

## **Executive Summary**

### **CSRC China Capital Market Development Report**

The “China Capital Markets Development Report” intends to provide a comprehensive yet brief overview of the development of China’s capital markets in the last decade and half, summarize the experience and lessons learned during the market evolution and facilitate future strategy.

The Report starts by reviewing the development of China’s capital markets in the context of China’s economic reform and opening up, highlighting a series of liberalization reforms in recent years which have made great impacts on or will impact the market development . Then the Report focuses on the detailed analysis of China’s capital markets by comparing that with select markets to identify the major strength and weakness of China’s capital markets. The Report finally proposes a long-term vision for future development, aiming at facilitating consensus building among government officials, professionals, experts and market participants who are interested in seeing healthy and efficient development of China’s capital markets.

**China’s capital markets development has been closely linked to and driven by China’s economic reforms, and in return contribute to the economic development.**

The historical review of China’s capital markets development shows that the country’s economic liberalization and reform starting in the late 1970s gave birth to the China’s capital markets. As China’s market economy evolved, there has been an increasing demand for a more market-oriented resource allocation, leading to the gradual establishment and development of China’s capital markets.

In retrospect, China’s capital markets have gone through three phases of development:

Phase I: From early 1978 to 1992; China initiates full-scale economic reform, and China’s capital markets began to emerge along the incorporation process of Chinese enterprises.

Phase II: From 1993 to 1998, with the establishment of China Securities Regulatory Commission (CSRC) as a key milestone; China consolidates its capital markets and their regulations. The regional pilot programs are expanded nationwide and national capital markets began to emerge and evolve.

Phase III: From 1998 onwards, with the promulgation of the Securities Law as a key milestone; the legal status of China’s capital markets in the economy has been formalized and strengthened, and a series of major reforms are implemented to facilitate further development.

The capital markets have become one of the driving forces behind a series of important

economic and social reforms, and their contribution and influence on China's economic and social development have grown steadily. Over time, they have become a dynamic component of China's financial system and the national economy.

As demonstrated in the report, China's capital markets increasingly provide funding to economic activities in the government, corporate sector and households in China.

The development of China's capital market has been made possible by significant economic and financial reforms, and in turn it facilitated reforms in other areas of China's economic and financial systems. Consequently, the capital markets' impact on the evolution of the corporate sector and on the economy and society as a whole continues to grow.

- **The impact of the capital markets on economic and corporate sector development**

Under the planned economy, resources were allocated by administrative means, resulting in low efficiency. With the gradual move to a market economy, China's capital markets have become an important platform for resource allocation.

**Listed entities have become an important component of the Chinese economic system:** By the end of 2007, the market capitalization of listed companies reached US\$4.48 trillion, accounting for about 140% of China's GDP<sup>1</sup>. Large-scale, profitable enterprises such as Baosteel, Sinopec, ICBC, China Life, China Ping An Group, and Daqin Railway have become the backbone of the capital markets. Meanwhile, listed companies begin to represent a broader range of industries in the economy, from the traditional industrial and commercial stocks, manufacturing, telecommunications, electronics, electricity and power, petroleum, chemicals to the financial sector. This development mirrors the growing importance of China's capital markets to the national economy.

The capital markets began to play the role of financing and improving resources allocation, facilitating the growth of corporate sector: The capital markets have enabled business entities to access more external financing sources while reducing their reliance on bank loans and fiscal appropriations. This has, to some extent, contributed to the reduction of the leverage ratio in corporate sector. By the end of 2007, listed companies had raised a total of US\$203.8 billion from stock issues, US\$ 7.5 billion from convertible bond issues and US\$ 116.6 billion from bond issues.

