Start of Chinese Experiment in Financial Deregulation

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I. Introduction

On 27 December 2012 the Shenzhen central sub-branch of the People's Bank of China ("PBOC") announced that it had agreed to the promulgation and implementation of *Interim Measures for the Administration of Qianhai Cross-Border Renminbi Loans* ("Interim Measures")[1]. This was followed, on 5 January 2013, by the PBOC's promulgation and implementation of *Detailed Rules for the Implementation of the Interim Measures for the Administration of Qianhai Cross-Border Renminbi Loans* ("Detailed Rules").

These two measures mark the start of an experiment in financial deregulation in Qianhai, part of the Shenzhen Special Economic Zone that is adjacent to Hong Kong and has been a model for economic growth in China since the country introduced market-oriented reforms in 1978. This paper takes a closer look at the background to the start of cross-border renminbi loans in Qianhai and considers its significance and prospects.

II. Establishment of Qianhai Shenzhen–Hong Kong Modern Service Industry Cooperation Zone

1. Role and limits of Shenzhen as special economic zone

At the center of the market-oriented reforms introduced by the Chinese government in 1978 was the creation of special economic zones. In 1980 four cities in the south of the country were designated special economic zones (Shenzhen, Zhuhai and Shantou in Guangdong Province, and Amoy in Fujian Province); foreign-invested companies were established; and the decision was taken to grant preferential treatment (e.g., of taxes, finance, land and wages). Shenzhen, which is next door to Hong Kong, played a particularly important role as an export-processing center in the early years by attracting companies from Hong Kong and absorbing young workers from China's

1 http://shenzhen.pbc.gov.cn/publish/shenzhen/1320/2012/20121227180958588120755/20121227180958588120755_.html

inland provinces. In the course of time, companies from not only Hong Kong but also Taiwan, Japan and the rest of the world established operations in Shenzhen.

Later (for example, after the Shenzhen Stock Exchange was established in 1990 and China's then leader, the late Deng Xiaoping, toured the south of the country, making a famous speech, in 1992), Shenzhen became a symbol of China's market-oriented reforms.

Boosted by preferential treatment and fueled by low-cost raw materials and labor, Shenzhen's development model (namely, that of economic growth led by exports) encouraged exports and accorded with the central government's policy of earning the hard currency China needed to finance the development of its domestic economy. However, when China joined the World Trade Organization in 2001 and removed trade barriers throughout the country, Shenzhen began to lose some of the unchallenged dominance it had enjoyed as a result of this preferential treatment and to move to a different (service-based) development model. Moreover, when the global financial crisis hit in 2008 and China found itself obliged to switch from its existing (export/investment-based) development model to a domestic demand/consumption-based model, Shenzhen also found itself obliged to find a new development model.

2. Need to align itself with Hong Kong

In this process, Shenzhen has aligned itself more closely with Hong Kong, and its economy has become increasingly service-based.

1) Framework Agreement on Hong Kong/Guangdong Cooperation

First, on 7 April 2010, in the presence of China's then vice-president, Xi Jinping, Guangdong and Hong Kong signed a *Framework Agreement on Hong Kong/Guangdong Cooperation*. The aim of the agreement, which was modeled on the *Closer Economic Partnership Arrangement* (CEPA) signed by mainland China and Hong Kong in June 2003 and the *Outline of the Plan for the Reform and Development of the Pearl River Delta* (2008–2020) enacted and promulgated by China's National Development and Reform Commission (NDRC) in December 2008, is to strengthen ties between Guangdong and Hong Kong in order to enhance the competitiveness of the Pearl River Delta region.

As far as finance is concerned, the CEPA seeks (1) to enhance Hong Kong's status as an international financial center and further the development of Guangdong's financial services industry, (2) to make it easier for financial institutions from Guangdong to open branches in Hong Kong and vice versa, and (3) to encourage the use of the renminbi to settle trade transactions[2] in Hong Kong. In short, it reflects a

[2] See Sekine, Eiichi, "Renminbi Trade Settlement as a Catalyst to Hong Kong's Development as an Offshore Renminbi Center," Nomura Journal of Capital Markets, Summer 2011, Vol.3, No.1.

desire to make closer integration between Hong Kong and Guangdong in the field of financial services a win-win situation.

Furthermore, the CEPA designated Qianhai a key cooperation zone. Then, in August 2010, the State Council (government) approved the *Overall Development Plan on Hong Kong/Shenzhen Cooperation on Modern Service Industries in Qianhai Area*, while in March 2011 the development plan for Qianhai was incorporated in China's 12th Five-Year Program (2011–2015).

