Chapter V

Financial Innovations

Financial innovation is the driving force for the development of modern financial sector. It is crucial to the improvement of financial services and enhancement of competitiveness of the financial industry. The Central Committee of CPC and the State Council have been attaching great importance to financial innovation. China's Eleventh Five-Year Plan has made it clear to "orderly develop the financial sector, encourage financial innovation and steadily develop integrated financial services". At present, it is necessary to vigorously promote financial innovation by taking comprehensive measures and effectively fending off the accompanying risks at the same time.

Development Status

While the "financial innovation" is a widely used term, the academic community does not have a uniform definition on it. Narrowly speaking, financial innovation refers to financial product and instrument innovation.[1] Broadly speaking, it refers to new forms of organization and development mode that cause structural changes in the financial sector as well as new products, services, instruments and technologies.

In China, financial innovation develops gradually along with the deepening of financial reform, experiencing a process from simply learning and imitating to vigorously conducting independent innovation. Before 1978, China's financial sector was characterized by less-than sophisticated institutions and limited business scope. Under the planned economic system, there was a lack of financial innovation, which includes not only the market players, but also the conditions and needs for financial innovation. Since the reform and opening up, the Chinese financial sector has witnessed a series of major and profound revolution, financial institutions system, market system and services system have been improved gradually, financial assets have increased substantially, and capital, asset quality and operational efficiency of financial institutions have been boosted and the building of financial infrastructure has made significant progress. The financial sector has further performed its functions. All above changes have laid a solid foundation for financial innovation in the new era.

Box 11 International Developments of Financial Innovation

Since the 1960s, financial innovation has flourished and become a major driving force for the development of the financial industry. Many new financial products and financial instruments have been put on the market and quickly copied or transformed and widely used.

1 In a report of G-10 Central Bank entitled "The International Banking Innovations in Recent Years", financial innovation is defined as the process of unbundling and repackaging some special features of financial instruments.

Financial innovation has distinctive characteristics of the times. In the 1960s, financial innovation was mainly to circumvent the rigid regulations on the exchange markets and capital flow adopted by most countries under the Bretton Woods System . From the 1970s to the 1980s, after the collapse of the Bretton Woods System, most of the developed countries adopted a floating exchange rate system, and financial innovation was mainly to prevent exchange rate and interest rate risks caused by floatability. A lot of hedging and risk-averting financial products and tools were introduced. Since 1990s, relaxing control on the financial industry has become a trend and enterprises and residents have had more extensive and higher demand for financial products and services. Improving profitability became the primary target of financial innovation and demand-driven innovation has prevailed. During this period, financial innovation mainly took the form of integration and internationalization, and various financial derivatives had emerged on the foreign exchange and capital markets. In addition, non-banking financial institutions in the form of insurance companies, pension funds, housing finance companies, finance companies, credit cooperatives, investment funds flourished and significantly changed the structure of the financial system.

In recent years, international financial innovation has become more complicated and sophisticated. Take the banking sector for example, the commercial banks have made innovation in business scope, products and management against the new risk features and condition changes. First, commercial banks have given more attention to the retail business, mortgage loans and credit card loans; Second, commercial banks have vigorously developed new products such as asset management products; Third, they have moved from the traditional credit services to providing intermediary services; Fourth, they have showed great interest in the emerging market economies and some of the large commercial banks have increased investments in these countries. These innovations have diverted the risks in the banking sector and made the risk distribution in the whole financial system more complex. It is difficult to predict the future value and losses of those complicated financial products and financial instruments since their effectiveness are not yet proven, and the sensitiveness of the financial system to the shocks becomes more uncertain.

Since 21st century, facing intense international competition and high financial services demand, financial innovation has become necessary not only to promote economic and social development but also to boost financial sector reform and development. The Eleventh Five-Year Plan has made it clear to "orderly develop the financial services sector, encourage financial innovation and steadily develop integrated financial services." With the joint efforts of government guidance and the voluntary momentums of the market, financial innovation has entered a new era of rapid development.