The capital markets have also made it possible for Chinese firms, esp. the State-owned enterprises, to revalue their assets and to improve corporate governance and the

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<sup>1</sup> The GDP growth rate of 2007 is estimated as 11%.

management of state-owned enterprises and assets

- **The capital markets are demonstrating growing influence over social development**

The capital markets offer diversified investment channels to Chinese residents. With the emergence of the capital markets, the range of investment products has expanded from bank deposits to stocks, government bonds, enterprise bonds, convertible corporate bonds, securities investment funds, warrants and futures. Meanwhile, many new financial concepts have also been introduced. In particular, wealth management is becoming increasingly popular among Chinese households, with the number of investor accounts increasing from 8.35 million in 1992 to nearly 138 million by the end of 2007. As a result, Chinese individuals are increasingly interested in the performance of listed companies and macroeconomic development when investing in the capital markets and sharing the growth of the Chinese economy.

The capital markets have also provided diversified investment instruments for insurance and pension funds and indirectly supported the improvement of the social security system. Insurance companies, the National Social Security Fund and enterprise annuity funds have been increasing their investment in the capital markets. By the end of 2007, insurance companies and the National Social Security Fund held a total of US\$31.4 billion and 10.1US\$ billion worth of floating A-shares respectively, and enterprise annuity funds invested a total of US\$7.38 billion in the capital markets.

A fully-fledged retirement pension and medical insurance system is currently under development in China, all of which will call upon the capital markets to provide effective investment channels. In turn, further deepening and widening of the capital markets will be beneficial to developing a more inclusive social security system in China.

So far, the development of China's capital markets has exerted a profound influence on the national economy and the society. Benefiting from the capital markets development, China's corporate sector has restructured, expanded and integrated, state-owned enterprises and their assets have become better managed, private enterprises have developed, and listed companies have increasingly become key components of the national economy. Moreover, China's financial market structures have been transformed, with enhanced capacity to counter financial risks. Financial institutions have improved their profitability and operational efficiency. More importantly, the capital markets have prompted many economic and social changes in China over the course of their own growth and development. Joint-stock companies have become the popular in Chinese corporate sector, leading to further improvement in corporate management, as well as spurring a refinement of relevant legal and accounting systems, and the establishment of credit systems. Wider public participation in the domestic capital markets has led to a wealth effect and the inception of wealth management for households. From the outset, development of the capital markets has been at the forefront of China's economic reforms

and a driver of growth of China's economy. The experience and lessons learned in capital markets development so far may also shed lights for reforms in other areas.

**Major reforms have been conducted in the last five years aiming at improving market regulation and supervision, strengthening the legal framework from capital markets, and improving market infrastructure and functionality.**

In recent years, the CSRC has implemented a series of reforms to improve market infrastructure and functionality. These measures included the initiation of the non-tradable share reform, improving the quality of listed companies, restructuring of the securities companies, reforming the share issuance system and the investment fund management market, and developing the base of institutional investors. Supplementary rules and regulations have also been developed and implemented since the enacting of the amended Company Law and Securities Law in 2006. The combination of these measures resulted in profound changes in China's capital markets.

**Release of Opinions of the State council on Promoting the Reform, Opening and Steady Growth of Capital Markets**

This round of reforms was guided by the 2004 State Council "Opinions of the State Council on Promoting the Reform, Opening and Steady Growth of Capital Markets" (the "Opinions"), which set the direction for reforms and development of the capital markets, and regarded as an important elevation of the development of China's capital markets to a national and strategic level.

The Opinions declares that developing the capital markets is of strategic importance, as it will support the development of a socialist market economy; optimize resource allocation; funnel surplus capital into long-term investment; facilitate the restructuring of state-owned enterprises; accelerate private sector growth; improve the structure and efficiency of the financial markets; and help maintain financial security.

**The non-tradable share reform**

The problematic overhang of the non-tradable shares stemmed mainly from a lack of unification of shareholding systems; a lack of clarity over the role and functions of the securities markets; and the infancy of the reform of the management of state-owned companies. This inherent flaw in the system hampered the development of China's equity markets and state-owned assets management. With the increasing issuance of new shares, the hangover of the non-tradable share on the growth of the capital market became increasingly obvious in recent years.

The effective resolution of the non-tradable shares problem could only be achieved through a transition to an entirely new shareholding structure. Such a system must eliminate differences between the various types of A-shares, balancing the interests of non-tradable and tradable shareholders with issues being resolve through negotiation. The reform was carefully designed and well-organized in its implementation, following the principle of "centralized planning and decentralized decision-making". An implementation strategy based on pilot programs to test the market reaction was followed by a gradual and coordinated market roll-out.

