43	1 240.85
Of Which: Deposits Included in Broad Money	1 484.07	1 293.29	1 037.13	1 027.39
Foreign Liabilities	3 905.35	3 926.62	3 384.32	3 247.44
Bond Issue	317.93	201.97	196.84	183.79
Paid-in Capital	1 748.38	1 780.84	1 757.56	1 760.61
Other Liabilities	2 385.47	3 004.50	3 050.34	5 305.19
Total Liabilities	**26 191.50**	**27 307.94**	**27 515.13**	**31 669.73**

Source: The PBC.

Table 14 Balance Sheet of Rural Credit Cooperatives in 2016

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	3.32	3.55	3.70	3.62
Reserve Assets	9 698.17	10 519.59	10 111.04	11 574.25
Deposits with Central Bank	8 894.40	9 810.31	9 394.45	10 989.44
Cash in Vault	803.77	709.28	716.59	584.81
Claims on Government	1 206.75	1 294.38	1 255.31	1 349.51
Of Which: Central Government	1 206.75	1 294.38	1 255.31	1 349.51
Claims on Central Bank	0.00	0.00	0.00	0.00
Claims on Other Depository Corporations	27 002.57	25 247.97	24 680.08	22 290.18
Claims on Other Financial Corporations	2 983.64	3 248.11	3 152.79	2 642.19
Claims on Non-financial Corporations	21 914.37	20 786.55	19 760.80	19 471.16
Claims on Other Resident Sectors	20 485.44	20 089.21	19 305.78	18 258.74
Other Assets	4 558.53	4 450.33	4 211.50	4 160.20
Total Assets	**87 852.79**	**85 639.67**	**82 481.00**	**79 749.85**
Liabilities to Non-financial Institutions and Households	64 256.37	62 305.64	59 913.43	57 661.97
Deposits Included in Broad Money	64 150.12	62 224.64	59 830.29	57 525.89
Corporate Demand Deposits	9 619.33	10 336.09	10 548.71	10 124.47
Corporate Time Deposits	2 664.18	2 827.77	2 480.96	2 127.42
Personal Deposits	51 866.61	49 060.79	46 800.62	45 274.00
Deposits Excluded from Broad Money	5.61	4.74	4.84	5.88
Transferable Deposits	0.58	0.40	0.82	1.49
Other Deposits	5.03	4.34	4.02	4.40
Other Liabilities	100.64	76.25	78.30	130.21
Liabilities to Central Bank	844.43	916.49	828.56	984.43
Liabilities to Other Depository Corporations	10 928.46	10 452.41	9 886.10	8 609.40
Liabilities to Other Financial Corporations	449.55	575.02	445.60	435.60
Of Which: Deposits Included in Broad Money	177.46	232.17	216.54	147.43
Foreign Liabilities	0.09	0.18	0.14	0.02
Bond Issue	40.22	37.78	60.11	72.46
Paid-in Capital	2 373.20	2 224.86	2 128.64	2 145.82
Other Liabilities	8 960.48	9 127.29	9 218.42	9 840.14
Total Liabilities	**87 852.79**	**85 639.67**	**82 481.00**	**79 749.85**

Source: The PBC.