Innovations of financial organization system and development mode

Innovating reform modes of state-owned commercial banks and achieving major breakthroughs in reforms of major sectors and key areas. The government creatively used some portion of foreign exchange reserve to inject capital into state-owned commercial banks. In terms of clarifying property ownership, the Central Huijin Investment Corporation was established to act as an investor on behalf of the state. In terms of NPAs disposal, tendering process and other market measures have been adopted. Many domestic and overseas strategic investors have been introduced to improve corporate governance on the base that the state is the controlling share-holder. To preserve and increase the value of state-owned assets and strengthen the market discipline, some financial institutions have been successfully listed on domestic and overseas capital markets. Through these innovations, SOCBs have improved corporate governance, earnestly strengthened internal control and risk management, changed operational mechanisms to a certain extent, and improved services and profits.

Innovating organization systems of small- and medium-sized financial institutions to improve the financial services to the economy. To address the urban-rural disparity which still exists amidst the rapid economic growth and other regional and structural imbalances, efforts have been made to innovate the organization systems of small- and medium-sized financial institutions to meet the needs arising from economic development and structural adjustment. Postal savings institutions reform has been accelerated and PSBC was established. Some new regional small- and medium-sized banks have been established and the attempt is under way to establish SME credit guarantee agencies. Comprehensive efforts have been made to deepen RCCs reform, explore the development of rural micro-finance institutions, vigorously conduct pilot program of agricultural insurance and continue to improve the rural financial organization systems.

Transforming operational mechanism of financial institutions and increasing their profitability. With deepening of reform in financial system and strengthening of opening up and competition, financial agencies have begun to change operational method and seek new sources of profit. Commercial banks have changed their profitability mode based mainly on interest income, expanded bank card business, fund custodian and other intermediary services, and vigorously developed personal pledge loans, personal asset management and other retail businesses. As a result, non-interest income has become new source of increased profit. Securities firms have explored differentiating business, taken advantage of professionals, standardized the securities broker business, begun new asset management and proprietary business and gradually changed the former single profitability mode. Insurance companies also have abandoned the salesperson booth development mode and gradually looked for business outsourcing, asset management consulting business, on-line insurance and other business modes.

Innovating financial institution development modes and steadily put forward the pilot program of integrated financial services. With the closer link among money market, capital market and insurance market, the banking sector, securities sector and insurance sector have deepened cooperation and pilot program of integrated financial services is steadily advancing. The mode of conducting integrated financial services, with financial holding company as its primary form, has been developing steadily and will provide diversified financial products and services. Financial institutions have innovated development modes and actively made cross-sector investment. By the end of 2006, fund management companies set up by commercial banks have managed 8 securities investment funds with net asset at RMB 30 billion yuan. Insurance fund has been utilized in more channels. There have been more cases of insurance companies investing in banks and securities firms and starting pilot program of investing in infrastructure and venture capital enterprises. In addition, innovation is being studied and promoted for commercial banks to set up financial leasing companies and insurance companies, for asset management companies to set up securities firms, and for insurance companies to set up fund management companies.

Financial product innovations

There has been rapid development in financial derivatives. In recent two years, with market-oriented interest rates reform, RMB exchange rate regime reform and share trading reform being advanced orderly, financial market players have a growing demand for circumventing market risks and domestic financial derivatives innovation has been boosted. On the stock market, call and put options have become new forms of considerations in share trading reform. In August 2006, CFFE was established and stock index futures will be launched in due time. On the inter-bank bond market, pilot program of bond forwards and the RMB interest rate swaps has met institutional investor's demand for averting interest rate risks. On foreign exchange market, with the RMB exchange rate regime further improved, RMB exchange rate flexibility has been gradually increasing. RMB forward purchase and sale, RMB forward, RMB exchange swap and other RMB derivatives have been launched. At the same time, overseas RMB derivatives also develop rapidly.