Non-tradable share reform helped to eliminate the legacy problems in China's stock market, where unequal rights were given to the shareholders of state-owned shares, legal person shares and tradable shares, resulting in different pricing of these shares. After the reform, unified equity rights and pricing were established and the secondary trading started to reflect the value of the listed companies more accurately. The reform helped to a large extent in improving capital resource allocation in China's capital markets, while narrowing the gap with international markets in terms of market system development.

By the end of 2007, 1298 companies listed on Shanghai and Shenzhen Stock Exchanges had either initiated or completed the process of floating the non-tradable shares, accounting for 98% of the total listed companies that were subject to the reform. At this time, only 33 listed companies had not commenced the non-tradable share reform procedures.

### **Improvement of the quality of listed companies**

In recent years, after the State Council's *Opinions*, the CSRC initiated a series of reforms in succession to boost the quality of listed companies, protect investors' rights and interests, and promote the sustained and robust development of capital markets. This included formulating *Opinions on Upgrading the Quality of Listed Companies*, which the State Council approved in November 2005. Since March 2006, CSRC has initiated a number of specific programs aiming at enhancing compliance of the listed companies, strengthening corporate governance and improving the quality of listed companies.

### **Comprehensive restructuring of securities companies**

The role of securities companies as intermediaries is critical to the healthy development of the capital markets. Many securities companies quickly expanded their business without building up sound business models, proper corporate governance and internal control measures. These deficiencies became apparent as they engaged in wild speculation in the market. Many were found engaging in illegal activities such as misappropriation of clients' capital and securities and insider trading. By early 2004, the whole industry was at the brink of bankruptcy with years of risky and sometimes illegal investments and lack of proper supervision and enforcement. With the State Council's endorsement, in 2004 the CSRC launched a comprehensive restructuring program to turn around ailing securities firms. In order to address both the symptoms of the problems and the root causes, the CSRC implemented three key strategies, namely liquidation and restructuring of failed companies, stricter supervision and industry capacity building, and initiated the comprehensive restructuring of securities companies.

The restructuring of securities firms resulted in establishing a long-term risk prevention mechanism, with many fundamental infrastructure systems being improved or modified. Upon completion of the restructuring, securities brokerage companies raised their awareness of operational compliance. Innovative programs were introduced to improve industry efficiency. By the end of November 2007, the total assets and net assets of the

106 securities brokerage companies reached \$232.7 billion and \$43.8 billion respectively, 352% and 265% compared with that of the same periods of 2003. In the first 11 months of 2007, the annual operating revenue of the industry was \$34 billion, with net profits of \$17 billion. All but two of China's 104 securities brokerage firms generated profit in 2006, ending four consecutive years of negative income across the industry between 2002 and 2005. All major financial indicators for the industry reached or surpassed previous record levels.

### **Reform of stock issuance system**

Between 1990 and 2000, when China's capital markets began to develop in early stage, public offerings of shares were subject to administrative approval from the authorities. In March 2001, a new ex-ante review and approval system for public offering of stocks was introduced by the CSRC, which required pre-issuance mandatory information disclosure and post-issuance investigation. At the same time, a regulatory system for supervising the public offering was developed with simplified and standardized procedure. Subsequently, more market-driven pricing for IPOs gradually replaced government-driven pricing mechanism.

Main measures taken included: improving the transparency of the share issuance approval system, strengthening market discipline on securities issuance, and market-oriented share issuance pricing.

### **Liberalization reform of the fund management industry and development of institutional investors**

In 2002, liberalization reform of the funds approval system was initiated by the CSRC. Approval procedures were simplified and a system of expert review was introduced, making the fund product approval process more systematic, transparent, professional and standardized. After 2003, approval procedures were further simplified to converge with internationally-accepted registration systems.

