Statement for the Record
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Hearing on
"Increasing Market Access for U.S. Financial Firms in China: Update on Progress of the Strategic & Economic Dialogue"

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Chairman Miller, Ranking Member McCarthy, and Members of the Subcommittee, I thank you for the opportunity to testify today on behalf of the Securities Industry and Financial Markets Association (SIFMA) on the importance of improved market access opportunities for financial services firms operating in China.[1] With the conclusion of the most recent Strategic and Economic Dialogue (S&ED), this hearing is especially timely and provides us with an opportunity to assess the progress made in recent years as well as areas that need continued attention and reform.

Our testimony will review the industry's priorities that we believe are necessary to allow our firms to compete on a level playing field, assess the significance of commitments made at the most recent S&EDs, and discuss the growth and global expansion of China's largest financial services firms and the implications for creating a level playing field.

We would also like to take this opportunity to reiterate our support for the S&ED and the efforts of Treasury Secretary Geithner, Under Secretary Brainard and their Treasury colleagues, Ambassador Locke, and the Administration. This year's S&ED yielded important commitments from which to build from, including raising equity ownership on securities joint ventures from 33 percent to 49 percent, reducing the "seasoning period" from five years to two, increasing

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

Qualified Foreign Institutional Investor (QFII) quotas to $80 billion, and calling for renewed dialogue on a bilateral investment treaty (BIT).

We believe the S&ED remains the primary forum in which to discuss financial services issues on a bilateral basis and feel ongoing dialogue and engagement is vital for pushing forward further liberalization of China's financial markets.

SIFMA has long supported more open, fair and transparent markets, and liberalization of the national treatment of financial services in U.S. multilateral and bilateral trade forums. The economic benefits of financial services sector liberalization reverberate throughout the world in the form of higher growth, foreign investment and capital formation. Specifically, such liberalization leads to new entrants, innovative products and services, and capital markets with greater depth and efficiency.

In the global economy, openness and fairness are essential to ensuring that markets operate efficiently so that capital can move seamlessly across borders and investors can easily and quickly buy and sell securities anywhere, while businesses can access capital at the lowest cost.

Industry Priorities

Despite recent progress towards increasing ownership stakes in securities joint ventures, full market access and national treatment for financial services firms in China remains an industry priority. While U.S. firms operating in China continue to face equity ownership restrictions, Chinese securities firms seeking to operate in the United States are able to enter without restriction on a nondiscriminatory and national treatment basis if they meet regulatory requirements. U.S. firms seeking to enter China continue to face discriminatory entry criteria and do not receive national treatment.

SIFMA has identified five key and inter-connected industry priorities to help ensure a more level playing field for our members currently in China.

- *Permit 100% ownership and right to establish in corporate form of choice*
  Establishing and developing relationships are essential to providing financial services. While the U.S. is the global leader in the export of financial services, a business presence in the host country is often the best, or indeed the only, effective way for firms to provide their products and services competitively. Furthermore, given that most countries do not permit the cross-border provision of financial services and products, the right to establish takes on particular importance. The right to enter a market and establish a 100 percent owned presence in a firm's corporate form of choice is commonplace in today's global markets.

- *Allow same scope of business*
  Foreign minority-owned joint ventures are limited to *underwriting* the A shares of Chinese corporations, and to underwriting and trading government debt, corporate debt, B shares and H shares. Additionally, the fundamental right to *trade* A shares, the most liquid domestic market, was not conferred on these foreign joint ventures, which compromises their underwriting business. Foreign entities are also restricted in many cases from trading renminbi and renminbi-linked products with foreign and domestic enterprises in China. Without the ability to trade renminbi, any progress otherwise made in expanding the permitted activities of foreign securities firms will be difficult to realize competitively.

- *Further develop QFII/QDII programs*
  Enacted in December of 2002, the Qualified Foreign Institutional Investor (QFII) Act permits qualified foreign institutional investors to invest in the securities of Chinese companies. Since the start of the Strategic & Economic Dialogue (SED) commitments, China has raised the quota for QFIIs from $10 billion to $80 billion and agreed to reduce the initial "lock-up" period for investments of certain QFIIs from one year to three months.[2] QFII requirements remain onerous with the effect of substantially limiting the utility of the program as well as the universe of investors that can take advantage of it.

  China's Qualified Domestic Institutional Investor (QDII) program, initiated in May of 2006, allows approved financial institutions in China to make overseas portfolio investments in foreign currencies, both for themselves and on behalf of clients. The program has been slow to gather momentum, due to limited knowledge of the program, a lack of understanding on the part of potential investors regarding overseas investing, and comparatively low returns associated with the original permitted investments.