Table 15 Statistics of Securities Market

Year	2011	2012	2013	2014	2015	2016
Number of Domestic Listed Companies(A shares, B shares)	2 342	2 494	2 489	2 613	2 827	3 052
Number of Domestic Listed Foreign Investment Shares (B shares)	108	107	106	104	101	100
Number of Overseas Listed Companies(H shares)	171	179	182	205	231	241
Total Issued Shares (100 million shares)	36 095.52	38 395.00	40 569.08	43 610.13	49 997.26	55 820.50
of Which: Negotiable Shares (100 million shares)	28 850.26	31 339.60	36 744.16	39 104.28	44 026.44	48 206.26
Total Market Value of Shares (RMB 100 million yuan)	214 758.10	230 357.62	239 077.19	372 546.96	531 304.20	508 245.11
of Which: Negotiable Shares (RMB 100 million yuan)	164 921.30	181 658.26	199 579.54	315 624.31	417 925.40	393 266.27
Trading Volume of Shares（100 million shares)	33 957.55	32 881.06	48 372.67	73 754.61	171 039.46	94 201.17
Turnover of Shares(RMB 100 million yuan)	421 646.74	314 667.41	468 728.60	743 912.98	2 550 538.29	1 267 262.64
Shanghai Composite Index (close)	2 199.42	2 269.13	2 115.98	3 234.68	3 539.18	3 103.64
Shenzhen Composite Index (close)	866.65	881.17	1 057.67	1 415.19	2 308.91	1 969.11
Number of Investor Accounts (10 thoussand)	-	-	-	7 294.36	9 910.54	11 811.04
Average P/E Ratio						
Shanghai	13.40	12.30	10.99	15.99	17.63	18.03
Shenzhen	23.11	22.01	27.76	34.05	52.75	52.20
Average Turnover Rate (%)						
Shanghai	124.80	101.59	123.59	439.50	388.50	220.89
Shenzhen	340.49	297.85	389.11	635.81	946.04	539.68
Government Bond Issuance (RMB 100 million yuan)	17 100	16 154	20 230	21 747	59 408	91 086
Corporate Credit Bonds Issuance (RMB 100 million yuan)		37 365	36 784	51 516	67 205	82 242
Turnover of Outright Government Bond Purchase in the Inter-bank Market(RMB 100 million yuan)			58 152	58 797	99 296	126 130
Turnover of Government Bond Repo in the Inter-bank Market (RMB 100 million yuan)			591 766	839 347	1 589 806	1 757 356
Number of Securities Investment Funds	914	1 173	1 552	1 897	2 722	3 867
Total Net Asset Value of Securities Investment Funds(RMB 100 million yuan)	26 510.37	28 661.81	30 025.77	45 353.61	83 971.83	91 593.05
Turnover of Securities Investment Funds Listed on Exchanges（RMB 100 million yuan）	6 365.80	8 667.36	12 562.04	19 904.62	76 859.68	13 745.89
Trading Volume of Futures (10 thousand lots)	105 413.75	145 052.57	206 182.30	250 585.57	357 768.26	413 781.28
Turnover of Futures (RMB 100 million yuan)	1 375 162.44	1 711 269.35	2 674 662.02	2 919 882.26	5 530 159.69	1 956 339.00

Source: The PBC, the CSRC, Asset Management Association of China, China Central Depository &.Clearing Co., Ltd.

Table 16 Ratio of Stock Market Capitalization to GDP

(RMB 100 million yuan unless otherwise noted)

Year	GDP	Market Capitalization	Ratio of market captialization to GDP (percent)	GDP	Negotiable Market Capitalization	Ratio of negotiable market captialization to GDP (percent)
1999	89 677	26 471	29.52	89 677	8 214	9.16
2000	99 215	48 091	48.47	99 215	16 088	16.21
2001	109 655	43 522	39.69	109 655	14 463	13.19
2002	120 333	38 329	31.85	120 333	12 485	10.38
2003	135 823	42 458	31.26	135 823	13 179	9.70
2004	159 878	37 056	23.18	159 878	11 689	7.31
2005	183 868	32 430	17.64	183 868	10 631	5.78
2006	211 923	89 404	42.19	211 923	25 004	11.80
2007	249 530	327 141	131.10	249 530	93 064	37.30
2008	300 670	121 366	40.36	300 670	45 214	15.04
2009	335 353	243 939	72.74	335 353	151 259	45.10
2010	397 983	265 422	66.69	397 983	193 110	48.52
2011	471 564	214 758	45.54	471 564	164 921	34.97
2012	519 322	230 358	44.36	519 322	181 658	34.98
2013	568 845	239 077	42.03	568 845	199 580	35.09
2014	636 463	372 547	58.53	636 463	315 624	49.59
2015	676 708	531 304	78.51	676 708	417 925	61.76
2016	744 127	508 245	68.30	744 127	393 266	52.85

Source: The NBS, the CSRC.