### **Road map of liberalization reform of the fund industry**

- I In 2000, the expert review system was implemented for approval process of fund products.
- I In 2002, the CSRC proposed to simplify the approval process and reduce control to initiate the market-orientated reform in mutual fund industry. In November of the same year, the CSRC issued the *Notification on Relevant Issues Concerning the Examination and Approval of Securities Investment Funds*.
- I In 2003, the CSRC issued *Administrative Measures of Expert Review System for Securities Investment Fund*.
- I In 2005, the CSRC issued *Circular on Relevant Issues Concerning the Further Improvement of Procedure for the Application and Examination of Raising Securities Investment Funds*, which adopted simplified procedures for internal review of

existing fund products.

I In 2007, the time required for approving fund applications was further reduced.

From the beginning of 2002 to the end of 2005, liberalization reform unleashed the potential of the fund industry despite an overall downturn in the market. Total net value of funds increased to over \$57 billion from \$10 billion. The market value of the floating shares held by securities investment funds also increased from 5 percent to nearly 20 percent of the total market capitalization of the tradable shares. In 2006, a total of \$ 50.5 billion of new funds were raised by the fund industry with the gradual recovery of the market. This amount is equivalent to almost the total funds raised over the previous eight years. By 2007, funds under management by fund companies reached \$448.5 billion. Today, the fund industry is recognized by the market for being more transparent and better operated than before and has gradually gained public reputation.

### **Gradual refinement of the legal system governing the capital markets**

Deepening economic and financial reforms, coupled with rapid economic development has led to many fundamental changes in the nature of the capital markets. Such changes have resulted in the emergence of new issues and challenges necessitating continued revision of the two laws.

In October, 2005, the Standing Committee of the National People's Congress of the People's Republic of China amended the *Company Law and Securities Law*. The amended laws took effect on 1 January, 2006.

In line with the revision of the two laws, the National People's Congress and the ministries and commissions of the State Council took the effort to amend related laws, regulations and departmental rules. The National People's Congress passed *Amendments to the Criminal Law(VI)* to clarify the responsibilities of listed companies, securities and futures operating entities relating to breaches of the law, and impose heavier punishments for market manipulation. The *Enterprise Bankruptcy Law* was revised at the same time to regulate bankruptcy procedures and protect the interests of all parties involved. The CSRC formulated administrative regulations to supplement the amendments to the two laws through the following actions: *Implementing Measures on Freezing and Sealing-up of Corporate Assets, Code of Corporate Governance for Listed Companies, Rules for the General Meetings of Shareholders of Listed Companies, Guidelines on Articles of Association of Listed Companies (2006 Amendments), Rules of Private Placement of Listed Companies, Administrative Measures for the Qualifications of Directors, Supervisors and Senior Managers of Securities Companies, Measures on the Administration of Securities Settlement Risk Funds.*

### **Major Challenges for China's Capital Markets Developments**

Although China's capital markets have benefited enormously from the country's buoyant economy and its desire to modernize, it is still not ready to meet its future economic development needs. China's capital markets are still in an early stage of development and face many teething issues, such as a small operational scale, little direct financing, weak market mechanisms and corporate governance, and a low level of competitiveness for

financial institutions. It also has a small institutional investor base, and insufficient legal and integrity supervisory mechanisms.

**China's capital market is still small, with an imbalanced development of bond and equity markets:** At the end of 2006, the total value of the securities assets<sup>2</sup> constituted only 22% of China's total financial assets, whereas in the US, UK, Japan, and Korea, the proportion was 82%, 71%, 62%, and 75% respectively.

**Under-representation of dynamics of the national economy.** Today, many group companies have only listed some of their subsidiaries on the market, while others are either not listed at all or listed only on overseas markets. Although the Small and Medium-sized Enterprises Board in the Shenzhen Stock Exchange has been established, smaller enterprises remain significantly under-served. As a result, domestic investors have not been able to fully benefit from China's economic growth through participation in the capital markets. Although notable progress has been made in enhancing corporate governance of listed companies in China, there remain problems in corporate governance practices of listed companies.

