



Chapter V

Financial Markets

In 2009 China's financial market performed in a sound manner, with brisk trade and progressing institutional constructions, which promoted the effectiveness of macroeconomic policy, deepened the financial system reforms and brought the role of maintaining the financial stability and enhancing financial support to economic development into a full play.

Market Overview

Trading on Money Markets Maintained Brisk

The volume of money market maintained notable growth. In 2009 trading on money market was brisk. The turnover of inter-bank borrowing rose 28.6 percent y-o-y to RMB 19.4 trillion yuan. The turnover of bond repos reached RMB 70.3 trillion yuan, up 20.9 percent y-o-y. This notable growth was mainly due to adequate liquidity and lower interest rates on money market, which made lower funds' cost possible and thus encouraged great trading demands.

Short-term transactions accounted for a large share of total trading. In 2009, the turnover of overnight inter-bank borrowing reached RMB 16.2 trillion yuan, accounting for 83.5 percent of the total volume of inter-bank borrowing, an increase of 13 percent y-o-y. The volume of 1-day bond pledged repo totaled RMB 54.6 trillion yuan, accounting for 77.7 percent of the total bond repos, up 14 percent y-o-y. Short-term transactions

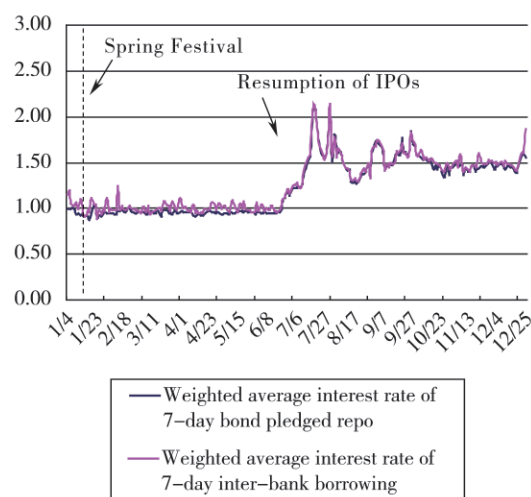
dominated the market, a sign that money market played a prominent role in adjusting the liquidity of financial institutions.

Interest rates on the money market hovered around a low level.

The volatility of interest rates in 2009 can be divided into two phases (Figure 5.1): In the first half of the year, interest rates fluctuated within a narrow range from 0.9 percent to 1.2 percent, while the second half witnessed wider movement influenced by factors such as fluctuations in market expectation and the resumption of IPOs. Take the weighted average interest rate of 7-day inter-bank borrowing for example, just in mid and late July, it hit 2.12 percent high and declined to 1.29 percent, which marked a fluctuation of more than 80 basis points. From a year perspective, the weighted

Figure 5.1 Interest Rates on Money Market in 2009

(percent)



Source: National Interbank Funding Center.

average interest rates of inter-bank borrowing and bond pledged repo in December were 1.25 percent and 1.26 percent, up 35 basis points and 36 basis points respectively from January.

