

# Building an international finance center: Tracking provincial financial sector ambitions for the next five years

China's leadership is watching closely to see how financial sanctions affect Russia. It's becoming increasingly clear that dollar dependence is a strategic vulnerability, and that China needs to achieve a degree of independence from the global dollar order.

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## Key takeaways

- Doing so will require a multifaceted approach that requires deeper capital markets, a diverse financial sector, the free flow of capital across China's borders, and the global acceptance of the yuan. But part of the equation also involves China developing one or more of its cities into an international financial center.
- We reviewed the five-year plans on financial sector development published by most of those cities or provinces with a vibrant financial sector. All have plans to increase the international relevance of their financial markets.
- The most important plans were those of Shanghai and Shenzhen, which have clear objectives to become international financial sectors.
- Those plans have four main components: (1) deepen and diversify capital markets, (2) develop and diversify financial services, (3) attract further foreign investment, and (4) build trust in China's financial system.
- The value of these plans is that they give us a framework for understanding the policy choices of financial regulators in the coming years, and perhaps even help us anticipate what policies might be in the pipeline.

As Western nations lock Russia out of the global financial system following its invasion of Ukraine, China's leadership is undoubtedly watching closely, witnessing the many ways dependence on the dollar poses strategic vulnerability. Over the years ahead, Beijing is likely to liberalize the capital account and promote the further internationalization of the yuan in a bid to decouple from – or at least achieve a degree of independence from – the global dollar order. However, encouraging the global – or at least regional – acceptance of the yuan is a multifaceted thing requiring deep capital markets, a diverse financial sector, and the free flow of capital across China's borders. Today we look at an aspect of that: How China might cultivate one or more of its cities as international financial centers (IFCs).

Since the release of the 14th Five-Year Plan (14FYP) last year, numerous localities have released five-year development plans for their financial sectors. We went through the plans of those provinces, provincial-level cities, and sub-provincial special-economic zones (i.e., Shenzhen) that have some claim to being a financial center: Shanghai, Shenzhen, Guangdong (because of its role in Greater Bay Area (GBA) financial integration), Liaoning (home of the Dalian Commodities Exchange), and Chongqing (which is being positioned as a western financial gateway to China).

Our goal wasn't to compile a comprehensive breakdown of what these areas intend to do over the next five years. Instead, we went looking for themes. The one theme that stood out was a desire to develop the international relevance of their financial sectors, and in some cases, become either an international or a regional financial center.

Liaoning's ambitions were the most circumscribed, focused entirely on becoming a globally relevant center for commodities and futures trading. Chongqing aspires to become a regional financial center by cultivating relationships with members of the Shanghai Cooperation Organization (SCO) – which are mainly based in Central Asia – and ASEAN, particularly by leveraging its close ties with Singapore. Meanwhile, Guangdong is focused on making the GBA a success by pursuing greater financial integration with Hong Kong and Macau.

However, it should come as no surprise that the two most interesting plans are those of Shanghai and Shenzhen, with both cities squarely focused on evolving into IFCs.

China is now at a stage of development that demands more complex financial services. Moreover, given its size and role in global trade, it seems inevitable that China's financial sector should one day play a regional role. While that may be true, according to the five-year plans we reviewed, international geoeconomic conditions are driving the urgency behind moves to develop as IFCs.

According to Shenzhen:

***“The competition among international financial centers in the Asia-Pacific region has become increasingly fierce ... It appears that Shenzhen is facing such competition that ‘if you don’t advance, you will retreat, and if you advance too slowly, you will also retreat.’”***

Guangdong puts it a little differently:

***“The trend toward regionalization and near-shoring of industrial supply chains is becoming clearer. On the financial front, global debt levels are rising, sustainability issues are becoming increasingly prominent, and the competition between countries and regions over global economic governance and the restructuring of the financial order is intensifying. The international financial system is accelerating in the direction of multipolarity, the number of new international financial centers is accelerating, and so it has become more urgent [for us] to build a financial hub with international influence.”***

Of course, the extent to which any city in China can become an international financial center will depend on the degree to which the central authorities liberalize the capital account. Further liberalization is clearly on the cards, and all the plans we looked at expressed enthusiasm for engaging in trials that relax limits on cross-border capital flows and experiment with the cross-border use of the yuan. However, the pace at which China liberalizes the capital account is entirely in the hands of Beijing. For a city to truly become an international or regional center, the yuan has to become an international currency.

Whether the yuan becomes an international currency is outside the scope of individual provinces to realize. That limits the ability of Shanghai and Shenzhen to become bona fide IFCs. That said, even without capital account liberalization, plenty of other conditions still need to be in place before either city can reasonably achieve international relevance.