2) Preferential treatment of Hong Kong financial institutions opening branches in Guangdong

The next development was on 16–18 August 2011, when China's then vice-premier, Li Keqiang, announced that six new policies on economic, trade and financial relations between Hong Kong and the mainland would be implemented during the course of the 12th Five-Year Program[3].

The six policies involved measures to (1) further deregulate the trade in services between Hong Kong and the mainland, (2) enhance Hong Kong's status as an international financial center, (3) help Hong Kong to develop its offshore renminbi market, (4) help Hong Kong become more involved in international and regional economic cooperation, (5) encourage Hong Kong and mainland companies to cooperate when moving into overseas markets, and (6) enable Hong Kong to play a key role in relations between itself, Guangdong, and Macau.

Another aim was to build on the CEPA and to fully deregulate the trade in services between Hong Kong and the mainland by the time the 12th Five-Year Program ends in 2015. Yet another was to build on financial cooperation between Hong Kong and the mainland and give Hong Kong financial institutions preferential treatment when opening branches on the mainland, especially in Guangdong (including Shenzhen).

3. New policies for Qianhai

On 27 June 2012, a few days before China's then president, Hu Jintao, visited Hong Kong on 1 July, to mark the 15th anniversary of its return to China in 1997, the Chinese government announced new policies to help Hong Kong in six areas of cooperation with the mainland: the economy and trade, financial services, educational exchanges, science and technology, tourism, and cooperation with Guangdong in particular. A few days later, on 3 July, the Chinese government approved (with effect from 27 June) the *Reply on the Relevant Policies Supporting the Development and*

[3] See Sekine, Eiichi, "Honkon Kin'yuu Saabisugyou no Shinkou o Hakaru Chuugoku Kokumuin Li Kokkyou Fukusouri no Supiichi" (Vice Premier Li Keqiang's Hong Kong Speech as a Move to Stimulate Hong Kong's Financial Services Industry), Kikan Chuugoku Shihon Shijou Kenkyuu, 2011 Autumn edition, Tokyo Club Foundation for Global Studies (in Japanese).

Opening Up of the Qianhai Shenzhen–Hong Kong Modern Service Industry Cooperation Zone.

Its aim was to try out in Qianhai (1) in the field of modern service industries (including finance) (2) some more particular policies than had been tried out in China's special economic zones, and to give Qianhai a key role in (3) furthering cooperation between Hong Kong and the mainland, and (4) developing more service-based industries in the Pearl River Delta.

The "more particular policies" that the government wanted to try out in the field of finance were (1) encouraging the repatriation of offshore renminbi via Qianhai, (2) encouraging cross-border renminbi loans, (3) encouraging the issue by residents of renminbi bonds in Hong Kong, (4) encouraging the creation of a fund of funds in Qianhai, (5) encouraging foreign equity investment in Qianhai, (6) encouraging activity by Hong Kong financial institutions, (7) attracting innovative financial institutions, and (8) attracting the headquarters of financial institutions (Figure 1). These policies to attract financial institutions while seeking to deregulate the renminbi bank loan market, bond issuance, and fund origination could be described as an attempt to create a "Special Qianhai Financial Zone."

III. Overview of cross-border renminbi loan market

The *Interim Measures* and the *Detailed Rules* are a specific attempt to investigate the prospects for loans by Hong Kong banks to Qianhai companies and for Qianhai projects within the framework of the CEPA and as part of the aforementioned policy of encouraging cross-border renminbi loans. We now consider the provisions for such loans in the *Interim Measures* and the *Detailed Rules,* and their results.

1. Provisions for cross-border renminbi loan market

1) Business flows

The *Interim Measures* allow companies that are not only registered and established in Qianhai but actually operate or invest there ("Qianhai companies") to borrow in renminbi from Hong Kong banks via Shenzhen clearing banks.

Under this procedure, Qianhai companies would, first of all, choose a clearing bank from those Shenzhen banks that engage in cross-border renminbi business, then have that bank report the transaction to the Shenzhen sub-branch of the PBOC, and, finally, open a normal account for depositing the renminbi funds remitted from Hong Kong.