Table 17 Ratio of Domestic Stock Financing to Bank Loan Increment

(RMB 100 million yuan unless otherwise noted)

Year	Domestic Stock Financing	Bank Loan Increment	Ratio (percent)
1999	897.39	10 846.36	8.27
2000	1 541.02	13 346.61	11.55
2001	1 182.13	12 439.41	9.50
2002	779.75	18 979.20	4.11
2003	823.10	27 702.30	2.97
2004	862.67	19 201.60	4.49
2005	338.13	16 492.60	2.05
2006	2 463.70	30 594.89	8.05
2007	7 722.99	36 405.60	21.21
2008	2 619.71	41 703.76	6.28
2009	3 894.53	96 290.18	4.04
2010	8 954.99	79 510.73	11.26
2011	5 073.07	68 751.14	7.38
2012	3 127.54	81 962.95	3.82
2013	3 457.52	93 326.01	3.70
2014	4 834.04	101 548.47	4.76
2015	8 295.14	117 007.11	7.09
2016	18 910.35	123 592.46	15.30

Note: Since 2008, the statistics of stock refinancing were divided into two items: asset injection and cash injection, and the former was not included in "Domestic Stock Financing" from then on.

Source: Calculated on the basis of data from the CSRC and the PBC.

Table 18 Statistics of Stock Market

Year		2010	2011	2012	2013	2014	2015	2016
Number of Domestic Listed Companies (A shares, B shares)		2 063	2 342	2 494	2 489	2 613	2 827	3 052
Of Which: ST Companies		153	137	96	57	43	52	66
Medium/Small-sized Companies		531	646	701	701	732	776	822
Growth Enterprise Board		153	281	355	355	406	492	570
Number of Domestic Listed Foreign Investment Shares (B shares)		108	108	107	106	104	101	100
Of Which: ST Companies				12		4	0	4
Total Issued Shares (100 million shares)		33 184.35	36 095.52	38 395.00	40 569.08	43 610.13	49 997.26	55 820.50
Of Which:Medium/Small-sized Companies		1 366.74	1 943.50	2 410.25	2 818.48	3 470.59	4 853.94	4 465.89
Growth Enterprise Board		175.06	399.53	600.89	761.56	1 077.26	1 840.45	2 630.61
Total Market Capitalization of Shares (RMB 100 million yuan)		265 422.59	214 758.10	230 357.62	239 077.19	372 546.96	531 304.20	508 245.11
Of Which:Medium/Small-sized Companies		35 364.61	27 429.32	28 804.03	37 163.74	51 058.20	103 950.47	98 113.97
Growth Enterprise Board		7 365.22	7 433.79	8 731.20	15 091.98	21 850.95	55 916.25	52 254.50
Market Capitalization of Negotiable Shares (RMB 100 million yuan)		193 110.41	164 921.30	181 658.26	199 579.54	315 624.31	417 925.40	393 266.27
Of Which: Medium/ Small-sized Companies		16 150.32	14 343.52	16 244.15	25 543.70	36 017.99	69 737.04	64 088.77
Growth Enterprise Board		2 005.64	2 504.08	3 335.29	8 218.83	13 072.90	32 078.68	30 536.90
Volume (100 million shares)	Total	42 151.99	33 957.55	32 881.06	48 372.67	73 754.61	171 039.50	94 201.17
	Daily Average	174.18	139.17	135.31	203.25	301.04	700.98	386.07
	Medium/Small-sized	4 055.35	3 729.74	5 075.85	8 245.92	11 313.54	25 409.94	20 578.14
	Growth Enterprise Board	400.53	761.69	1 478.14	3 035.83	4 035.31	9 938.88	9 509.90

(concluded)