Box 12 RMB Derivatives Innovation

In the 1990s, as the scale of China's international trade continued to expand, the influence of RMB on the international markets was gradually increasing. The OTC RMB derivatives market started to appear in the offshore. In 1996, Hong Kong and Singapore set up offshore RMB business of RMB NDF, since then there had been non-delivery RMB options, non-deliverable swap, structured notes, futures and other derivative products in RMB. In August 2006, CME launched the world's first Exchange traded RMB derivative, namely futures contract in RMB/Dollar, RMB/Euro and RMB/Yen, with contract unit of RMB 1 million yuan. The daily clearing balance was counted according to the RMB exchange rate fluctuation and the contract settlement at maturity was in the dollar, the euro and the Japanese yen cash.

While offshore RMB derivatives product developed rapidly, product innovation of the domestic foreign exchange market has increased. The pilot RMB forward purchase and sale business starting from April 1997 was the first RMB derivative in China. Since then, with the RMB exchange rate formation mechanism improved, the RMB exchange rate flexibility has become more resilient. In August 2005, the central bank stipulated that all eligible commercial banks could offer RMB forward purchase and sale business and RMB-to-foreign currency swap business. The inter-bank foreign exchange market launched the RMB foreign exchange swap business in April 2006, and launched the UK Pound/RMB forward and swap, which enriched domestic financial derivative products and provided an important tool for financial institutions and enterprises to circumvent the exchange rate risk.

After more than 10 years of development, domestic foreign exchange market cultivated a large number of professionals familiar with the foreign exchange business and more advanced foreign exchange trading, settlement and risk control systems were established, which created good conditions for the further development of RMB derivative products. The next step will be for PBC to work in close coordination with relevant authorities, make full demonstration, continue to expand RMB foreign exchange forwards and swaps trading products, continue to accumulate experience, improve related systems and infrastructure, and launch RMB futures products at an early time.

The innovation of asset management products is very active. Commercial banks, securities firms, asset management companies, insurance companies and trust and investment companies introduce asset management products respectively with many varieties but little differentiation. They are mainly divided into RMB asset management products and foreign exchange asset management products.

In terms of RMB asset management products, commercial banks' RMB asset management products are mainly invested in Central Bank Bills, treasury bonds, policy finance bonds and short-term financial bills. Securities firms mainly provide integrated asset management services. By the end of 2006, commercial banks have altogether launched over 20 RMB asset management brand products, 14 innovation-type securities firms launched 22 integrated asset management products, 9 special asset management products and the total assets stood at about RMB 60 billion yuan. Fund management companies have launched blended funds, money market funds and so on. The Shanghai and Shenzhen Stock Exchanges have launched ETF and LOF. Insurance companies have innovated asset management business to financial institutions and Huatai Insurance Co., Ltd. developed the first asset management products for insurance institutions—Huatai value-added investment products. Trust and investment corporations launched bank-trust linked asset management products.

Regarding the foreign exchange asset products, the first one is structured foreign exchange deposit, i. e. some commercial banks attached certain financial derivatives to the ordinary foreign exchange deposits, which make the sum of principals plus interest linked to the future prices of financial derivatives. The second one is overseas asset management services standing for clients. In April 2006, the QDII system was introduced, which allowed qualified banks to poll RMB funds of domestic institutions and individuals to purchase foreign exchange within a certain amount and invest in fixed-income foreign exchange products. It allowed qualified fund management companies and other securities institutions to gather foreign exchange funds owned by domestic institutions and individuals within a certain amount to invest in fixed-income portfolios abroad (including stocks). It allowed qualified insurance companies to purchase foreign exchange and invest in fixed-income foreign exchange products and money market instruments. As of the end of 2006, a total of 15 commercial banks received a cap of USD 13.4 billion to purchase foreign exchange for overseas client asset management and investment. Insurance companies received a cap of USD 5.4 billion to purchase foreign exchange abroad. In September 2006, the Hua An Fund Management Co., Ltd was granted to issue the first QDII fund product in China—the Hua'An International Balanced Fund— and invested in New York, London, Tokyo, Hong Kong and other major international markets.

