

# To Start the Special Legislation of Chinese Financial Holding Company as Soon as Possible

Yue Caishen, *Southwest University of Political Science and Law*

Zhang Xiaodong, *People's Bank of China, Xi'an Branch*

## ***1. The necessity and urgency of starting the special legislation of Chinese financial holding company as soon as possible.***

### **1.1 Making FHC Act is the need for driving financial system innovation.**

Compared with the traditional separate operation, integration operation represented by financial holding company has a series of advantages in economies of scale, economies of scope and synergy. To financial industry, integration operation can reduce operation costs and risks and improve management levels across cycle. To clients, integration operation can satisfy “one-stop” financial service and save transaction cost. To financial industry, integration operation is beneficial to push forward the products and service innovation like the economic organization structure, operation mode and intersectionality innovation and a series of financial institutional innovation such as technological supervision ideas and methods innovation like one-client, multi-accounts to better serve entity economy development.

### **1.2 Making FHC Act is the need for improving the international competitiveness of Chinese financial enterprises.**

Integration operation has become the mainstream operation mode in current international financial industry. The U.S. passed the Financial Services Modernization Act in as early as 1999, removed the Glass-Steagall Act, got rid of the limitation of integration operation, cleared the legal obstacles for financial holding company development and promoted the rapid development of American financial industry. The global economic crisis began in 2008 proved stronger anti-risk ability of financial holding company in crisis. Under the circumstances of financial internationalization, the strict limitation on the financial industry “separate operation” is bad for Chinese financial industry in international financial market competition.

### **1.3 Making FHC Act is the need for preventing financial systemic risks.**

On one side, there are a great number of different kinds of financial holding companies in China, with complex structures, large scales and highly correlative transactions. They are of an obvious systematic importance in financial system and easy to accumulate and trigger systematic risks. On the other side, the existing laws, regulations

*Yue Caushen: the dean and professor of School of Economic Law and the director of Economic Law Studies Center in Southwest University of Political Science.*

*Zhang Xiaodong works for People's Bank of China, Xi'an Branch.*

*With the deepening reform in Chinese financial industry, there appear many problems with operation reform. Integration operation represented by financial holding companies not only has various advantages in economies of scale, economies of scope, but also plays an important role in synergy of Chinese financial institutions. Therefore, it is highly significant for Chinese financial industry reform to start making the special legislation of financial holding company as soon as possible.*

and regulatory system cannot provide reliable assurance for financial holding company development. CBRC, CSRC and CIRC adopt primary supervisory model in financial holding company, while poor regulatory coordination is inherent disadvantage of separate regulatory system. The lack of effective coordination among different financial regulators and little information sharing cause bad regulation effects. Making FHC Act cannot only provide institutional guarantee for their healthy development, but also establish a relatively satisfactory regulatory legal system to prevent possible accumulated or hidden risks.

***2. Conditions are ripe for starting the special legislation of financial holding company.***

2.1 Regulators have experienced years of exploration for financial holding company regulatory model.

To prevent the risks of financial holding company, CBRC, CSRC and CIRC held the first joint regulatory conference on Sept. 18th, 2003 and established the primary supervisory model in financial holding company, which is according to the principles of separate regulation, well-defined duties, orderly cooperation, transparent policies and high efficiency, regulating the related organizations and business separately within the financial holding companies according to the nature of business, and leaving the relevant regulators to regulate group companies of financial holding companies according to nature of their main business. The exploratory work in this aspect offers reference for making FHC Act.

2.2 The plans and relevant laws of financial industry development make room for legislation.

The Party's 3rd Plenary Session of the 16th Central Committee in 2003 proposed promoting "the dynamic integration of money market, capital market and insurance market". "The Eleventh Five-year Plan" and "the Twelfth Five-year Plan" put forward to promoting "steadily and actively" the trials of financial industry integration operation. Article 43 in the Law of the People's Republic of China on Commercial Banks is modified as: "No commercial bank shall undertake the businesses of trust and investment and securities dealing business, nor shall they invest in the non-self-use real property or non-bank financial institutions and enterprises, unless it is otherwise prescribed by the state". The laws do not ban financial industry from integration operation and make room for integration operation of financial industry, and provide evidence for the legislation of FHC Act. The Provisions on the Main Functions, Internal Structure and Staffing of the People's Bank of China issued by the State Council in 2008 prescribe that the People's Bank of China responsible for establishing, jointly with the financial regulatory departments, regulatory

rules for financial holding companies, and standards and norms for the cross-sector financial business, and responsible for monitoring financial holding companies and cross-sector financial instruments.