- *Improve bond market depth/liquidity/efficiency*
  China is striving to expand its domestic bond and capital markets on a par with global leaders. Great strides and significant progress has been made toward the goals of modernization and the attainment of global best practices. However, China's advancement continues to be hindered by discriminatory rules and policies which disadvantage foreign banks, especially with respect to bond underwriting and derivatives trading. In addition, if China's sometimes opaque regulatory system is not reformed it will seriously impede the future development of the financial markets.

[2] Since the inception of the QFII program in 2002, China has raised the quota from $10 billion to $80 billion.

- *Promote regulatory transparency*

  Transparent and fair regulatory systems play an integral role in the development of deep and liquid capital markets that attract market participants, increase efficiency and spur economic growth and job creation. Lack of transparency in the implementation of laws and regulations can seriously impede the ability of securities firms to compete fairly. On the other hand, transparency instills the confidence needed to attract both the suppliers and users of capital to make the best use of the markets. Securities firms are often confronted with non-tariff barriers in the form of regulatory restrictions, and lack of transparency in the implementation and application of regulations. These barriers prevent access in much the same way as tariffs, but unlike tariffs, no quantitative mechanism exists to reduce them.

Recent S&ED Commitments and Results

We believe the S&ED plays a key role in advancing the U.S.-China economic relationship. The S&ED provides the best forum for constructive, high-level engagement on priority issues, including financial services market access. Since the SED was established in 2006, our priorities have not waivered. SIFMA has consistently urged both the Bush and Obama Administrations to engage in a results-oriented discussion that leads to the reduction and elimination of barriers that continue to obstruct global financial services firms in China.

Timing is critical. While the U.S. continues to advocate for improved market access and the reduction of regulatory barriers, China has increased its global profile considerably. China's financial institutions are more globally active, and Chinese authorities are full participants in the G20, the Financial Stability Board, and the International Organization of Securities Commission's (IOSCO) Technical Committee. As China assumes a greater leadership role in international institutions, it necessitates a responsibility to reduce restrictions and eliminate discriminatory barriers in order to meet these global commitments and responsibilities. However, metrics developed by the World Bank and Organization for Economic Cooperation and Development (OECD) rank China as one of the most restrictive markets for financial services in the G20. Indeed, China's policies related to inward investment in financial services are more restrictive than other BRIC nations by a significant margin.

As we stated previously, this year's S&ED yielded commitments from China to allow our member companies an increased opportunity to conduct business in China on a more level playing field. We would like to briefly highlight the most notable outcomes from the dialogue.

- *Increased equity caps from 33 percent to 49 percent for securities JVs*

  The S&ED commitments allow non-Chinese financial services firms to hold up to a 49 percent equity stake in securities joint ventures. China also agreed to allow investors from the U.S. and other economies to establish joint venture brokerages

to trade commodity and financial futures and hold up to 49 percent of the equity in those joint ventures.

How this commitment is implemented is key. Despite this progress, we remain concerned that some incoming joint ventures will remain at a competitive disadvantage relative to existing participants. We are also concerned by the absence of or non-transparent actions taken by the China Securities Regulatory Commission (CSRC) in enforcement in this regard.

Importantly, the development of securities joint ventures will rely in part on the integrity of a rule of law. Until the current risks associated with a regulatory regime and/or existing dispute resolution systems are mitigated or remediated, the foreign parties may be at a disadvantage as compared to domestic participants.

Recommendation: China should put in place a precise and transparent roadmap, on an agreed upon timetable, that would result in providing foreign securities firms with the right to own 100 percent of a Chinese financial services firm and the ability to engage in a full range of securities activities. We outline in further detail a proposed timeline for implementation below that helps to guide a transition.

- *Reduction of the "seasoning period" to 2 years*
  The Chinese agreed to allow qualified securities joint ventures which have been in on-going operation for no less than two years to apply to expand into brokerage, fund management, and trading activities that are essential to building competitive securities businesses. This period was reduced from five years.

  Recommendation: While we appreciate the reduction in the seasoning period, we believe it should be eliminated entirely. Continuing to tightly regulate the expansion and activity of joint ventures impedes the capability and operations of financial services institutions operating in China.

- *Increased QFII quotas*
  China agreed to increase the total quota for Qualified Foreign Institutional Investors (QFII) to $80 billion from $30 billion.[3]

  Recommendation: While we welcome this step, QFII quotas should be lifted completely to allow for the free flow of capital to and from Chinese capital markets. Continued, progressive liberalization, done in consultation with foreign and domestic capital markets participants, would almost certainly result in greater

[3] This number reflects only the 2012 S&ED commitment to raise QFII quota restrictions.

foreign investment in China's securities markets, adding to the depth and breadth of trading in those markets and result in increased capital available to Chinese issuers.