**Small bond market, with nascent corporate bond market.** By the end of 2006, the total outstanding of bond market was US\$ 0.8 trillion, accounting to only 28.7% of the year's GDP, lagging behind mature, overseas markets and also lower than those of emerging markets, such as Korea and India. By the end of 2007, China's bond market has increased to US\$ 1.16 trillion in total outstanding, but treasury bonds, and financial bonds accounted for 90.3% of the total, while enterprise bonds<sup>3</sup> amounted to only US\$ 50.3 billion, or 5.2% of the market. Corporate bond market (excluding Enterprise Bonds) is still small, accounting for no more than 2% of GDP by the end of 2006. It is also dominated by short-term commercial papers.

**Fragmented bond markets with domination of commercial banks as investors:** Today, bonds are traded separately on different market segments, including exchanges, the inter-bank bond market, and the OTC retail markets, under different regulations, depending on the nature of the issuers and the bonds. Commercial banks are the major investors in the bond markets, holding up to 79% of the total bonds outstanding. The low liquidity and the weak price discovery in the secondary market due to the market segmentation are aggravated by the dominance of commercial banks in the bond market.

**Nascent financial derivatives markets:** Today, financial derivative products such as warrants (put and call) and bond with warrants are traded in small quantities on China's exchanges. This occurs in the absence of share options, index futures, interest rate futures, and currency futures which are popular in many other markets. A domestic derivative OTC market has yet to be developed, but China is witnessing huge changes in this area.

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<sup>2</sup> These include equities, enterprise bonds, corporate bonds, asset-securitized products, treasury bonds and financial bonds.

On 8 September 2006, the China Financial Futures Exchange was established, and plans are now in place to introduce index futures products to the exchange.

**Market efficiency needs to be further improved:** In recent years, regulatory reforms in securities issuance have significantly enhanced the domestic market's price mechanism for resource allocation. However, China's weak market economy system and unhealthy credit culture hampers the efficiency of the capital markets which enable better resource allocation. Further efforts to improve the efficiency in share issuance, bond issuance, trading mechanisms, clearing and settlements are to be carried out.

**Improvement in legal framework, market integrity, regulatory and enforcement effectiveness needed.** As an emerging market in a transitional economy, China's capital markets are developing with continuous structural and institutional reforms, calling for establishment of complementary laws and regulations during the process. With the fast development of the capital markets, adjustments, amendments and improvement of the existing laws and regulation will be an on-going effort with the changing internal and external environment.

**The development of supervisory framework lagging behind market development.** Market supervision is still featured with much administrative influence. Although a regulatory system was developed to oversee China's capital markets, issuers, investors, and intermediaries have historically relied heavily on the State and its policies. To a large extent, market integrity has been maintained through administrative means. Moreover, the external sanction system such as the court system for civil and criminal lawsuits for investor and creditor protection has not been fully developed.

**Enhancing enforcement will be a major task.** Sanctions and enforcement on frauds and illegal activities in securities markets have been difficult in China due to insufficient professional staff, interference and pressure from interest groups and the lack of supporting legal framework.

**Building-up of healthy capital market culture a long way to go.** In the relatively short history of capital markets in China during the transition from the planned economy to market economy has not completed, cases of management entrenchment or "insider control" have been found from time to time, hurting the interests of shareholders, especially the small shareholders. Frauds, price manipulation and insider trading happened as well, damaging the reputation and credit of the profession.

### **Strategies for China Capital Markets Development (2008 to 2020)**

The liberalization reforms of the past two decades have given China considerable experience which could be applied to future strategic measures in capital market development, including:

- promoting capital markets as part of a national development strategy and increasing public awareness of their importance
- incorporating markets into the economy while coordinating development with economic and social goals
- engaging in liberalization reform by providing incentives to market participants
- strengthening the legal and regulatory framework
- gradually opening of the market to make it more competitive in the world financial system.

With sophisticated legal and regulatory systems, bigger and more efficient markets, and improved international competitiveness, China's capital markets can play an important role in building a harmonious society. Then China will become a significant and influential member of the world financial system.