The measures that Shanghai and Shenzhen intend to put into place over the next five years fall into four main categories. They plan to:

- Deepen and diversify capital markets
- Develop and diversify financial services
- Attract further foreign investment
- Build trust in China’s financial system

The rest of this report will outline the specific measures that the two cities intend to implement. However, it’s important to keep in mind that these may fall well short of allowing either city to achieve IFC status. In fact, it might require a further five years, or even another ten – assuming they can become IFCs at all – before they’re able to achieve that goal. The value of these plans is that they give us a framework for understanding the policy choices that Shenzhen, Shanghai, and the central authorities make in the coming years, and perhaps even help us anticipate what policies might be in the pipeline.

China’s economy is intricately tied into the global dollar-dominated order. Extricating it will be a complex process that involves China having vibrant financial hubs capable of providing financial services denominated in yuan to countries within its economic sphere of influence. Achieving IFC status is a long-term process, but Shenzhen and Shanghai – and to a lesser extent Chongqing and Guangdong – already have plans to move in that direction.

## Deepen and diversify capital markets

Both Shanghai and Shenzhen have plans to hugely increase the number of listed companies and bonds that trade on their exchanges and increase the range of financial products available. That includes developing new markets where new types of financial assets can be traded. This is part of the central government's plans to overhaul the role of China's capital markets, not only so that they play a greater role in financing the economy, but also so that they become a place for households to park savings as they migrate away from the property sector.

However, while the need to diversify and deepen China's capital markets is driven mainly by domestic concerns, there's also an international element. If China intends to one day transform the yuan into a reserve currency, China's domestic markets need to not only be able to absorb the full volume of global funds that want yuan-denominated assets, but also provide the full spectrum of risk assets.

### Shanghai

- Support Shanghai Equity Custody Trading Center to build a fully functional debt-to-equity asset trading platform.
- Study the establishment of a private equity and venture-capital equity-share transfer platform in Pudong, and promote the development of the secondary trading market for private equity and venture capital equity shares.
- Promote the establishment of an international financial asset trading platform.
- Accelerate the unified opening of China's bond market, including the inter-bank and exchange bond markets, to further facilitate the participation of qualified foreign investors in China's bond market.
- Promote the further opening of the futures market and provide more convenient risk hedging support for foreign investors holding domestic RMB assets.
- Expand the issuance of "Panda Bonds."
- Promote RMB bonds to become qualified collaterals recognized by the international market, and establish cross-border mutual recognition channels for RMB bonds and other collaterals.
- Support governments, enterprises, and financial institutions from countries and regions along the BRI to issue bonds and other financial products in Shanghai.

### Shenzhen

- Support the Shenzhen Stock Exchange in taking the lead in listing overseas companies.
- Promote the opening of Shenzhen's bond market to the outside world.
- Promote the construction of a bond platform for the GBA, and explore the interconnection of the bond market in the GBA.
- Explore the establishment of cross-border mutual recognition channels for RMB bonds as collateral, and gradually promote RMB bonds to become qualified collateral recognized by mainstream financial institutions in Hong Kong and Macao.

## Develop and diversify financial services

While it's important to deepen China's capital markets, developing the range of financial services that Shenzhen and Shanghai offer is also critical. That's in part because Chinese firms desperately need them. For example, better access to trade finance is something that small firms around the country are in desperate need of, and this is getting increasing attention from China's authorities. Meanwhile, the development of entirely new services like green finance is needed to help the central government realize its goal of carbon neutrality. And China's demographic changes mean that services like wealth management are assuming a far greater degree of importance and require development beyond their current situation.

However, many other countries – particularly members of the Belt and Road Initiative (BRI) – also lack access to those same financial services. As China liberalizes its capital account – and assuming the yuan becomes more readily accepted globally – then the services cultivated in Shenzhen and Shanghai for a domestic market will also find potential customers in neighboring countries.

The areas of finance that Shanghai and Shenzhen intend to develop further are: Maritime finance, insurance, trade finance, wealth management, and green finance.

### Maritime finance

#### Shanghai

- Promote the development of shipping finance.
- Develop derivatives such as shipping freight index futures and expand the international influence of Shanghai shipping prices.
- Attract shipping insurance companies to enter in Shanghai and enrich shipping insurance products.

#### Shenzhen

- Accelerate the establishment of the International Ocean Development Bank, effectively play a leading role, and help Shenzhen build a marine financial hub that leads the Pan-Pearl River Delta, radiates to Southeast Asia, and serves the BRI.
- Vigorously guide banking institutions to use syndicated loans, financial leasing, and other methods to provide financing support for maritime-related enterprises, and expand financing channels for the maritime industry.
- Explore the issuance of corporate maritime development bonds at home and abroad, encourage industrial (equity) investment funds to invest in comprehensive maritime development enterprises and projects, and increase the proportion of direct financing for the maritime industry.
- Actively develop characteristic financial industries such as shipping finance, maritime insurance, reinsurance, and ship finance.