Year		2010	2011	2012	2013	2014	2015	2016
Turnover (RMB 100 million yuan)	Total	545 633.54	421 649.72	314 667.41	468 728.60	743 912.98	2 550 538.29	1 267 262.64
	Daily Average	2 254.68	1 728.07	1 294.93	1 969.45	3 036.38	10 453.03	5 193.7
	Medium/Small-sized	85 832.42	69 026.48	61 891.45	100 224.00	152 166.56	497 556.18	344 164.94
	Growth Enterprise Board	15 717.88	18 879.15	23 304.64	51 182	78 041	285 353	216 832
Average Turnover Rate (%)	Shanghai	197.61	124.80	101.59	123.59	439.50	388.50	220.89
	Shenzhen	557.46	340.49	297.85	389.11	635.81	946.04	539.68
Average P/E Ratio	Shanghai	21.61	13.40	12.30	10.99	15.99	17.63	15.94
	Shenzhen	44.69	23.11	22.01	27.76	34.05	52.75	41.21
	Medium/Small-sized	56.93	28.26	25.42	34.07	41.06	68.06	50.35
	Growth Enterprise Board	78.53	37.62	32.01	55.21	64.51	109.01	73.21
Shanghai Composite Index	Open	3 289.75	2 825.33	2 212.00	2 289.51	2 112.13	3 258.63	3 536.59
	Highest	3 306.75	3 067.46	2 478.37	2 444.80	3 234.68	5 166.35	3 538.69
	Date	2010-1-11	2011-4-18	2012-2-27	2013-2-18	2014-12-31	2015-6-12	42 373
	Lowest	2 319.74	2 134.02	1 949.46	1 849.65	1 991.25	2 927.29	2 638.30
	Date	2010-7-2	2011-12-28	2012-12-4	2013-6-25	2014-1-20	2015-8-26	42 396
	Close	2 808.08	2 199.42	2 269.13	2 115.98	3 234.68	3 539.18	3 103.64
Shenzhen Composite Index	Open	1 207.33	1 298.60	871.93	887.36	1 055.88	1 419.44	2 304.48
	Highest	1 414.64	1 316.19	1 020.29	1 106.27	1 504.48	3 140.66	2 304.49
	Date	2010-11-11	2011-1-6	2012-3-14	2013-10-22	2014-12-16	2015-6-12	42 373
	Lowest	890.24	828.83	724.97	815.89	1 004.93	1 428.37	1 618.12
	Date	2010-7-2	2011-12-28	2012-12-4	2013-06.25	2014-4-29	2015-1-19	42 396
	Close	1 290.87	866.65	881.17	1 057.67	1 415.19	2 308.91	1 969.11

Sources: The CBRC,Shanghai Stock Exchange and Shenzhen Stock Exchange.

Table 19 Summary of China's Bond Issuance

(RMB 100 million yuan)

Year	Government Bonds			Financial Bonds			Corporate Credit Bonds		
	Issue	Redemption	Outstanding	Issue	Redemption	Outstanding	Issue	Redemption	Outstanding
1997	2 411.79	1 264.29	5 508.93				255.23	219.81	521.02
1998	3 808.77	2 060.86	7 765.70				147.89	105.25	676.93
1999	4 015.00	1 238.70	10 542.00				158.20	56.50	778.63
2000	4 657.00	2 179.00	13 020.00				83.00		861.63
2001	4 884.00	2 286.00	15 618.00				147.00		
2002	5 934.30	2 216.20	19 336.10				325.00		
2003	6 280.10	2 755.80	22 603.60				358.00		
2004	6 923.90	3 749.90	25 777.60				327.00		
2005	7 042.00	4 045.50	28 774.00				2 046.50	37.00	
2006	8 883.30	6 208.61	31 448.69				3 938.30	1 672.40	
2007	23 139.10	5 846.80	48 741.00				5 181.00	2 880.90	7 683.30
2008	8 558.20	7 531.40	49 767.80				8 723.40	3 277.84	13 250.62
2009	17 927.24	9 745.06	57 949.98				16 599.30	4 309.12	25 540.80
2010	19 778.30	10 043.38	67 684.90				16 094.45	5 099.23	36 318.15
2011	17 100.00	10 959.00	75 832.00	23 491.00	7 683.00	75 748.00	23 548.00	10 326.00	49 095.00
2012	16 154.00	9 464.00	82 522.00	26 202.00	8 588.00	93 362.00	37 365.00	8 750.00	77 710.00
2013	20 230	8 996	95 471	26 310	13 306	105 772	36 784	18 673	93 242
2014	21 747	10 365	107 275	36 552	19 345	125 489	51 516	27 388	116 214
2015	59 408	12 803	154 524	102 095	53 852	184 596	67 205	39 757	144 329
2016	91 086	19 709	225 734	52 421	28 232	173 738	82 242	61 139	175 180

Notes:①"Financial Bonds" are bonds issued by financial insitutions, including financial bonds issued by CDB; policy financial bonds; common bonds, subordinated bonds and hybrid bonds issued by commercial banks; asset-backed securities; bonds and short-term financing bills issued by securities companies; and financial bonds issued by asset management companies.