Figure 1: Qianhai Shenzhen–Hong Kong Modern Service Industry Cooperation Zone: a testing ground for financial deregulation

	Business area	Direction
Basic aim		• Try out financial reforms and innovation in Qianhai as a model for opening up China's financial services industry.
1	Repatriate offshore renminbi via Qianhai	• Consider and develop routes for repatriating offshore renminbi via Qianhai and establish innovative testing grounds for cross-border renminbi business as well as develop Hong Kong as an offshore renminbi center.
2	Assist cross-border renminbi loan market	• Assist Qianhai banks with renminbi loans for offshore projects.
		• Actively consider renminbi loans by Hong Kong banks to Qianhai companies and projects within the framework of the CEPA.
3	Assist resident issuers of renminbi bonds in Hong Kong	• Assist Qianhai companies and financial institutions that meet certain criteria to issue renminbi bonds in Hong Kong (within the limits approved by the State Council) and use the proceeds to develop Qianhai.
4	Assist establishment of mother fund	• Assist with the establishment of a fund of funds for equity investment in Qianhai.
5	Assist with attracting foreign equity investment	• Assist foreign (including Hong Kong) equity investment funds with innovation and development in Qianhai.
		• Assist foreign equity investment companies with the development of new approaches in areas such as capital settlement, investment, and fund management.
6	Assist with attracting Hong Kong financial institutions	• Give Hong Kong greater access to Qianhai's financial markets.
		• Ease restrictions on Hong Kong financial institutions (e.g., when opening branches and providing financial services) in Qianhai within the framework of the CEPA.
7	Attract innovative financial institutions	• Assist with the establishment in Qianhai of innovative financial institutions that can help to improve market mechanisms on a pilot basis and in accordance with the development plans and needs of the country as a whole.
		• Similarly, consider and foster the development of trading platforms for new products and assist with the development of business models and the reform of financial system mechanisms aimed at harnessing Qianhai's services to the development of the real economy.
8	Induce financial institutions to establish (regional) headquarters in Qianhai	• Assist domestic (including Hong Kong) and foreign financial institutions with the establishment of global or national managerial and operational headquarters in Qianhai, and step up the pace of internationalizing China's financial services industry.
In implementing the above policies, the NDRC, PBOC, CBRC, CSRC, and CIRC should cooperate in enacting the necessary provisions.		

Source: Nomura Institute of Capital Markets Research, from State Council data

2) Use of funds

Under the *Interim Measures*, cross-border renminbi loans in Qianhai must be used for construction and development purposes, assuming that these are compatible with government policy. Furthermore, under the *Detailed Rules*, renminbi loans must be used for purposes that are compatible with the requirements of the *Catalogue for the Industrial Development of Qianhai*, with priority given to loans for imports and other outward payments.

Although the *Catalogue for the Industrial Development of Qianhai* has yet to be published, it is likely to include restrictions on the use of renminbi loans in order to prevent them from being misused (e.g., to arbitrage interest rate differentials between the mainland and Hong Kong or to lend to companies not located in Qianhai).

There are also restrictions on their use (1) to invest in marketable securities or financial derivatives, (2) for entrustment loans, (3) to purchase investment products, and (4) to purchase property other than for use by one's own company.

3) Interest rates

Under the *Interim Measures*, the Shenzhen sub-branch of the PBOC has to be informed before any loans are made. However, cross-border interest rates in Qianhai can be set by negotiation between the lender and loan applicant, as can the tenor of a loan, provided it is reasonable and in accordance with the purpose of the loan.

We see the fact that the lender and loan applicant can set the interest rate by negotiation and that lenders can borrow the funds at a low rate in Hong Kong and add a spread when using them to make cross-border loans in Qianhai as an important move towards financial deregulation in China.

Traditionally, the PBOC sets a reference rate and a permissible fluctuation range for deposit and loan rates in China (Figure 2). Loan rates have gradually been deregulated. The first move was in October 2004, when the cap on loan rates (thitherto the reference rate × 1.1) was abolished. However, the floor on loan rates (set at the reference rate × 0.9) was retained, while the reference rate became a cap for renminbi deposit rates, which were allowed to fluctuate. The next move was in June 2012, when the floor on loan rates was lowered (to the reference rate × 0.8), while the cap on deposit rates was raised (to the reference rate × 1.1). This was the first time that deposit rates were allowed to fluctuate upwards. The latest move was in July 2012, when the floor on loan rates was lowered (to the reference rate × 0.7).

At some point in the future we expect Qianhai to be given the status of an offshore market and for cross-border renminbi loans on that market to be a pilot for the deregulation of renminbi interest rates in the rest of the country.

4) Foreign debt management

(1) Renminbi loans from Hong Kong to be managed at area level

Under the *Interim Measures*, the Shenzhen sub-branch of the PBOC will manage the balance of loans to Qianhai by Hong Kong financial institutions in accordance with the development of the renminbi business in Hong Kong, the construction and development needs of Qianhai, and the need for macroeconomic control in the country as a whole.