Major strategies for market supervisors till year 2020 would include:

- Maintain fine balance between the government and the market force; strengthen legal and regulatory framework; and build fair, transparent, and efficient markets
- Create a fully multi-layered stock market
- Liberalize the bond markets and speed up the bond markets development
- Develop the futures and derivatives markets steadily
- Improve the quality of listed companies
- Build up internationally competitive securities industry and financial service industry
- Improve capital markets' culture and foster a favorable environment for capital markets' sustainable development

1. **Maintain fine balance between the government and the market; strengthen legal and regulatory framework; and build fair, transparent, and efficient markets.** Simplify administrative procedures, foster market-driven IPO process and product innovation. Strengthen the legal and regulatory framework. Reinforce regulatory team-building, improve regulatory efficiency, and improve regulatory coordination, prevent financial crisis.
2. **Create a fully multi-layered stock market.** The need for a multi-layered stock market is becoming increasingly apparent, as both the funding requirements of enterprises and the needs of investors grow more diverse.

3. **Liberalize the bond markets and speed up the bond markets development.** To help develop China's bond market, a unified and centralized regulatory system, which prescribes clear responsibilities, should be established with a set of rules addressing the issuance, trading and disclosure of bonds. A set of market-oriented corporate bond approval procedures will help to improve efficiency, and issuers will gradually be given more flexibility to decide on the rate, maturity, and type of bonds to offer. Measures will be taken to interconnect the the exchanges and the inter-bank bond markets to become a more secure and efficient marketplace. Technical system upgrades will be completed to expedite the custody-transfer processes between the different registration and settlement agencies. A bigger and broader institutional investor base capable of recognizing and managing risks will be sought.

4. **Steady development of the futures and derivatives markets.** In order to support the development of the Chinese economy, there is great need for a large scale futures markets for commodities, including metal and agricultural products, to help companies manage their risk exposures. Along the way, there will also be commodities options and other financial derivatives.

To ensure market discipline and stability, futures margins and the net capital of futures companies will be monitored. In addition to setting up exchanges for futures markets, more effort shall be applied to improving futures trading and settlement processes.

Financial institutions, subject to compliance rules, will be allowed to use financial derivatives as a risk management tool. Hedging transactions in the derivatives markets will be encouraged. Securities companies, commercial banks and other financial institutions will be encouraged to act as brokers and dealers in the futures market.

#### **5. Improve market discipline and quality of listed companies**

Improvements on the required content and format of information disclosure will be made to enhance the quality of disclosure. New monitoring methods will also be introduced to improve effectiveness and to increase non-compliance costs. International best practices on electronic filing will be benchmarked to improve the timeliness of disclosures. To continuously improve corporate governance, more initiatives will be introduced such as:

- improving the effectiveness of independent directors
- encouraging listed companies to strengthen internal controls, and reinforce self assessments and external audits
- improving incentives structures
- encouraging institutional investors to exercise external supervision
- fostering active, market-oriented, and disciplined M&A activities with relevant laws and regulations to supervise during and after transactions.

A more flexible de-listing mechanism will be put in place to adjust for market changes.

Officers of de-listed companies who have violated laws and regulations will be legally accountable. The rights of investors and creditors will be protected in accordance with the new Bankruptcy Law.

## **6. Encourage competition to foster more globally competitive financial service industry in China**

To achieve the full development of the capital markets, it is vital to establish an environment supporting innovation and fair competition in the securities and futures industry. To create such an environment, further liberalization reform to allow more financial innovations and fair competition of participants, and further empowerment of market participants, will be necessary. The evolution towards good corporate governance and management of securities companies, funds, and futures companies will be actively pursued, with reference to domestic circumstances and international experience. In addition, share-based incentive schemes will be set up to retain and attract suitable talents. Securities companies should enhance their internal controls and develop a comprehensive and effective set of early warning mechanisms. Diversifying operations and expanding business scope, coupled with M&A and exit mechanisms, will help market players to better compete in the dynamic global environment.