②Due to statistical method adjustment, since 2012, the item "Enterprise bonds" is replaced by "Corporate credit bonds", including debt financing instruments of non-financial enterprises, enterprise bonds, corporate bonds, convertible bonds, bonds with detachable warrants, and SME private-funded bonds.

Source: The PBC.

Table 20 Statistics of China's Insurance Sector

(RMB 100 million yuan unless otherwise noted)

Items	2010	Growth (y-o-y) (percent)	2011	Growth (y-o-y) (percent)	2012	Growth (y-o-y) (percent)	2013	Growth (y-o-y) (percent)	2014	Growth (y-o-y) (percent)	2015	Growth (y-o-y) (percent)	2016	Growth (y-o-y) (percent)
Premium Income	14 527.97	30.44	14 339.25	—	15 487.93	8.01	17 222.24	11.20	20 234.81	17.49	24 282.52	20.00	30 959.10	27.50
1.Property Insurance	3 895.64	35.46	4 617.82	18.54	5 330.93	15.44	6 212.26	16.53	7 203.38	15.95	7 994.97	10.99	8 724.50	9.12
2.Personal Accident Insurance	275.35	19.69	334.12	—	386.18	15.58	461.34	19.46	542.57	17.61	635.56	17.14	749.89	17.99
3.Health Insurance	677.47	18.03	691.72	—	862.76	24.73	1 123.50	30.22	1 587.18	41.27	2 410.47	51.87	4 042.50	67.71
4.Life Insurance	9 679.51	29.80	8 695.59	—	8 908.06	2.44	9 425.14	5.80	10 901.69	15.67	13 241.52	21.46	17 442.22	31.72
Claims and Payments	3 200.43	2.40	3 929.37	22.78	4 716.32	20.03	6 212.90	31.73	7 216.21	16.15	8 674.14	20.20	10 512.89	21.20
1.Property Insurance	1 756.03	11.44	2 186.93	24.54	2 816.33	28.78	3 439.14	22.11	3 788.21	10.15	4 194.17	10.72	4 726.18	12.68
2.Personal Accident Insurance	71.39	11.69	81.84	14.64	96.80	18.28	109.51	13.12	128.42	17.27	151.84	18.24	183.01	20.53
3.Health Insurance	264.02	21.65	359.67	36.23	298.17	(17.10)	411.13	37.88	571.16	38.92	762.97	33.58	1 000.75	31.17
4.Life Insurance	1 108.99	(12.59)	1 300.93	17.31	1 505.01	15.69	2 253.13	49.71	2 728.43	21.09	3 565.17	30.67	4 602.95	29.11
Operating Expenses	1 538.35	24.66	1 882.38	22.36	2 171.46	15.36	2 459.59	13.27	2 795.79	13.67	3 336.72	19.35	3 895.52	16.75
Bank Deposits	13 909.97	32.23	17 737.17	27.51	23 446.00	32.19	22 640.98	(3.43)	25 233.44	11.45	24 349.67	(3.50)	24 844.21	2.03
Investment	32 136.65	19.48	37 736.67	17.43	45 096.58	19.50	54 232.43	20.26	66 997.41	23.54	87 445.81	30.52	109 066.46	24.72
Of Which: Government Bonds	4 815.78	18.80	4 742.40	(1.52)	4 795.02	1.11	4 776.73	(0.38)	5 009.88	4.88	5 831.12	16.39	7 796.24	33.70
Securities Investment Funds	2 620.73	(5.00)	2 915.86	11.26	3 625.58	24.34	3 575.52	(1.38)	4 714.28	31.85	8 856.50	87.87	8 554.46	-3.41
Total Assets	50 481.61	24.23	60 138.10	19.13	73 545.73	22.29	82 886.95	12.70	101 591.47	22.57	123 597.76	21.66	151 169.16	22.31

Notes: ①Since 2011, the calculation of premium income has been adjusted according to the *Interpretation No.2 of Corporate Accounting Standards* circulated by the Ministry of Finance. As a result, data of premium income since 2011 are incomparable with those in previous years.

②Data of premium income, claims and payments and operating expenses are data for the year.