## Insurance

### **Shanghai**

- Give full play to the active role of the Shanghai Insurance Exchange to build a world-class reinsurance center.

### **Shenzhen**

- Support Shenzhen, Hong Kong, and Macao-based insurance institutions to develop innovative cross-border motor vehicle insurance, cross-border medical insurance, cross-border RMB reinsurance, and other businesses.

## Trade finance

### **Shanghai**

- Standardize the development of supply chain financial products such as inventory, warehouse receipts, orders, and accounts receivable financing, and improve the supply chain bill platform
- Improve the efficiency of accounts-receivable financing for small, medium, and micro enterprises, and encourage core enterprises to confirm their rights through accounts-receivable financing service platforms.
- Improve the supply chain bill platform, and encourage banks to provide more convenient financing such as discounting and pledging for supply chain bills.
- Encourage qualified foreign capital to enter Shanghai to establish or take shares in securities, funds, futures, and life insurance companies, wealth management subsidiaries of commercial banks, insurance asset management companies, pension management companies, and credit rating agencies.
- Support more foreign banks to apply for securities investment fund custody qualifications and obtain underwriter qualifications in the inter-bank bond market. Support foreign institutions to apply for fund investment advisory qualifications.

## Wealth management

### **Shenzhen**

- Support the development of emerging wealth management formats such as private banks, family trusts, and family offices, and enrich the organizational system of the asset management industry.

## Green Finance

### **Shanghai**

- Build Shanghai into a carbon pricing center with international influence.
- Promote the securitization of green assets.
- Develop green insurance.
- Support the development of innovative products like green leasing and green trusts.
- Support the introduction of carbon forwards, carbon swaps, carbon futures, carbon leasing.

- Strive to build a green financial hub that connects domestic and international markets.
- Promote the two-way opening of a green financial market.

#### **Shenzhen**

- Build Shenzhen into a global sustainable finance center

#### **Guangdong**

- Support the development of Guangdong and Shenzhen as carbon emissions trading centers.
- Carry out a carbon emissions trading foreign exchange pilots.
- Establish a GBA common market for green finance.

### **Attracting foreign investment into the financial sector**

Traditionally, China's desire to attract foreign financial institutions has been perceived as being about expertise. China is still relatively inexperienced in more complex forms of financial services, and encouraging foreign participation is a way to learn from abroad. But as Shenzhen and Shanghai move toward becoming IFCs, the mere presence of foreign financial institutions is a prerequisite for developing cross-border business opportunities. Consequently, Shanghai doesn't just want to attract big names from the US and EU, but also banks from BRI countries.

#### **Shanghai**

- Attract financial institutions from countries and regions along the BRI to set up legal persons or branches in Shanghai.
- Promote the development of trade finance, and encourage multinational companies to set up capital operation centers that radiate to the Asia-Pacific and face the world.

### **Building trust**

One of the reasons for Hong Kong's success as a gateway for foreign capital into China is that Hong Kong boasts a transparent legal system that has a tradition of honoring contracts. Investors are wary of investing in mainland China because the legal system often makes decisions based on political considerations. The concern for many investors is that the Chinese legal system won't give them a fair hearing, and that the courts generate inconsistent decisions based on opaque considerations.

China's authorities are aware of those concerns. While they have no intention of overhauling the country's entire legal system, they are striving to make the law as it applies to the financial system more appealing to foreign investors. In short, Shanghai and Shenzhen are trying to create an investment environment that foreigners are willing to trust.

#### **Shanghai**

- Build an environment of financial rule of law and rules in line with international standards.



- Protect property rights and equal competition.
- Protect the legitimate rights and interests of financial consumers.
- Improve the professionalism of trials, and their international credibility and influence.
- Explore making more international financial arbitration rules applicable to Shanghai arbitration commissions.
- Strengthen financial training for judicial and law enforcement personnel.
- Cultivate internationally competitive credit rating agencies.
- Support the People's Bank of China Credit Information Center to achieve full coverage of corporate and personal financial lending information in the Yangtze River Delta.

### Shenzhen

- Establish a financial dispute mediation mechanism.
- Explore online mediation.
- Improve the professionalism of financial arbitration and financial trials.
- Explore and implement an internationally competitive cross-border financial tax policy.
- Strive to set up the Shenzhen Financial Court.
- Promote the construction of an international financial arbitration center in the GBA.
- Support the development of professional services institutions such as accounting, auditing, legal, credit rating, asset evaluation, investment consulting, and credit services.
- Make it easier for Hong Kong and Macao-based professional services institutions to practice in Shenzhen.
- Strengthen strategic cooperation with world-renowned financial media.