- *Commitment to continue BIT discussions*
  The United States and China commit to schedule a seventh and subsequent BIT negotiating rounds, and to intensify negotiations.

  Recommendation: Develop a high standard and commercially meaningful U.S.-China BIT which would improve access to China's market and reduce and eliminate measures that either discriminate against U.S. investors or deny them market access. A high standard BIT – one that SIFMA would strongly support – would guarantee, at a minimum, national treatment and "most favored nation" treatment, pre- and post-establishment of an investment, fair and equitable treatment, full protection and security, regulatory transparency, the free transfer of capital, protection against uncompensated expropriations, and availability of a rigorous and objective investor-state arbitration mechanism for enforcing those obligations.

A Level Playing Field

Despite the commitments made through the S&ED, more work needs to be done to ensure U.S. financial services firms are able to operate on a level playing field in China. While U.S. financial services firms operating face significant hurdles, Chinese financial institutions are expanding globally with operations in most major Western financial centers. Illustrative of this growth - four of the ten largest global financial institutions, including three of the top five, are headquartered in China.

Chinese financial services institutions are also expanding into the U.S. market. The Federal Reserve recently approved applications by three Chinese banks, most notably the Industrial & Commercial Bank of China (ICBC), to expand operations in the U.S. Last year, the Federal Reserve also approved a branch application from the Bank of Communications to establish operations in California.[4] It has also been widely reported that China's largest brokerage firm, CITIC Securities, is planning to enter the U.S. market.[5] As stated previously, Chinese firms seeking to do business face no restrictions on the size or scope of their operations and must only meet the prudential requirements established by U.S. regulators.

As China's largest financial institutions are developing a presence abroad, China is also working to develop platforms to allow it to better compete in the global financial markets. The Shanghai

[4] U.S. Federal Reserve Announcement, April 8, 2011. http://1.usa.gov/wJegBr

[5] Wall Street Journal, *China's Citic Planning Push Into U.S. Market*, February 14, 2012. http://on.wsj.com/Ajejde

Stock Exchange Strategic Plan, introduced in 2010, aims to develop the Exchange into "one of the most influential bourses in the world, boasting a mature stock market, an improved bond market, a highly developed fund market, an abundance of securities derivatives and an increasingly rational investor structure."[6] Without a more open financial system, China will be unable to attract sufficient foreign investment to achieve these goals.

Conclusion and Recommendations

The S&ED joint statements states that "China is committed to transforming its economic development pattern, improving the livelihood of its people and actively expanding domestic demand, with increasing consumption as a strategic priority in expanding domestic demand." The most reliable and expedient way for China to meet its massive capital demand is to access the larger pools of capital available in the global markets.

Our member firms can contribute to the development of China's financial markets by sharing their expertise on the infrastructure needed to effectively serve a sophisticated and globally oriented client base. Sophisticated financial institutions can also provide new financial products and services that meet the changing needs of Chinese investors, demonstrate the benefits of high corporate governance standards, and consult on legal issues that must be addressed to help domestic equity and capital markets flourish. Ultimately, the modernization of China's financial system, especially its capital markets, will benefit both the U.S. and global economies.

We look forward to working with the Committee, Congress, and the Administration to further expand the U.S. securities industry's access to China through the use of bilateral and multilateral trade forums.

Consequently, we believe the Committee has a central role to ensure the timely implementation of China's current S&ED commitments while at the same time pursuing a level playing field for U.S. firms.

To ensure we meet these goals, we offer two recommendations: first, an annual report to Congress demonstrating China's implementation of commitments agreed to at each S&ED; and second, increasing the frequency of the economic portion of the dialogue to twice per year as was done during the original SED.

We appreciate the Committee's interest in this issue, and the opportunity to testify today.