Efforts were made to continue the pilot program of credit assets securitization and mortgage loan securitization. As of the end of 2006, two banks and two asset management companies offered credit asset securitization and mortgage loan securitization business. Asset securitization products issued amounted to RMB 16.404 billion yuan, a growth of 111.83% compared with that of 2005. Securities firms issued financial asset securitization products through asset management, and there were seven enterprise asset securitization projects with asset securitization products issued amounted to RMB 23.885 billion yuan and provided a new channel for corporate' financing.

Product innovation in the inter-bank market and the exchange market proceeded steadily. In 2006, the inter-bank market introduced mixed capital bonds, bond borrowing and lending, restructuring asset-backed bonds and other innovative products. Enterprise short-term financial bills, financial bonds and commercial banks subordinated bonds further developed. Exchange market introduced listed corporate bonds, convertible corporate bonds with separate transactions, corporate bonds with warrants and other fixed-income products. All of these products enriched market investment instruments and increased the market liquidity.

Financial services innovation

Financial services innovation is manifested as the followings: financial agencies have established a market-oriented and customer-based marketing concept and provided customized services according to the classification of customers. First, commercial banks have innovated marketing concept, provided comprehensive, differentiated, multi-layered financial services, developed qualified customers through setting up Client Manager and Customer Service Center. Second, while providing personal banking services to advanced customers, banks have also offered micro-credit, community financial services to many ordinary customers. Third, they have increased financial services to small enterprises and rural areas by strengthening credit support to small enterprises, employments, students, migrant workers, private sectors, etc. and expanding financial agencies' credit to the agriculture, rural areas and farmers. Agriculture insurance as an innovation of supporting agriculture has been incorporated in the agricultural support and protection system.

Financial instrument and technology innovation

Following economic development and progress of science and technology, financial instrument and technology innovation with the support of information technology, electronic technology and network technology has provided a fast and convenient channel for consumers to obtain financial products. The financial industry has increased investment in science and technology, sped up the construction of electronic financial services, developed rapidly bank cards and other non-cash payment instruments and offered a large number of efficient and convenient online electronic services, including electronic fund transfers, internet banking, wireless payment and mobile-phone payments. As of the end of 2006, more than 40 domestic commercial banks have developed e-banking business. Banks issued 1.2 billion bank cards with transaction volume worth more than RMB 64 trillion yuan, an increase of 25% and 31% respectively over the previous year. In the securities industry, the SMEs board and Agency Share Transfer System provides an important market platform to SMEs and to high-tech enterprises. Direct online marketing of funds, online insurance, and other new marketing channels have further developed.

Box 13 The Launch and Closure of YinZhengTong

YinZhengTong allowed investors to use bank savings account as a securities trading settlement fund account for the trading of stocks and securities on the basis of networking of the banks and securities companies. It was a cross bank-securities business.

Since the first launch of YinZhengTong in 1998, it received warm welcome from all parties. For customers, YinZhengTong integrated savings account and securities clearing account, and customers could initiate transactions from the bank side, or from the securities company side, which was more efficient. YinZhengTong technically prevented misappropriation of client funds and ensured safety of the customer transactions and settlement funds without the establishment of a third-party custodian system for clients' securities transaction and settlement funds. Securities firms, relied on the huge client resources and network resources of the commercial banks, therefore, it was conducive to the rapid expansion of its securities brokerage business. For commercial banks, YinZhengTong broadened the types of financial services and increased intermediate business income. YinZhengTong became an all-win business innovation.

In May 2006, relevant authorities issued the *Notice on the Implementation of Securities Law on Regulating Securities Institutions' Stock Brokering Business* and halted YinZhengTong operations. In November, the CCB, Industrial Bank, Minsheng Bank, and other banks signed with Guotai Jun'an the third-party custodian cooperation agreement which remarked that the third-party custodian system was launched officially. Third-party custodian system took over some functions of the YinZhengTong.