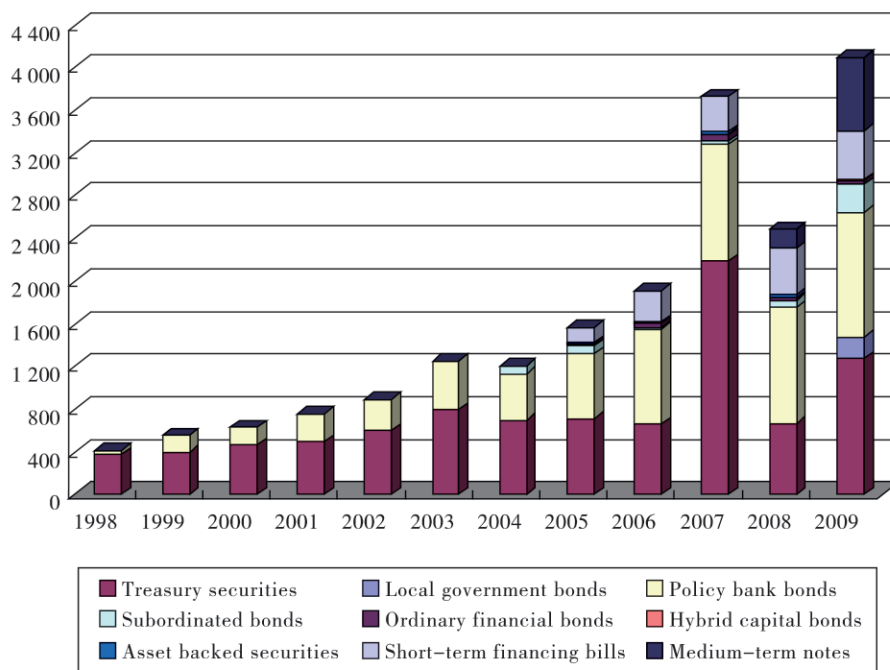
Bond Market Grew Rapidly

Bond market expanded rapidly. In 2009, the aggregated RMB bonds issued on the bond market registered RMB 4.9 trillion yuan, a y-o-y increase of 68.5 percent. The issuance of government securities, subordinated bonds, medium-term notes, enterprise bonds and other bonds grew by a relatively large margin over 2008 (Figure 5.2). By the

end of 2009, outstanding bonds deposited on the bond market have been RMB 13.3 trillion yuan¹, among which the bonds deposited on the inter-bank market have registered RMB 13 trillion yuan, up 30 percent over 2008. Such gradually expanding issuance of various bonds gave enterprises a wider channel of direct financing. The bond market showed itself as an important financing and investment playground for government, financial institutions and enterprises by playing an increasingly important role in effective allocation of resources, transmission of monetary policy and promoting the healthy operation of economy.

Figure 5.2 Issuance of Major Bonds on Inter-bank Bond Market

(billion of RMB yuan)



Source: China Government Securities Depository Trust and Clearing Co., Ltd.

1 Excluding the deposited central bank bills.

Medium-and short-term bonds dominated the bond market. In 2009, the issuance of bonds with the maturity within 5 years accounted for 48.8 percent of the total, up 1.6 percent y-o-y. The issuance of 5 – 10 year bonds accounted for 26.8 percent, down 2.3 percent over 2008. The issuance of bonds with a maturity of 10 year or longer accounted for 24.4 percent, up 0.7 percent over last year.

Trading volume of bonds increased while price remained stable. In 2009, turnover of the inter-bank bond market saw a 27.4 percent y-o-y increase to RMB 47.3 trillion yuan. Bond price movement was relatively stable, and bond indices fluctuated within a narrow band. The index of bond on inter-bank market dropped 1.88 points, from 132.11 points at the beginning of 2009 to 130.23 points at the end of the year, down 1.4 percent. The index of government securities on the exchanges rose from 121.22 points at the beginning to 122.35 points at the end of 2009, an increase of 1.13 points or 0.9 per-

cent. Yield curve of government securities on the inter-bank bond market moved upward.

Investors in the bond market diversified. In 2009, specific asset management portfolio of fund management companies and asset management plans of securities companies entered into to the inter-bank bond market, which made the market cover five types of unincorporated institutional investors including annuities, insurance products, trust products, specific asset management portfolio of fund management companies and asset management plans of securities companies. By the end of 2009, the inter-bank bond market had already had 9 247 participants from various financial institutions to non-financial institutional investors. All the market players formed a diversified market structure within which market makers acted as the core, and financial institutions as participants and other institutional investors were involved. Inter-bank bond market had become an important investment and financing playground for all kinds of participants.

Box 13 Asset Securitization Is an Important Measure in the Development and Risk Prevention of Financial Market

With the rapid development, the securitized assets gradually become the most active products in financial markets since the late 1970s. Asset securitization is vital for commercial banks to strengthen management and diversify credit risk. It also plays a multiple role in joining the credit market and capital market and thus promoting the

development of capital market. For commercial banks, asset securitization can solve the maturity mismatch of assets and liabilities, adjust and optimize credit loan structure and also change the traditional business model. Meanwhile, securitization of credit assets can stimulate the asset liability management of commercial banks, which may

change the present passive situation, that is, meeting capital adequacy requirements with continuous injection of capital during expansion. When it comes to financial markets, the securitization of credit assets offers new investment options for securities markets and explores new financing channels for credit market. It also plays an active role in broadening the financing channels of SMEs, reducing the potential credit risks on the investment and financing platform of local governments, and prompting the commercialization transformation of policy banks by activating their assets.