Figure 2: Renminbi lending and deposit rates in mainland China and Hong Kong

[Interest rates in mainland China]

Deposit rates		Lending rates	
Sight deposits	0.35%		
Fixed(3 mths)	2.60%		
Fixed(6 mths)	2.80%	6 mths	5.60%
Fixed(1 yr)	3.00%	6 mths-plus-1 yr	6.00%
Fixed(2 yrs)	3.75%	1 yr-plus-3 yrs	6.15%
Fixed(3 yrs)	4.25%	3 yrs-plus-5 yrs	6.40%
Fixed(5 yrs)	4.75%	5 yrs-plus	6.55%

[Renminbi deposit rates in Hong Kong]

Sight deposits	
RMB5,000 or less	–
RMB5,000-plus-RMB199,999	0.25%
RMB200,000-plus	0.30%

Fixed deposits	
1 day	0.25%
7 days	0.30%
14 days	0.30%
1 mth	0.50%
2 mths	0.50%
3 mths	0.55%
6 mths	0.60%
12 mths	0.60%

Note: 1. Mainland rates are those announced by the PBOC and in effect since 6 July 2012.
2. Hong Kong renminbi deposit rates are those indicated by Bank of China (Hong Kong) on 7 March 2013.

Source: Nomura Institute of Capital Markets Research, from State Council data

This means that such loans will be managed not on a company-by-company basis but for Qianhai as a whole. In other words, even in the case of inward direct investment using renminbi, the current system of monitoring foreign debt on a company-by-company basis will be discontinued[4] and that, as a result, companies will no longer have to register foreign loans. This will reduce their administrative burden and allow cross-border renminbi transactions to be conducted flexibly on a trial basis.

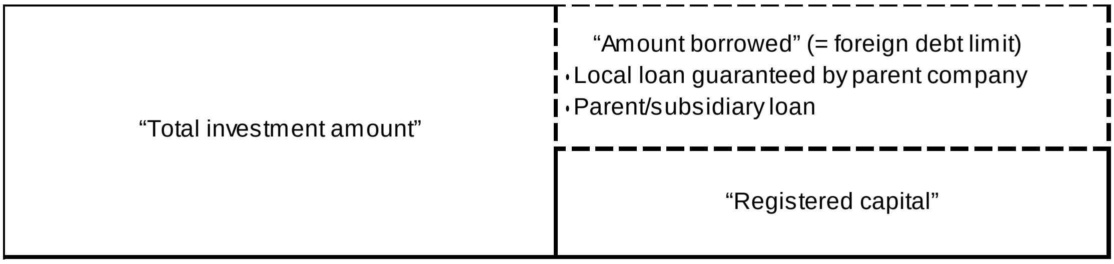
(2) Rules governing foreign-invested enterprises' borrowing limits

Capital transactions in China are still subject to certain restrictions, including restrictions on the size of foreign-invested companies in China and the sectors in which they may operate. As far as the former (company size) is concerned, foreign-invested enterprises need to meet the requirements for "total investment amount" (the total of the shareholders' equity, or capital, needed to start up a locally incorporated company and that company's debt) (Figure 3).

Furthermore, foreign-invested enterprises have to meet certain minimum capital requirements that depend on their total investment amount (Figure 4). Once a company's total investment amount and capital have been decided, the difference between them is its "debt." Any liabilities that a company incurs must not exceed its borrowing limit.

[4] See Sekine, Eiichi, "Renminbi-denominated Inward Direct Investment Gets Underway in China," Nomura Journal of Capital Markets, Spring 2012, Vol.3, No.4.

Figure 3: Schematic diagram of rules governing total investment amount and foreign debt



Note: 1. Total investment amount - registered capital = amount borrowed (i.e., foreign debt limit).
2. Foreign debt limit = short-term (12 months or less) outstanding foreign debt + medium-term (more than 12 months) cumulative accrued foreign debt.
3. Loans from a local financial institution guaranteed by a borrower's parent company are regarded as foreign debt when they are repaid.