The Importance of Financial Innovation to Maintain Financial Stability and Promote the Development of the Financial Industry

Financial innovation stimulates the development of financial sector reform and also represents the current global financial development trend. To significantly improve the financial institutions' competitiveness and the financial service, realize all-round, coordinated, sustainable development of economy and society, promote industrial upgrading and transformation of the growth mode, build an innovation-oriented country and a harmonious society, it is necessary to enhance financial innovation capability.

Providing diversified financial products and services to meet the need of the society. Due to the few varieties, single structure, homogeneity and lack of high-tech content and lack of high value-added products, financial products in China fails to meet the ever-growing social demand for diversified financial services. With the development trend towards internationalized financial activities, business integration, electronic transactions, product diversification and customized service, financial institutions should develop market-oriented, demand-based, diversified and customized financial products and services to further satisfy the financing needs of enterprises, especially SMEs, meet greater needs of the residents for asset management, pension, medical care, education for their children and other risk management services in addition to the traditional savings, payment and settlement and consumer credit, and meet the needs of coordinated economic and social development.

Transforming the operation mechanism and significantly enhancing the financial institutions' competitiveness. China's financial sector development mode is extensive, with inadequate corporate governance, internal control and risk management. The financial institutions' operation mechanism has not yet been fundamentally transformed . Asset profitability is low and qualified talents are in shortage of. With the enhancement of internationalization of financial industry, there is a need to expand business scope of financial institutions, change business growth mode, reduce transaction costs, increase profitability, conduct effective management and avoid risks, strengthen market competitiveness and improve financial services through financial innovation.

Improving the financing structure, transferring and diversifying banking sector's risk. Due to high proportion of indirect financing and underdevelopment of direct financing, enterprise financing is highly dependent on the banking system and banks would have to bear the risks that financial markets should bear. Financial risks are overconcentrated in the banks. Financial innovation not only promotes the development of direct financing and increases the proportion of direct financing, but also spreads and transfers the banking sector's risk to a variety of investors, particularly non-financial institutions, thereby effectively transferring and diverting the banking sector's risk.

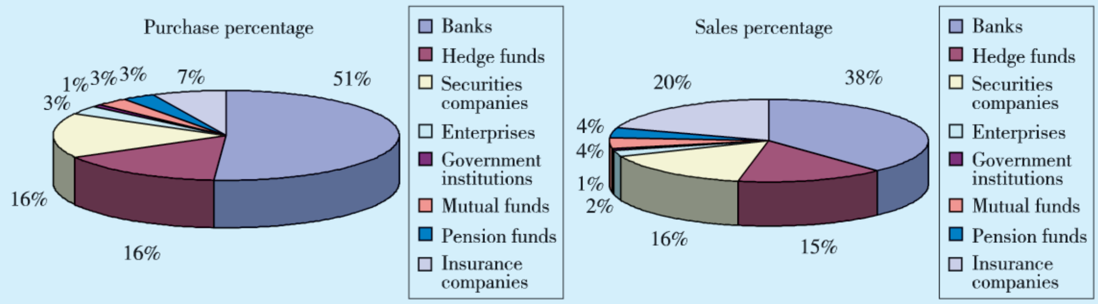
Box 14 Commercial Banks' Financial Innovation: Credit Derivatives

In recent years, the global financial market has been advancing rapidly. New financial products and services have been constantly emerging, and financial institutions operating policies and development modes have gone through major changes, one important aspect of which is the emergence and development of credit derivatives.

Credit derivatives refer to various instruments and techniques to detach and transfer some or all of the credit risks, including CDS, CDO, CLN, and TRS.[1] The credit derivative market participants mainly include banks, hedge funds and securities companies.

1 The definition comes from ISDA.

Figure Main Participants of Credit Derivatives Market



Source: BBA Credit Derivatives Report 2003/2004.

