The New Regulation on Asset Management in China and Its Influence on the Financial Industry

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Abstract: With the development of financial markets, China's regulatory system has gradually improved. In April 2018, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the Central Bank jointly promulgated a new asset management regulatory document. This essay would explore and analyze the impact of the document on China's financial industry.

Keywords: New Regulation; Asset Management; Financial Industry

1. Introduction

The China Banking Regulatory Commission, the China Securities Regulatory Commission and the Central Bank jointly issued a new asset management regulatory document on April 27, 2018. The document did not make concessions in the important regulations such as breaking rigid exchange, de-channeling, de-multiple nesting and unified leverage, but made improvements in non-standard definitions, product grading restrictions, net value enforcement, and extension of transition period. It could enhance the enforceability and reduce market volatility. On the one hand, GaoJie(2018) points out that it can achieve unified supervision of multi-sector, bank funds and non-bank supervision together. On the other hand, under the guidance of the leading documents, patch documents have been issued one after another and implemented. This article would analyze the contents of the document and discuss the impact on China's financial industry.

2. The Core Contents of the New Regulation

2.1 Limiting non-standard investment and strengthening its asset management

Firstly, it is stipulated that standardized creditor's rights assets should meet the following requirements at the same time: a). Equally differentiated and transactable; b). Full disclosure of information; c). Centralized registration and independent trusteeship; d). Fair pricing and perfect liquidity mechanism; e). Trading in the inter-bank market, stock exchange market and other trading markets established with the consent of the State Council. It also stipulates that the assets of creditor's rights other than standardization are non-standardized assets of creditor's rights. Where a financial institution issues assets management products and invests in non-standardized creditor's rights assets, it shall abide by the relevant regulatory standards such as quota management and liquidity management formulated by the financial supervision and regulation department.

Secondly, the regulation stipulate that non-standard assets should be "just converted", pointing out that financial institutions cannot provide any direct or indirect, explicit or implicit guarantees, repurchases and other commitments to bear risks for non-standard creditor assets or equity assets invested in asset management products.

Finally, financial institutions need to meet the deadline matching for asset management. In order to reduce the risk of term mismatch, financial institutions should strengthen the duration management of asset management products, and the duration of closed asset management products should not be less than 90 days. Where assets management products are directly or indirectly invested in non-standardized creditor's rights assets, the termination date of non-standardized creditor's rights assets shall not be later than the expiration date of closed assets management products or the latest opening date of open assets management products.

2.2 De-channeling and eliminating multilayer nesting

First, the regulation stipulates that financial institutions cannot provide access to asset management products of other financial institutions to circumvent regulatory requirements, such as investment scope and leverage restrictions. Asset management products can be reinvested in one level of asset management products, but investment asset management products may not be reinvested in asset management products other than securities investment funds.

Second, if a financial institution invests its assets management products in assets management products issued by other institutions, thereby entrusting its assets management products funds to other institutions for investment, the trustee shall be an institution with professional investment capacity and qualifications subject to supervision and regulation by the financial supervision and regulation department. In addition, the trustee of public-offered assets management products should be a financial institution, and the trustee of private-offered assets management products can be a private-offered fund manager. The trustee shall earnestly perform its active management duties, and shall not recommit or reinvest in assets management products other than public securities investment funds.
Last, the trustee should conduct due diligence on the trustee, implement the management of the list system, specify the admission criteria and procedures, responsibilities and obligations, duration management, conflict of interest prevention mechanism, information disclosure obligations and exit mechanism of the trustee. The entrusting agency shall not be exempted from its own responsibilities by entrusting other institutions to invest.

2.3 Penetrating supervision and centralized supervision

On the one hand, the rules stipulate that the total assets of a single product shall be calculated in accordance with the penetration principle. And the implementation of penetrating supervision, for multi-tier nested asset management products, identify the final investors of the product upwards, and identify the underlying assets of the product downwards.