Source: Nomura Institute of Capital Markets Research, from a variety of sources

Figure 4: Minimum capital requirements for foreign-invested enterprises

Total investment amount	Minimum ratio of registered capital to total investment	Provisos
$3mn or less	70%	–
$3–10mn	50%	However, minimum registered capital of $2.1 million required if total investment $4.2 million or less
$10–30mn	40%	However, minimum registered capital of $5.0 million required if total investment $12.5 million or less
More than $30mn	One-third or more	However, minimum registered capital of $12.0 million required if total investment $36.0 million or less

Source: Nomura Institute of Capital Markets Research, from a variety of sources

(3) Requirement for a foreign-invested enterprise to register its "foreign debt"

If a foreign-invested enterprise's debt is funded by means of a parent/subsidiary loan from an offshore parent company, it is regarded as "foreign debt." In China, foreign debt (i.e., foreign currency owed to non-residents by Chinese organizations) is monitored by a number of authorities (the NDRC, the Ministry of Finance (MOF) or the State Administration of Foreign Exchange (SAFE)), depending on the borrower.

Foreign-invested enterprises are required to register any foreign debt with their branch of SAFE within 15 days of signing a loan agreement. In addition, foreign-invested enterprises' foreign debt is subject to the following restrictions (Figure 4).

(i) Foreign debt incurred by foreign-invested enterprises must not normally exceed the difference between their officially approved total investment amount and registered capital (i.e., their borrowing limit).

(ii) Medium- and long-term foreign debt (with a maturity of more than 12 months) is calculated on a cumulative accrual basis. Short-term foreign debt (with a maturity of not more than 12 months) is calculated in terms of balances.

(iii) Loans from a local financial institution (including local Chinese branches of Japanese banks) guaranteed by a borrower's parent company are regarded as foreign debt when they are repaid.

(iv) If a foreign-invested enterprise borrows more than the difference between its total investment amount and its registered capital, the agency that originally approved it must reassess its total project investment amount.

(4) Registration of foreign debt in the case of inward direct investment using renminbi

Although inward direct investment using renminbi was officially approved by the Ministry of Commerce (MOFCOM) and the PBOC in October 2011, debt incurred in the form, for example, of a parent/subsidiary loan from an offshore parent company is treated as renminbi-denominated foreign debt in accordance with the *Notice on Issues Related to the Standardization of the Business Operations of Cross Border Renminbi Capital Account Items* issued by SAFE's General Affairs Department on 7 April 2011 and must be registered as "foreign debt" in accordance with the current rules.

However, this will no longer be necessary in Qianhai, which has been designated a testing ground for cross-border renminbi loans. This should facilitate such loans, albeit on a trial basis.

2. Cross-border renminbi loan market

There have already been a number of cross-border renminbi loans. On 28 January 2013 signing ceremonies were held for 11 loans with a total value of RMB8 billion to Qianhai companies from Hong Kong, including mainland Chinese, banks (Figure 5)[5].

The largest loan (by the Hong Kong branch of Agricultural Bank of China to Shenzhen Petrochemical Exchange) was for RMB6 billion. Furthermore, with most of the loans at annual rates of 4–5%, the Qianhai companies involved were able to borrow at more favorable rates than those available to companies in the rest of China (6%, see Figure 2).

At about the same time (namely, on 25 January 2013), the Shenzhen Municipal Government published a list of the (19) Qianhai modern service industry projects it had approved in 2012 (Figure 6)[6]. Most of the projects on the list are projects in financial services, logistics, IT , and science and technology. The list also includes the aforementioned recipients of cross-border renminbi loans and shows that the approved projects have the necessary financial backing.

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[5] See 21st Century Business Herald, 28 February 2013.

[6] http://www.szqh.gov.cn/qhdt/gzdt/201301/t20130126_2104174.htm

Figure 5: Cross-border renminbi loan agreements (first batch)

Deal	(Hong Kong-based) Bank	(Qianhai-based) Company
1	Bank of China (Hong Kong)	KONKA Optoelectronic Technology, Tencent E-commerce Information Technology, ZTE Supply Chain ("ZTESC"), ZTE Cloud Service
2	Industrial and Commercial Bank of China (Asia)	Qianhai Development & Investment Holding Co, Shun Feng E-Commerce, Baotong Supply Chain (Shenzhen), YH Global Logistics
3	HSBC	Qianhai Development & Investment Holding Co, Shun Feng E-Commerce
4	Dah Sing Bank Hang Seng Bank Bank of Communications (Hong Kong)	Qianhai Development & Investment Holding Co
5	China Development Bank (Hong Kong) CITIC Bank International Bank of China (Hong Kong) Standard Chartered Bank	Qianhai Development & Investment Holding Co
6	China Merchants Bank (Hong Kong)	Qianhai Development & Investment Holding Co, Baotong Supply Chain (Shenzhen), Farun Logistics
7	Wing Lung Bank (Hong Kong)	Baotong Supply Chain (Shenzhen), Huajian Investment
8	Bank of East Asia	Shenzhen Qianhai Guangda Logistics
	Nanyang Commercial Bank	CREC Ruilong Logistics
9	Agricultural Bank of China (Hong Kong)	Shenzhen Petrochemical Exchange, Shenzhen Qianhai Petrochemical Industry Development
10	China Construction Bank (Hong Kong)	Qianhai Development & Investment Holding Co, China Communication Technology
11	China Construction Bank (Shenzhen) Bank of Communications (Shenzhen)	Huafu Hongkong Trading, Luen Fu International Development (Hong Kong), Baoneng International (Hong Kong)