Since introduction in 1993, the credit derivatives market has been expanding geometrically. BBA[1] predicts that by the end of 2008, the amount of the global credit derivatives contracts will increase to USD 33 trillion.

The rapid development of credit derivatives market improved the distribution of credit risk and changed the commercial banking business. First, as initiator of credit risk, the banks can transfer part of the risk to non-bank financial institutions and other market players. These market players, out of their own risk management and investment objectives, participate in the credit derivatives transactions, give full play to their respective comparative advantages to divert and absorb credit risks, therefore strengthen the financial system flexibility. Second, fundamentally change the bank's credit risk management measures and improve the bank's credit risk management by establishing a uniform internal credit management system and measurement indicators. Third, the banks are able to maintain the good relations with the core customers while spreading the loan portfolios, therefore, the credit paradox[2] problem commercial banks face is resolved efficiently. Fourth, banks are guided to expand their business fields, adjust the asset structure and improve profitability mode.

While transferring credit risk, credit derivatives also caused the lack of transparency in distribution of credit risk. Lack of timely and comprehensive information about the risk of the non-bank financial institutions makes it hard to assess risk, thus increasing the uncertainty. In addition, as a new type of financial product, it depends on the more complex financial market infrastructures, which increase operational risk of the banks to some extent.

---

1 BBA Credit Derivatives Report 2006.

2 The so-called credit paradox is that from a risk management perspective, portfolio theory requires banks to prevent excessive centralization of credit relations and pursue a comparatively decentralized loan portfolios. But from the practice of banking business perspective, scattered loan faces the risk of deterioration of relations with the core customer, and is not able to concentrate on the more advantageous business in geographic or industry terms.

Improving the financial system and optimizing financial structure. Considering the reality of unsound financial system and financial structure, underdeveloped capital and insurance market, unbalanced urban-rural and regional financial development and insufficient services for agriculture, farmers, rural areas and SMEs, we should vigorously promote financial innovation in stock market and bond market, strengthen financial services for SMEs, agriculture, farmers and rural areas and township-level economic development, and steadily advance comprehensive pilot programme for financial industry, which will promote the integrated and coordinated development of the money market, capital market and insurance market and promote coordinated urban-rural and regional development.

Enhancing financial regulation and supervision and increasing the financial industry's capacity to fend off risks. To ease the pressure from the imbalanced BOP, excess liquidity, unsound financial regulation mechanisms and many hidden financial risks, we can innovate the macroeconomic management measures to further improve predictability, soundness and effectiveness of monetary policy, strengthen liquidity management, rationally control total monetary credit, establish and improve interest rates formation and transmission system mainly determined by market supply and demand and continue to improve RMB exchange rate formation mechanism. By promoting financial regulation innovation and improving the rules, procedures, ways and means for supervision, we can strengthen and improve financial regulation, implement agency supervision, functional regulation, compliance and risk monitor, and single agency regulation and group and consolidated regulation. Further accelerate the building of financial safety net, strengthen the coordination between monetary policy and fiscal, industry, investment, trade, and regulatory policies to increase the comprehensive strength, core competitive edge and risk resilience of the China's financial industry.

Creating a Favorable Environment, and Vigorously Promote Financial Innovation

At present, it is necessary to vigorously promote financial innovation, and expand service areas and innovative financial products to meet the needs of economic and social development. To this end, there is a need to address the following questions.

Correctly handle the relationship between financial innovation and regulation. China's financial sector is characterized by excessive administrative examination and approval, opaque approval rules and lack of clear definition of responsibility, which has depressed and slowed down the progress of financial innovation. Therefore, it is necessary to vigorously promote financial innovation and achieve coordination and mutual promotion between financial innovation and regulation. First, under the principle of segregated industry supervision, constant endeavor should be made to promote financial regulatory innovation. Facing the new situation of the financial reform, opening up, innovation and development, the relevant authorities should establish and improve a coordination mechanism to further strengthen financial supervision and coordination. The aim is to achieve the combination of agency regulation with functional regulation, compliance monitoring with risk control, single regulatory body with consolidated regulation. Second, it is imperative to update the concepts of regulation, improve the ways and means of supervision and carry out proper regulation.