## **7. Gradual opening-up of the market to build up globally competitive capital markets**

It is envisaged that capital markets will open up in a gradual, balanced, and mutually beneficial manner. The selection of opening routes, as well as the degree and pace of reform, will be targeted on improving the international competitiveness of the domestic industry. While taking precautions to protect the safety and integrity of the domestic financial system, restrictions on foreign shareholding in securities joint ventures and their business scope will be gradually lifted. The share of overseas capital in the domestic market will increase. Overseas companies will also be accepted for listing in domestic exchanges, which will open domestic markets and raise global competitiveness. Cooperation with Hong Kong, Macau and Taiwan will be continued. Incentives and conditions for domestic securities and futures investors to “go out” will be created to encourage qualified securities companies, fund management, and futures companies to set up overseas branches or joint ventures to operate in selected fields. Domestic institutional investors with sound internal controls will be allowed to invest in international markets, where they can learn from international best practices.

Collaborations with overseas securities regulators, international securities regulatory organisations and other relevant bodies will be enhanced with the objective of managing cross border financial risks that come with a globalized marketplace.

## **8. Improve capital markets’ culture and foster an environment good for the sustainable development of capital markets.** A healthy environment will facilitate the

development of capital markets. Education programs for small and medium investors will be conducted, focusing on risk awareness and value investment. This should enhance investors' understanding regarding the protection of their own interests, and further bring to awareness the fact that they are responsible for their own risk. Healthy shareholder involvement and a sound equity culture will help protect investor interests and reduce the risk of undue control by dominant shareholders. Finally, the integrity of market participants will be enhanced with an increased emphasis on open, fair and equitable disclosure. A unified tracking system will be set up to allow market participants to share information on identified dishonest behavior.

### **Prospects for China's capital markets (2020)**

The past two decades have provided China's capital markets with a myriad of experience and achievements. Building on such experiences as well as referencing to international best practices, China will be able to set up tangible and strategic measurements to fully realize its capital market potential. It is predictable that China's capital markets will grow and prosper while making significant contributions to the domestic economy.

#### A vision for future capital markets (2008 – 2020)

- | A fair, transparent, and efficient marketplace supported by a sound legal and regulatory framework
- | Expanded market depth and width, marked by efficiency, multiple layers and openness
- | World class investment banks and asset management institutions emerge to provide better services
- | A larger role in economic and social progress, and a driving force in building a harmonious society

#### **1. A fair, transparent, and efficient marketplace supported by a sound legal and regulatory framework**

By 2020, China's legal and regulatory framework will be more sophisticated and complete, supporting a market system that is transparent, efficient, and highly secure.

This system includes government supervision, self-discipline among trade associations, self-regulation among market participants and wider forms of public scrutiny. The emphasis of supervision would have shifted from administrative approval to disclosure requirements, and the form of supervision changed from institutional regulations to functional supervision. The role of government will have transformed from a manager to a supervisor.

#### **2. Extended market depth and width**

By 2020, China will significantly extend the depth and width of its capital markets through establishing bonds, stock, commodities and financial derivatives markets, bringing a rich collection of product offerings and a variety of trading platforms to help Chinese enterprises become stronger and better. International capital will be more involved and international companies will be able to float in China's markets. The

infrastructure will continue to improve and China will have a significant bearing on international markets due to the depth, liquidity and efficiency of its markets.

### **3. The emergence of world class players**

By the time China's capital markets reach maturity in 2020, securities companies, fund management and futures companies will have achieved higher standards of management, sounder governance, more effective incentive schemes and more sophisticated risk management structures. In the backdrop of a strengthening capital market, other professional service firms such as accounting firms, law firms, appraisal firms and credit rating agencies. There will be more, bigger and more professional financial intermediaries with higher standard of services. A large number of professionals from around the world who understand international best practices will join the forces to serve in China.

**4. China's capital markets will play a larger role in economic and social progress, and become a driving force in building a harmonious society.** By 2020, China's capital markets will have developed from the emerging market in a transitional economy to a more mature stage. Capital markets will become the most important place to raise capital or allocate resources. The securitization level will reach that of a developed country, and China will have a well structured financial system with more elasticity, vigor and stability. By 2020, not only will China's capital markets be supporting enterprise growth and upgrading the industrial base, they will also be redirecting investment to less developed regions. Futures on agricultural products will help transform rural production and operation, contributing to the prosperity of the new socialist countryside. Capital markets will provide an investment avenue for retirement funds and social security funds, thus supporting China's aging population.