③Data of bank deposits, investment and total assets are data of the year-end balance.

Source: Calculated based on data from CIRC Website.

Table 21 The Structure of Non-life Insurance Premium Income

(RMB 100 million yuan unless otherwise noted)

Insurance Lines	2012	Proportion (percent)	2013	Proportion (percent)	2014	Proportion (percent)	2015	Proportion (percent)	2016	Proportion (percent)
Automobile Insurance	4 005.17	72.43	4 720.79	72.84	5 515.93	73.11	6 198.96	73.59	6 834.55	73.76
Enterprise Property Insurance	360.36	6.52	378.80	5.84	387.35	5.13	386.16	4.58	381.54	4.12
Cargo Transportation Insurance	101.71	1.84	102.94	1.59	95.44	1.27	88.16	1.05	85.46	0.92
Accident Insurance	126.54	2.29	150.93	2.33	171.93	2.28	199.95	2.37	247.69	2.67
Liability Insurance	183.77	3.32	216.63	3.34	253.30	3.36	301.85	3.58	362.35	3.91
Others	752.33	13.60	911.07	14.06	1 120.45	14.85	1 248.18	14.82	1 354.60	14.62
Total	5 529.88	100.00	6 481.16	100.00	7 544.40	100.00	8 423.26	100.00	9 266.17	100.00

Source: The CIRC.

Table 22 The Structure of Life Insurance Premium Income

(RMB 100 million yuan unless otherwise noted)

Insurance Lines	2012	Proportion (percent)	2013	Proportion (percent)	2014	Proportion (percent)	2015	Proportion (percent)	2016	Proportion (percent)
Life Insurance	8 907.90	89.46	9 424.99	87.75	10 901.57	85.90	13 241.40	83.49	17 442.09	80.40
Of Which: Common Life Insurance	969.65	9.74	1 200.27	11.17	4 296.49	33.86	6 728.14	42.42	10 451.65	48.18
Participating Insurance	7 854.29	78.88	8 132.81	75.72	6 508.75	51.29	6 413.19	40.44	6 879.77	31.71
Unit-linked Insurance	4.35	0.04	4.42	0.04	4.42	0.03	4.18	0.03	3.85	0.02
Accident Insurance	259.64	2.61	310.41	2.89	370.63	2.92	435.61	2.75	502.20	2.32
Health Insurance	790.35	7.94	1 005.52	9.36	1 418.09	11.17	2 182.13	13.76	3 748.51	17.28
Total	9 957.89	100.00	10 740.93	100.00	12 690.28	100.00	15 859.13	100.00	21 692.81	100.00

Source: The CIRC.

Table 23 Insurance Premium Income of China's Different Regions in 2016

(RMB 100 million yuan)

Regions	Insurance Premium Income	Property Insurance	Life Insurance	Accident Insurance	Health Insurance
Total	30 959.10	8 724.50	17 442.22	749.89	4 042.50
Guangdong	2 986.06	708.13	1 612.01	77.52	588.40
Jiangsu	2 690.25	733.43	1 506.96	61.32	388.53
Shandong	1 966.29	520.33	1 157.01	37.64	251.32
Beijing	1 838.96	369.25	1 101.62	44.91	323.18
Sichuan	1 712.08	457.21	991.30	37.81	225.75
Henan	1 555.15	372.95	1 003.37	27.73	151.10
Shanghai	1 529.26	371.15	913.25	53.09	191.77
Zhejiang	1 527.32	569.35	713.95	45.87	198.16
Hebei	1 495.27	442.13	888.04	25.62	139.47
Hubei	1 051.77	263.22	630.01	30.13	128.41
Hunan	886.46	273.05	495.76	22.26	95.39
Anhui	876.10	312.79	440.36	16.66	106.28
Liaoning	838.36	221.76	499.79	13.02	103.78
Shenzhen	834.45	237.40	426.10	35.50	135.45
Fujian	755.00	211.13	410.67	20.22	112.98
Shaanxi	714.74	191.38	440.02	15.25	68.08
Shanxi	700.55	174.15	455.33	11.17	59.90
Heilongjiang	685.52	148.90	413.60	12.32	110.71
Jiangxi	608.71	183.65	347.96	11.82	65.28
Chongqing	601.61	165.23	335.25	17.65	83.48
Jilin	557.12	133.23	370.61	7.46	45.81
Tianjin	529.49	127.56	349.56	7.67	44.70
Yunnan	529.37	224.43	218.63	18.51	67.80
Inner Mongolia	486.87	162.73	263.00	9.29	51.85
Guangxi	469.17	165.71	238.59	16.96	47.91
Xinjiang	439.90	153.38	214.75	14.18	57.59
Qingdao	335.90	105.96	178.13	6.67	45.13
Guizhou	321.28	153.15	128.79	11.50	27.84
Gansu	307.66	100.61	167.90	10.10	29.04
Dalian	277.32	73.06	175.41	5.11	23.75
Ningbo	257.56	127.22	108.74	6.29	15.31
Xiamen	162.60	63.17	76.52	5.46	17.43
Ningxia	133.90	46.09	68.23	3.52	16.06
Hainan	133.21	47.60	68.18	3.44	13.99
Qinghai	68.73	29.64	28.84	2.03	8.21
Tibet	22.25	13.90	3.84	2.31	2.20
Group and Head Office Level	72.91	70.47	0.13	1.88	0.44