On the other hand, the regulatory authorities have strengthened centralized supervision, stipulating that the market value of a single public offering asset management product investing in a single securities or a single securities investment fund shall not exceed 10% of the net assets of the asset management product. Moreover, the market value of all public offered asset management products issued by the same financial institution shall not exceed 30% of the market value of a single securities or a single securities investment fund. In addition, all asset management products of the same financial institution shall invest in stocks issued by a single listed company, which shall not exceed 30% of the negotiable stocks of the listed company.

2.4 Unified leverage requirements and risk management

Regulations stipulate that the total assets of classified private equity products shall not exceed 140% of the net assets of the products. The classification proportion of fixed income products shall not exceed 3:1, equity products shall not exceed 1:1, and commodities and financial derivatives and mixed products shall not exceed 2:1. Financial institutions issuing classified asset management products shall independently manage the asset management products and shall not delegate them to inferior investors. And graded asset management products may not directly or indirectly provide principal-guaranteed income arrangements for priority share subscribers.

In addition, the financial institution shall make a risk reserve according to 10% of the asset management product management fee income, or measure the operational risk capital or the corresponding risk capital preparation according to the regulations. When the risk reserve balance reaches 1% of the product balance, it can no longer be withdrawn.

2.5 Net value regulation

Regulations point out that financial assets adhere to the principle of fair value measurement and encourage the use of market value measurement. If one of the following conditions is met, it may be measured at the amortized cost in accordance with the accounting standards of enterprises:

1. Asset management products are closed-end products, and the invested financial assets are held at maturity for the purpose of collecting contract cash flow.
2. Asset management products are closed-end products, and the financial assets invested do not have active trading market for the time being, or there is no quotation in the active market, nor can the fair value be measured reliably by using valuation technology.

2.7 Breaking the rigid exchange supervision

If it is found that there exists rigid payment behavior, the following two types of institutions shall be distinguished for punishment:

1. If a deposit-type financial institution makes rigid payment, it shall be deemed to use assets management products with deposit essential characteristics to carry out regulatory arbitrage. The Banking Insurance Regulatory Authority of the State Council and the People's Bank of China shall regulate the arbitrage according to the deposit business, make up the deposit reserve and deposit insurance premium in full, and impose administrative penalties.
2. Where a rigid payment occurs in a non-deposit licensed financial institution, it is deemed to be an illegal operation, which shall be corrected and punished by the financial supervision, the regulation department and the central bank of China according to law.

In the process of auditing, if the external audit institutions fail to fulfill their duties diligently, investigate the corresponding responsibilities according to law or impose administrative penalties, and incorporate relevant information into the national credit information sharing platform to establish a joint punishment mechanism.

3. The Impact of the New Regulations on the Financial Sectors

3.1 Impact on the insurance industry

The insurance industry has a steady allocation of funds, a high proportion of active investment, so it is less affected by the new regulation (Tong Weihao, 2018). Insurance capital management was originally established to specialize in the management of insurance funds of parent companies and other insurance companies. Among them, it mainly provides enterprise annuity, pension fund and other asset management services for institutional customers. Therefore, the trustee funds have the characteristics of low cost, long term, and strict management and risk control. Therefore, the main feature of insurance management is to actively manage investment in capital allocation, and the investment style is more robust than other managers.

At present, the insurance industry basically meets the requirements of product and standardized operation under the new regulations. Industry corridor business is small. In
2015, the CIRC announced that the current existing channel business scale is about 1 trillion RMB, accounting for about 7%, and issued relevant documents to strengthen supervision. Other key issues include the unification of leverage, the prohibition of capital pools and other important new regulations. The CIRC has issued a rectification before, and has not put forward significant new requirements compared with the current regulatory requirements.