Source: Nomura Institute of Capital Markets Research, from 21st Century Business Herald, 28 January 2013

3. Creation of routes for repatriating renminbi from Hong Kong

The PBOC has stated its view that the trial of cross-border renminbi loans in Qianhai has (1) provided valuable financial assistance for Qianhai's development, (2) created more opportunities to use offshore renminbi funds, (3) contributed to the growth of the renminbi assets and liabilities of Hong Kong banks, and (4) boosted activity on the offshore renminbi market and facilitated cross-border renminbi transactions in both directions.

Since China permitted the use of renminbi to settle trade transactions in July 2009, renminbi deposit balances in Hong Kong, one of China's key trading partners, have soared. However, a shortage of renminbi investment products in Hong Kong has led to the creation of routes for repatriating renminbi from Hong Kong to the mainland.

The first of these was the extension in August 2010 of eligibility to participate in China's interbank bond market to three types of foreign financial institutions ("eligible

Figure 6: First series of Qianhai Modern Service Industry projects (approved in 2012)

Deal	Company	Project name/description
1	Shenzhen Petrochemical Exchange	Industrial service platform for petrochemical trading in Shenzhen
2	Qianhe Capital Management	Qianhe Capital Management's high-profile clients' wealth management
3	Shenzhen Qianhai Financial Assets Exchange	Platform for financial trading in Qianhai
4	A Capital Group (Shenzhen)	Emerging industry investment fund
5	China Shenzhen Emission Exchange	Public service platform for low-carbon finance trading
6	China Asset Management	Energy industrial fund, high-end daily life service industrial fund, modern service industrial fund
7	Qianhai Insurance Trading Center (Shenzhen)	Insurance trading centre in Qianhai
8	CIMC SSC (Shenzhen)	Technologies for virtual customs checkpoint in free-trade port area and Shenzhen-Hong Kong customs project for trade facilitation
9	YH Global Logistics	YH's global supply chain management center
10	Tencent Information Technology	Tencent Integrated information platform for e-commerce logistics system
11	ZTE Supply Chain	ZTESC's bonded VMI center in Qianhai
12	Taihai Network Technic (Shenzhen)	Platform for payment and settlement for courier company Shun Feng Express
13	Baotong Supply Chain (Shenzhen)	Platform for supply chain management and information system
14	China Merchants Bonded Logistics Sai Cheng Integrated Logistics Solutions (Shenzhen)	Cross-border e-commerce service platform
15	AnyCheck Information Technology	Proprietary AnyCheck cloud-based health management portal and international outsourcing projects
16	Shenzhen E-Port	Qianhai public logistics information platform (first stage)
17	Creative Technology (Shenzhen)	Platform for cultural and creative industries
18	Shenzhen ACTO Digital Video Technology	R&D and commercialization of high-luminosity video systems
19	Intertek Group (Shenzhen)	Service platform for industrial upgrading inspection and testing

Source: Nomura Institute of Capital Markets Research, from Authority of Qianhai Shenzhen–Hong Kong Modern Service Industry Cooperation Zone data

offshore institutions"). The three types of eligible offshore institution are (1) overseas central banks (including fiscal authorities), (2) renminbi clearing banks in Hong Kong and Macau (Bank of China), and (3) overseas banks authorized to settle trade transactions in renminbi. The second was inward direct investment using renminbi, which went from the pilot stage to the official stage in October 2011 (see above). The third was portfolio investment using renminbi, which was permitted in December 2011. This allowed RMB qualified foreign institutional investors (RQFIIs) to invest in mainland China using renminbi raised in Hong Kong via the Hong Kong branch or subsidiary of a mainland Chinese asset management company or securities company.