2.3 The development of financial holding company provides the practice and experience for legislation.

Currently, various kinds of financial holding groups are developing rapidly in China like Citic Group, China Everbright Group, Ping An Group, Baosteel Group, China Merchants Group, China Huaneng Group, New Hope Group, Wanxiang Group and so on. Meanwhile, many local governments also actively integrate local financial institutions to form financial holding groups. Although there don't exist relevant laws in China, all kinds of financial holding companies should strengthen risk management on their own and establish necessary internal control system. The establishment and operation of internal control system provide experience material for Chinese financial holding company legislation.

2.4 Legislation of developed countries and areas can offer useful reference to China.

To promote the establishment and development of financial holding companies, many countries (areas) enacted laws about financial holding company, such as Japanese Financial Holding Company Act in 1997, American Financial Services Modernization Act in 1999, the Financial Holding Company Act in Taiwan in 2001 and so on. After the economic crisis in 2008, the western developed countries represented by America and Britain generally believe that the root cause of crisis is not integration but the excessive development of financial derivatives and supervision loopholes. It is unrealistic for financial industry to return to strict separate operation. Integration operation will remain and develop following new regulatory requirements and standard. On Sept. 2012, BCBS, IOSCO and IAIS, three international financial organizations all together organized the joint forum and issued the amended Principles for the Supervision of Financial Conglomerates including delegated regulation, regulatory functions, corporate governance, capital adequacy and flow and risk management (insider trading, concentration ratio and so on ), all together five parts.

### ***3. Suggestions to special legislation of Financial Holding Company Act***

First, financial holding company is closely related to banks. Chinese relevant departments are now working on the amendment of Law of the People's Republic of China on Commercial Banks. As to the choice of its legislative model, Law of PRC on Commercial Banks cannot fully cover all kinds of financial holding companies. Therefore, financial holding

companies cannot be regulated in the frame of the amendment of Law of PRC on Commercial Banks.

Second, Chinese financial operation system should transfer to, not directly jump to integration operation. Therefore, establishing financial holding company system is the best choice of Chinese financial system reform, which is by developing financial holding company to realize the appropriate mixed operation in financial industry, to improve the operation model and profit model of financial institutions, to motivate the vigor and creativity of financial institutions and to better serve the entity economy.

Third, the core of Financial Holding Company Act is to establish the regulatory framework that is suitable for financial holding company. The optional regulatory frameworks are followed. The first one is primary supervisory model where corresponding regulators are responsible for the group company of financial holding company according to the nature of their main business. The second one is single supervisory model where single regulator is takes charge of regulation of financial holding company. The third one is umbrella regulation model where the central bank on the top of the umbrella is responsible for the risk management of financial holding company legal persons and the all-round supervision evaluation of the steady operation in financial industry, while the regulators adopt the separate regulation to the subsidiary companies of financial holding company. We think that umbrella regulation can better adapt to China's situation, which can integrate at most the current regulating resources (separate regulation of subsidiary companies) and let the central bank play the role of macro-control. The umbrella regulation is a more viable option to avoid the shortage that it is difficult for separate regulation to prevent the overall risks of financial holding company.

Forth, the special legislation of financial holding company should include clarifying the body of regulation to financial holding company to promote the regulatory system reform, setting up regulatory rules for financial holding company to intensify the prevention from systematic risks, improving the corporate governance structure to have better effect, standardizing the connected transactions to prevent from the accumulated risks and avoiding interests conflicts to fairly protect the interests of investors. Considering the particularity of CEO of financial holding company, special legal systems can be prescribed in legislation like more responsibilities.

*Translator/ Shi Ying*