3.2 Impact on the securities industry

The new regulation has many constraints on securities business. The first is channel business, which requires not only tightening the capital side, but also blocking the original business path of channel business. More specifically, it allows only one layer of nesting, and requires penetrating the supervision to the underlying assets and investors, and identifying the source and direction of funds. Secondly, the fund pool business requires “separate management, separate accounting, separate accounting for each capital product fund to achieve risk isolation”, and requires “net value management, which can timely reflect the income and risk of basic assets” to achieve effective information disclosure. In addition, it also requires “no rigid payment” to break the risk of concealing the fund pool through the rigid payment. After meeting the requirements of net value management, term matching and risk isolation, the essence of fund pool business is no different from that of common public or private products(Wang Zhe, 2017). Therefore, in the process of supervision of fund pool business, non-standard fund pool is the focus of supervision for many times, while investing in bonds with high liquidity or standardized asset pool can survive on a rolling scale without increasing, and gradually transform according to the requirements of public and private products. Finally, it restrains and unifies leverage, prevents and controls the risks of graded leverage amplification system and blockages the loopholes that can break through the regulatory restrictions. On the one hand, we should unify the leverage requirement of asset management products. On the other hand, we should specify the grading requirement, and the intermediate share should be included in the priority share, so as to supervise the past behavior of magnifying the leverage multiples by designing the intermediate stage in disguised form.

3.3 Impact on the trust industry

The new regulation also has a great impact on the trust industry. Firstly, in terms of channel business, trust trusted assets balance is about 26.3 trillion at the end of 2017, of which transaction management trusts account for about 60%, and the growth rate of scale will slow down or shrink under de-channel (Chen Jin, 2018). Second, reduce leverage to the unified requirements, smooth the original leverage advantage, or adjust product leverage to compliance requirements by increasing priority funds, so as to avoid leverage. According to Xing Cheng(2018), trusts need to reduce leverage. Thirdly, the problem of non-standard capital pool is transformed partly or through non-standard sublending or non-standard subcontracting with the management of securities firms.

3.4 Impact on the fund industry

The new asset management regulation has the greatest impact on the fund industry. As for the public fund management, regulations specify that the public offering management that meets the requirements may be invested appropriately. The advantage of public offering fund lies in its transparent and compliant operation of the original products, which basically meets the requirements of net value management and has less negative impact on the new regulations (Sun Juanjuan, 2017). Therefore, at the level of public offering fund, it will return to its original source, benefit net value products, and have a strong investment and research ability with a good prospect of gains. It is expected that more funds will dock with the public offering fund.

The changes faced by the industry include prohibition of new capital-protected products, withdrawal of public-offered capital-insured and graded funds, obstruction of the channel business of fund-specific accounts, rationalization of fund return curve, decline of the scale of monetary funds, inflow of funds outside the banking commission, increase of individual investors with medium and low risk preferences, unification of regulatory requirements of the capital management industry, and homogeneous competition with actively managed capital management products(Cao Quanwei, 2017).

In addition, the regulation also has a deep impact on the public funds industry. Firstly, the public funds benefit indirectly after the diversion of the newly converted funds. The public funds have formed net value management, which is expected to attract the banks to manage their finances, securities companies and trusts to break the newly converted funds. In addition, the restructuring and rebalancing of the capital management pattern, banks set up capital management companies independently to compete with the funds at the end of the public offerings (Liu Xingcheng, 2018). Finally, the industry improves the level of active management, product innovation to form international investment, to bid overseas excellent managers.

For private equity funds, the new regulations point out that the total assets of each private product shall not exceed 200% of the net assets of the product, and open-ended private products shall not be classified into shares and the investment threshold shall be raised. In addition, the business model of private equity funds is limited. The new regulations consider that asset management business belongs to the franchise industry and must be included in financial supervision.

4. Conclusion

The new regulation of management should be strengthened from three aspects. Firstly, by restricting nesting and realizing penetrating supervision, identifying the funders and underlying assets, bank funds can no longer hide their true investment through multi-tier asset management products, and the feasibility of avoiding supervision and investing in restricted areas is reduced. Secondly, it requires breaking
rigid payment and strengthening liquidity risk management of term mismatch. It is difficult for banks to invest in long-term non-standard products with short-term funds. The net value management will also break the traditional pattern of rigid bank payment and change its investment style. Finally, it points out that financial institutions whose main business does not include asset management business should establish asset management subsidiaries with independent legal personality to carry out asset management business.

The new regulation on asset management has a significant and far-reaching impact on the financial industry. The promulgation of the new regulation also marks the further improvement and strengthening of China's regulatory system.

References


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