Note: Data of "Group and Head Office Level" refers to the premium income earned by the group and head office, which are not reflected in any region's data.

Source: The CIRC.

Table 24 Transactions of Payment Systems

(10 thousand transactions/RMB 100 million yuan)

Items/Year	2012		2013		2014		2015		2016	
	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value
HVPS	47 035.96	17 719 972.13	59 548.66	20 607 617.10	71 256.49	23 468 933.87	78 883.86	29 520 565.22	82 566.97	36 162 984.12
BEPS	75 393.50	185 477.54	104 027.48	203 154.11	143 580.15	220 751.23	183 526.95	249 402.68	234 830.13	309 131.24
IBPS	26 580.35	35 630.14	71 784.34	94 684.65	163 914.52	177 893.21	296 555.07	277 563.81	445 314.80	374 610.10
ACH	39 135.21	665 182.46	41 871.79	682 892.87	38 381.54	632 193.30	39 515.72	1 243 363.80	37 246.57	1 308 049.55
CDFCPS	111.05	33 614.79	139.44	44 294.86	191.13	52 809.80	207.88	57 002.02	198.58	54 732.23
Intra-bank Payment Systems of Banking Institutions	895 492.15	6 245 593.61	1 075 915.50	7 452 224.44	1 431 813.80	8 962 797.55	1 970 775.51	11 940 122.11	2 583 027.85	12 154 693.66
UnionPay Bankcard Interbank Clearing System	1 248 897.88	217 631.82	1 513 946.08	322 972.28	1 867 366.07	411 097.10	2 066 757.44	492 752.74	2 376 180.09	670 694.00

Note: HVPS (High Value Payment System), BEPS (Bulk Electronic Payment System), IBPS (Internet Banking Payment System), ACH (Automatic Clearing Houses), CDFCPS (China Domestic Foreign Currency Payment System)

Source: The PBC.

责任编辑：董　飞
责任校对：李俊英
责任印制：

图书在版编目（CIP）数据

中国金融稳定报告（Zhongguo Jinrong Wending Baogao）2017：英文/中国人民银行金融稳定分析小组编. —北京：中国金融出版社，2017.10
ISBN 978－7－5049－9213－0

Ⅰ.①中…　Ⅱ.①中…　Ⅲ.①金融市场—研究报告—中国—2017—英文　Ⅳ.①F832.5

中国版本图书馆CIP数据核字（2017）第234971号

出版
发行 中国金融出版社
社址　北京市丰台区益泽路2号
市场开发部　（010）63266347，63805472，63439533（传真）
网 上 书 店　http://www.chinafph.com
（010）63286832，63365686（传真）
读者服务部　（010）66070833，62568380
邮编　100071
经销　新华书店
印刷　北京市松源印刷有限公司
装订　平阳装订厂
尺寸　210毫米×285毫米
印张
字数　　千
版次　2017年　月第1版
印次　2017年　月第1次印刷
定价　00.00元
ISBN 978－7－5049－　　－
如出现印装错误本社负责调换　联系电话（010）63263947