Figure 7: Renminbi deposit and loan balances in Shenzhen

(Unit: RMB100mn)

Year	Renminbi loan balance	Renminbi deposit balance
End-2007	8,467.61	11,791.94
End-2008	9,551.93	13,462.94
End-2009	12,086.12	17,498.67
End-2010	14,276.20	21,081.92
End-2011	16,355.68	24,081.11
End-2012	18,020.11	27,378.63
End-January 2013	18,392.81	27,868.44

Source: Nomura Institute of Capital Markets Research, from PBOC Shenzhen central sub-branch data

During the pilot stage there was an investment quota of RMB20 billion, but this was raised to RMB70 billion in April 2012 and to RMB270 billion in November 2012. Furthermore, in March 2013, eligibility was extended to (1) the Hong Kong branches or subsidiaries of mainland Chinese commercial banks and insurance companies, and (2) foreign financial institutions registered or operating in Hong Kong.

Extending the repatriation routes from Hong Kong in this way from portfolio investment (bonds and equities) and inward direct investment to bank loans has accelerated the internationalization of the renminbi. In the five years from the end of 2007 to the end of 2012 the balance of renminbi loans in Qianhai increased by some 110% from RMB846.8 billion to RMB1,802.0 billion (Figure 7).

IV. Related policies

1. Other related policiess

1) Attracting talented people from overseas

The Chinese government has announced a number of related policies in addition to those on cross-border renminbi loans.

The first is a policy to attract talented people from overseas. On 17 January 2013 the Qianhai Authority and the Shenzhen Bureau of Labor and Social Security released the *Regulation on Identifying Overseas High-End Talent and Professionals in Short Supply in Qianhai* (enacted on 29 December 2012) following their earlier release of the *Interim Measures on Individual Income Tax Subsidies for Overseas High-End Talent*.

According to the aforementioned Reply of July 2012, (1) highly skilled workers or skilled workers in short supply in Qianhai will be eligible to have any extra tax that they pay as a result of a higher rate of individual income tax in mainland China (a progressive rate, ranging from 3% to 45%) than in their home country subsidized, and (2) subsidies will be free of tax. On 24 December 2012， the Shenzhen Qianhai

Figure 8: Qianhai Shenzhen–Hong Kong Modern Service Industry Cooperation Zone: tax incentives

Tax incentives	Direction	
Corporate income tax	•	Reduce rate of corporate income tax on newly established "special businesses" in Qianhai to 15% (standard rate: 25%).
	•	"Special businesses" have to be on both the List of Permitted Industries and the List of Preferred Industries. The lists will be decided by the NDRC and MOF in consultation with other government departments.
Individual income tax	•	Any extra income tax payable by skilled workers or those in short supply in Qianhai compared with the tax they would have paid in their home country will be subsidized (standard rate of tax in mainland China: 3–45% progressive rate).
	•	The subsidy will take the form of tax exemption.
Business tax	•	Income derived from insurance services provided to logistics companies registered in Qianhai will be exempt from business tax (standard rate: 3%).

Source: Nomura Institute of Capital Markets Research, from State Council data

Administration Bureau released the *Interim Measures on Individual Income Tax Subsidies for Overseas High-End Talent*. After being accredited by the Shenzhen Qianhai Administration Bureau, the workers may pay individual income tax capped at 15 percent for their wages and salaries. The Shenzhen government will subsidize the exceeding portion. (Figure 8). While we have yet to hear of any actual cases, we see this as an important move to attract the highly skilled overseas human resources that Qianhai will need for its development.

2) Attracting equity investment by foreign companies

According to a report in the *Shanghai Securities News* on 6 March 2013, the Shenzhen Municipal Government recently promulgated *Provisional Measures for Implementing a Pilot Scheme on Foreign Investment in Equity Investment Enterprises of Shenzhen* together with related regulations.

The measures include (1) an initial pilot scheme, (2) an initial pilot scheme in Qianhai, (3) a one-stop foreign exchange settlement and registration service, and (4) preferential treatment of eligible foreign-invested equity investment companies not only in Shenzhen but also in Qianhai.

While we will have to wait for the publication of the *Catalogue for the Industrial Development of Qianhai* and the *Catalogue of Tax Incentives for Qianhai Companies* currently being considered by the central government (NDRC and MOF) to see exactly which types of investment will be affected, we do know that the government is prepared to reduce the enterprise income tax rate from 25% to 15% (Figure 8).

3) Trading platforms

Progress has also been made in creating the platforms that will be used to trade financial and related products in Qianhai.

