Foreword

It was ten years ago when I last wrote the Foreword for the previous version of this Book. At the time, I had the privilege of serving as the Chief Adviser to the China Securities Regulatory Commission, a position I left in 2004 to return to my practice at the Hong Kong Bar.

In the last ten years, the financial landscape of China and the World in general has drastically changed. China has become much more integrated into the global trading as well as the financial system. In the wake of the worldwide financial crisis of 2008, China has become one of the important players in the setting of the global regulatory agenda. Its vast foreign currency reserves, now exceeding USD3 trillion, play an important role in the global markets and its own currency, the RMB, is being gradually internationalized.

In the past ten years, the Chinese stock markets have grown into consistently one of the top five in the World, in capitalization and turnover. The stock and bond markets have become more accessible to international capital through the Qualified Foreign Institutional Investors (QFII) programme, the quota for which stands at USD80 billion at the time of writing and I am sure this will expand. With the institutionalization of the RMB, off-shore holders of RMB may now invest in the Chinese stock market through RQFIIs, the quota for which now stands at RMB70 billion. Admittedly, these are small sums compared to the size of the market capitalization, but there is no doubt that the quotas will increase as the RMB further internationalizes.

The Stock Market has become much more driven by fundamentals than it was ten years ago, with a large increase in the number of domestic fund managers. The Shanghai Financial Futures Exchange has been trading an Index Fund of 300 stocks for two years and is one of the most liquid financial futures exchanges in the world.

A fixed income market is beginning to emerge as interest rates are being gradually deregulated. Large corporations have been issuing tradable bonds, as a preferred means of financing. The banking regulator, the CBRC, is requiring higher capital adequacy and liquidity ratios from banks and the increasing cost of capital is pushing banking institutions into exploring more efficient use of capital. Securitization of bank loans has begun, as regulation and regulatory agencies become more attuned to the need for a market with a diverse range of investments.

Financial intermediaries have to become more sophisticated as they compete for clients. Banking institutions, working with insurance companies and securities firms, have for some years been permitted to offer bancassurance products and securities investment services to clients. Securities firms have been permitted to provide advisory services, and insurance companies offer a whole range of wealth management products. Chinese investors have for some years now been able to invest overseas through the Qualified Domestic Institutional Investor (QDII) system.

The National Social Security Fund has now amassed close to one trillion RMB in assets under management and is the largest pension investor in China. For six years now, China has been operating its own Sovereign Wealth Fund (SWF) in the name of China Investment Corporation (CIC). CIC is a member of the International Working Group of Sovereign Wealth Funds and is a subscriber to the Santiago Principles. These Principles require transparency and social responsibility by SWFs.

In the next ten years, we will see even more substantial changes in the Chinese financial landscape. The stellar performance of the Chinese economy in the past decade has been the result of a set of consistent public policies designed to build infrastructural and human capacity. The next decade will see a slowing rate of infrastructural investment but there will be an increased rate of investment in human and institutional capacity. The rate of growth in the GDP will slow but the quality of the investment will improve. At the same time, the creation and provision of services will command a greater portion of China's GDP. This will require stronger institutions – higher quality regulation, higher levels of expertise, more diversification of opportunities, more diversified markets and more integration into the global economy and financial system.

Despite the improvements that have taken place in China, there is still a large shadow banking system catering to small and medium enterprises and to people who cannot get access to the regulated financial system. A substantial amount of the funds which flow into the stock market and property market in Hong Kong, have come through the PRC shadow banking system. Large quantities of RMB and foreign currencies are being informally swapped beyond the pale of official statistics. A shadow banking system exists because it caters to a real community need but the regulated financial system is deficient. No developed economy can afford to allow a shadow banking system of any scale to exist, because financial risks are not captured and the effectiveness of fiscal as well as economic policies is dulled. The absorption of the shadow banking system into the mainstream financial system will be one of the important challenges of the next decade.

A further challenge will be the continuing integration of the Chinese financial system into the global financial system. The internationalization of the RMB will be at centre stage of developments in the coming decade. The regulatory and policy changes needed to sequence an internationalization of the RMB will present a formidable challenge both to officials and the financial sector.

All of the above challenges will require robust institutions based on internationally recognized principles underpinning the Rule of Law and an industry capable of quickly responding to the ebbs and flows of policy making in future.

This brings me to the contents of this book, which is far more than an update to the last version. The Chinese financial system has changed in more fundamental ways than a mere update can capture. I therefore congratulate the authors for producing a completely new volume, aptly named, *A New Look*, into the area of investment in the Chinese financial system. The detailed expositions of each subject will give anyone seriously interested in investment in China an excellent overview of the features and eccentricities of the Chinese system. This is a book I would thoroughly recommend to investment managers and individual investors alike.

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