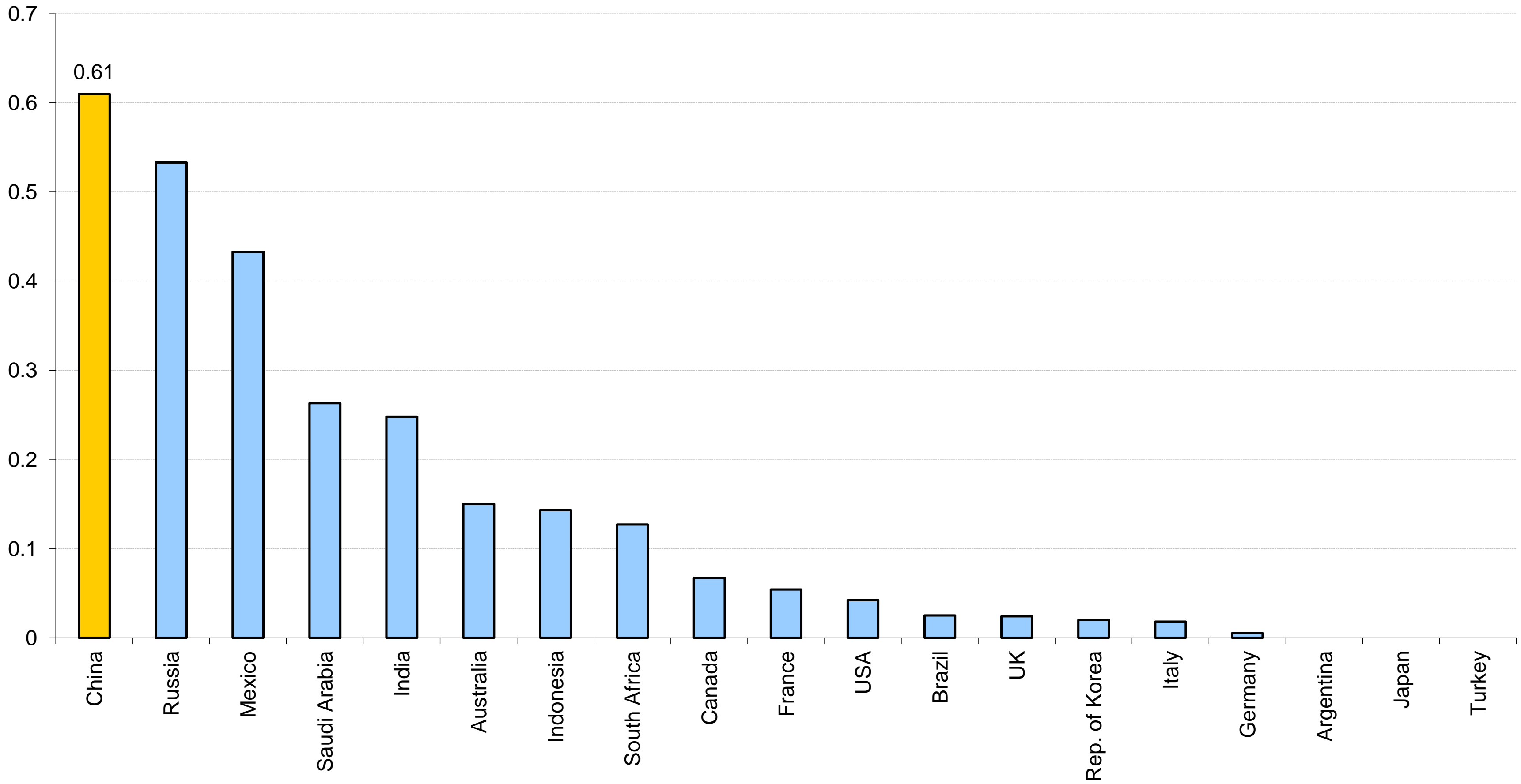
Thank you.

[6] Shanghai Stock Exchange, December 13, 2010, http://bit.ly/zs13AC, Accessed March 1, 2012.

Annex 1: Timetable for Implementation

Period 1	Period 2	Period 3	Period 4
6/30/2012 - 12/31/12	1/1/13 – TBD2	TBD3 - TBD3	Can begin anytime during TBD3
Develop transparent licensing procedures	Permit increase in ownership towards 100%	Transitional individual firm cap removed permanently	If at any time industry reaches or exceeds ZZ% in Period 3, China has an option to impose a cap after three years or 2020; after transition period is over
Permit and approve 33% jv licenses, consistent with GATs/SED commitments	Firms permitted XX% increase in transitional individual firm cap	Industry can grow up to ZZ%; if the industry does not reach or exceed ZZ% during Period 3, aggregate cap is permanently lifted	No more aggregate caps at the end of Period 3
Increase ownership to 49% by end of 2012	XX% industry aggregate share in [beginning of period], growing to YY% by the end of 2020, on a pro rata basis Allow full range of securities		

Annex 2: Restrictiveness in Financial Markets



Note: Restrictiveness measures are taken from a recent study by the OECD (2010 Update) to identify the level of regulatory restrictions on foreign direct investment with 1 being a closed market and 0 being an open market. We present each nations aggregate score and its score in the financial sector (Banking and Insurance).