The first development was the establishment, on 8 April 2011, of the Shenzhen Qianhai Financial Assets Exchange (SQFAE)[7]. This was to enable the transfer of (1) private equity funds, (2) bank financial planning investment products (collective investment schemes originated by banks), and (3) trust products registered in Shenzhen. It has also been used to transfer equity stakes in Shenzhen financial institutions.

The second development was the establishment of the Shenzhen Petrochemical Exchange. This was to enable trading in petroleum products. Trading on the exchange began on 9 January 2013 with 36 trades with a cumulative value of RMB6.28 billion. Trading value is expected to increase to RMB200 billion in 2013 and to RMB500bn in 2015.

The third development is the establishment of the Qianhai Equity Trading Center. This is intended to be a source of finance for Chinese SMEs. CITIC Securities has indicated that it intends to take a 30% stake in the Center for a price of not more than RMB1.5 billion. Other securities companies that have stated their intention to become shareholders are Guosen Securities and Essence Securities.

4) Qianhai's future

According to a report on *Securities Times Online* (www.stcn.com) dated 6 March 2013, 500 companies are already registered and operating in Qianhai with a total share capital of RMB89.8 billion. In addition, according to a report from the same source dated 17 January 2013, 30 Fortune 500 (mainly financial service) companies are expected to establish operations there.

Some 70% of the companies operating in Qianhai are financial service companies, many of them apparently private equity firms. According to a report on *Securities Times Online* dated 18 January 2013,the Shenzhen branch of the China Securities Regulatory Commission (CSRC), the Shenzhen Securities Regulatory Bureau, therefore plans to set up a self-regulatory organization, the Shenzhen Venture Capital Association (SZVCA), in Qianhai to encourage private equity and M&A firms, as well as publicly offered funds, to come under its umbrella in order to foster the fund industry's development. With regard to publicly offered funds, the CSRC awarded an asset management license to Qianhai Kaiyuan, a fund management company formed by a number of mainland financial institutions, on 27 December 2012.

Qianhai is also one of the three zones in the Pearl River Delta Financial Reform and Innovation Comprehensive Experimental Zone (approved by the State Council on 27 June 2012) granted special treatment in the area of financial services, the two others being Hengqin (in the Zhuhai Special Economic Zone adjoining Macau) and

7 http://www.sqfae.com/cn/index.aspx

Nansha, both in Guangdong. Qianhai's future is seen as lying with that of the Pearl River Delta as well as that of Hong Kong.

V. Conclusion

Qianhai's future, mainly as a center for financial services, is also of considerable interest to China's new leaders, who were chosen at the CPC's 18th National People's Congress in November 2012. Qianhai was also a destination of China's new president, Xi Jinping, when he made his first official domestic visit (to Guangdong) last December after his election in November.

Mr Xi took the visit as an opportunity to describe Guangdong as having been, and continuing to be, at the forefront of China's market-oriented reforms. We see Mr Xi's decision to make his first official domestic visit as president to Guangdong, which was where China's market-oriented reforms began in 1978, as a signal to both a national and international audience that the country's new leaders intend to continue those reforms. It has also been seen as contrasting with (the then) President Hu Jintao's first official domestic visit in November 2002, after the 16th National People's Congress, to Xibaipo, the center of the revolutionary struggle.

During his visit Mr Xi also said that the reason the government had approved the decision to develop Qianhai was that it wanted to encourage even greater cooperation and integration between Guangdong and Hong Kong as well as between Shenzhen and Hong Kong, and stressed that Qianhai would be expected to face the outside world (via Hong Kong) and share its experiences as a testing ground for reforms with the rest of the country. Qianhai's willingness to participate in the *Framework Agreement on Hong Kong/Guangdong Cooperation* vouches for its commitment to achieving this.

Although, at 14.92sq km, Qianhai is only a fraction of the size of Shenzhen, which, at 2,000sq km, is roughly the same size as Tokyo, Qianhai's proximity to Hong Kong airport (10 minutes) and Shenzhen airport (seven minutes) under a plan to link it to each of these by rail should leave no one in any doubt about the convenience of its location. It will be interesting to see whether Qianhai can become the flagship for China's service industries in general and its financial services industry in particular, with the necessary infrastructure in terms not only of office accommodation but also of a legal framework, preferential treatment, and training. Much will also depend on whether the experiment in financial deregulation that Qianhai's cross-border renminbi transactions represent and which form the cornerstone of the zone's preferential treatment proves sufficiently attractive to foreign companies and financial institutions. It goes without saying that it will also be interesting to see whether Japanese companies and financial institutions are attracted to Qianhai.