Since the outbreak of subprime crisis in 2007, the global asset securitization market fell into stagnation. With deepening understandings of the causes of the crisis, it is globally accepted that a sustainable asset securitization market on a more stable basis is important to strengthen bank capital and overcome loan supply constraint. Various countries have carried out several means to revive the asset securitization market, including rebuilding market confidence, expanding the scope of investors, providing more rating choices, improving the originate-to-distribute model and making securitization of assets more transparent with more liquidity. What should not be neglected is that in all reform proposals, the institutions initiating and supporting securitization products are required to hold a certain percentage of underlying assets or bonds of all grades within their balance sheet. At present, thanks to the effective measures, several se-

curitization markets such as the US auto loans market and credit card market, European covered bonds market and some other securitization markets have recovered in lead.

In March 2005, approved by the State Council, establishment of the Pilot Coordination Group on Securitization of Credit Assets by PBC with some relevant agencies started the credit asset securitization pilot project in China. With the joint efforts, China's securitization market begins to take shape and runs well. The pilot has achieved the desired result.

Accompanied by growing types of products, the originating institutions became diversified with following characteristics. First, the issuance of the asset-backed securities increased year by year. Second, the underlying assets gradually extended to non-performing loans, auto mortgage loans, and SMEs loans from the previous ordinary loans and personal housing mortgage loans. Third, the pilot financial institutions extended from the policy banks and state-owned commercial banks to joint-stock commercial banks and auto finance companies. The asset management companies qualified for asset securitization also gained opportunities for practice in the pilot. Fourth, the joint-stock commercial banks, urban commercial banks, credit co-operatives, finance companies, foreign banks and securities investment funds gradually joined in the team of asset-backed securities holders.

Institutional framework was gradually improved.

It is an important principle of promoting legislation synchronously with the pilot in the credit asset securitization pilot project. According to the characteristics of the asset securitization business, the Coordination Group designed a set of institutional framework to meet the requirements of the pilot. PBC, CBRC, the Ministry of Housing and Urban-Rural Development, MOF and the State Administration of Taxation published nearly 10 agency regulations to set up the framework of general management of the pilot, the supervision and administration methods, the market operation rules, the rules on change in housing mortgage holdings, accounting principles and tax management methods and others. These regulations established a preliminary institutional framework of credit asset securitization, regulated the pilot work and ensured its operating in an orderly manner.

Risk constraint mechanism successfully stood the test of the market.

Putting risk prevention first, the regulators continued to strengthen risk management from the beginning of the pilot. *Administrative Measures on Pilot Securitization of Credit Assets* defined the principles of risk control in main process of credit asset securitization. CBRC launched *Supervisory Measures on Pilot Securitization of Credit Assets of Financial Institutions* to set a series of requirements on market access, operation rules, risk management, capital requirements, supervision and legal liabil-

ities. From a view of market management, PBC set up regulations on information disclosure in the securitization of credit assets, and registration, custody, trading and settlement of asset-backed securities on the inter-bank market through PBC Notices. PBC also guided the National Interbank Funding Center and the China Depository Trust and Clearing Co., Ltd. in designing an integrated business system for asset-backed securities issuance and trading in order to strengthen the risk prevention of asset-backed securities.

The pilot has been fruitful. First, the bond products diversified while the bond market improved. After nearly five years of development, credit asset-backed securities market has begun to take shape and has become an important part of bond market. Bearing unique risk-return features and term structures, asset-backed securities have become another important alternative asset in institutional investors' asset allocation strategies. Second, the pilot provided the originating financial institutions with a wider range of choices in asset-liability management tools. Through the operation on securitization, financial institutions could not only set corresponding liability goals according to the scale and structure of securitization business and thus actively adjust the structure of loans, but also make a transformation from the credit-holders holding to maturity to the credit assets providers and traders. Third, the profit model of the originating institutions has been changed. While

transferring the traditional loan interest, the originating institutions got loan service revenue, yields on holding sub-prime securities and trading asset-backed securities through credit assets securitization. Fourth, the financial institutions' incentive for innovation has been stimulated. The financial institutions