Enhancing the standards of accounting, disclosure, and corporate governance to improve the market infrastructure for financial innovation. Innovative financial market infrastructure includes high level of accounting standards, sound information disclosure and corporate governance, intermediaries with good reputation, convenient and effective payment and settlement systems, sound legal system and the tax system. First, with reference to international accounting standards, the national accounting standards should be improved and an accounting system reflecting fair value should be established. Second, the practices of financial institutions in information disclosure and corporate governance should be improved, and transparency of information and market discipline should be enhanced. Third, strengthening intermediary services should be pushed forward in order to enhance integrity and service quality. Fourth, payment and settlement system should be further advanced. The registration, custodian, the payment and settlement transactions, and other basic services should be improved to facilitate financial transactions. Fifth, a legal system and a tax system favorable to financial innovation should be established and improved, defining property rights, claims and other basic legal concepts to protect intellectual property rights and other legitimate rights of investors.

Cultivating the market's self-driven growth, and giving full play to financial institutions in financial innovation. Today, China's financial innovations mainly rely on the administrative influence. With the establishment and improvement of China's socialist market economy, there is a need to update the financial development philosophy, enhance the motivation of innovation, establish incentive mechanisms to encourage financial institutions to make independent innovation, respect the innovative spirit of financial institutions, and give full play to financial institutions for innovation and their innovative vitality so as to foster the market's self-driven growth and nurture investors who are able to bear the risks.

Enhancing investors' education and creating a favorable external financial environment for innovation. Financial innovation increases the complexity of financial products and services. If investors lack adequate financial knowledge, it will be difficult for them to correctly understand the interests of the financial products and make accurate judgment, which can become a negative factor for the financial market stability. There is a need to reinforce investors' financial knowledge and education on financial risks. First, we should provide investors with relevant information and training and enable them to obtain knowledge of financial innovation. Second, we should improve information disclosure system, financial institutions should fully reveal the risks of products. Third, investors should take self-education and be responsible for their own investment decisions.

Adhering to the combination of introduction and innovation, and making efforts to assimilate advanced concepts, technology and managerial expertise. Compared with the innovation of some large foreign financial institutions, Chinese financial institutions' independent innovation is inadequate. There are not enough professionals and technology tools to support innovation, and the content of technology and services in the financial innovation are quite low. Today's international financial services have undergone tremendous changes regarding assets and liabilities management, financing techniques and operational concepts. To improve the competitiveness of the financial industry, we must adhere to the combination of introduction and innovation, and learn from other countries in terms of excellent financial innovations, and strive to assimilate advanced concepts, technology, and managerial expertise to promote financial innovation which suits China's national conditions.

Attention must be given to negative factors contained in the financial innovation to effectively prevent financial risks. Financial innovation also contains new risks while promoting financial stability. First, financial innovation strengthens the link between different financial sectors and financial markets, and promotes domestic and foreign financial market integration process. Financial risks move more easily across industries, markets and borders, which have increased the possibility of systemic risk. Second, financial innovations have made financial institutions face even more complex risk profile and business environment and raise challenges on their risk pricing and risk management capacity. In financial innovation process, if financial institutions ignore risk management and lack ability in financial product design and pricing as well as professionals and the international financial market investment experience, it may result in significant losses. Third, financial innovation increases the difficulty for the financial regulatory system and puts a higher requirement for market infrastructure. Therefore, with the financial innovation being vigorously promoted, it is necessary to guard against risks, actively and steadily push forward financial innovation in line with the national conditions, avoid innovation going astray and attach great importance to macro and micro risks arising from financial innovations, and strengthen risk management and control.

(By Tao Ling and Hu Ping)