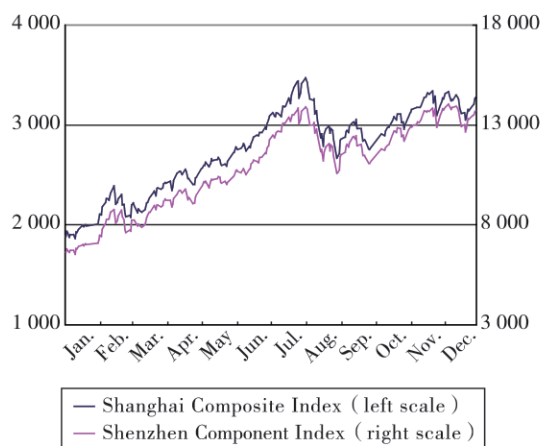
explored a new market-oriented approach of handling non-performing assets by issuing restructuring asset-backed securities. Auto finance companies explored new financing channels to promote automobile consumption through the issuance of automobile mortgage asset-backed securities.

Trading on the Stock and Futures Markets Was Brisk and Function of Financing Enhanced

The stock indices grew by a large margin and turnover of stock market hit a historical high. In 2009, the Shanghai Composite Index had its peak and trough at 3 478.01 points and 1 844.09 points respectively. At the end of the year, the index was 3 277.14 points, up 79.98 percent y-o-y. The Shenzhen Component Index soared to 14 096.97 at its peak, from 6 514.49 points at its bottom in 2009. By end-2009, it increased 111.24 percent y-o-y to stand at 13 699.97 points (Figure 5.3). At the end of 2009, there are 1 718 (including 108 B-share companies) listed companies on Shanghai and Shenzhen stock markets, among which 93 entered this year. The total market capitalization rose 100.99 percent y-o-y to RMB 24.39 trillion yuan, in which the market capitalization of tradable share witnessed a rise of 234.54 percent over 2008 to RMB 15.13 trillion yuan. The market capitalization of total shares and tradable shares of 36 Growth Enterprise Board (GEB) listed companies reached RMB 161.008 billion yuan and RMB 29.897 billion

yuan respectively. In 2009, the total turnover of stock market reached RMB 53.6 trillion yuan, while the daily turnover registered RMB 219.667 billion yuan, up 100.66 percent and 102.31 percent respectively y-o-y, both hitting a historical high.

Figure 5.3 Shanghai Composite Index and Shenzhen Component Index in 2009 (Close price)



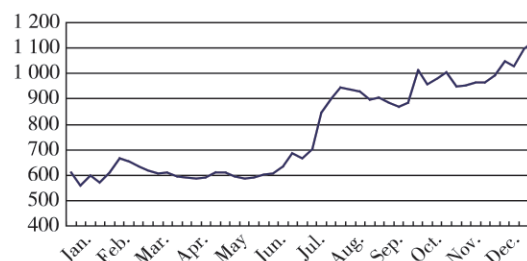
Source: Wind Info.

Financing function of the stock market

was enhanced, and funds raised from bond issuance of listed companies rose significantly. In 2009, a total of RMB 460.954 billion yuan was raised on the domestic capital market, ranking second-high in history. Amount of RMB 389.453 billion yuan was raised on the A-share stock market, among which IPOs raised RMB 187.9 billion yuan, an increase of 81.3 percent y-o-y. Secondary offerings contributed to RMB 25.586 billion yuan, down 75.94 percent y-o-y. Non-public offering raised RMB 161.483 billion yuan, up 347.16 percent over 2008. Allotment raised RMB 10.597 billion yuan. Warrant exercise raised RMB 3.886 billion yuan. A total of RMB 71.501 billion yuan was raised by bond issuance on the Shanghai and Shenzhen stock market, among which bonds issued by listed companies raised RMB 63.84 billion yuan, up 121.67 percent y-o-y.

Futures market expanded steadily, and product innovation was promoted orderly. In 2009, China's futures market saw a transaction of 2.16 billion lots and RMB 130.5 trillion yuan, up 58.2 percent and 81.5 percent respectively y-o-y. Turnover of commodity futures ranked the world first, which was worth 43 percent of the world total. New products like deformed steal bar, rebar wire, early long-grain nonglutinous rice and PVC were introduced to the market. Up to now, a total of 23 different products have been traded on the commodity futures market and the system based on various bulk commodity futures was preliminarily established.

Figure 5.4 ICBC Bill Inter-bank Discount Price Index in 2009



Source: ICBC Bill Center.

Bill Market Grew Rapidly

In 2009, a total of RMB 10.3 trillion yuan of commercial drafts were issued, an increase of 45.3 percent y-o-y. Discounted bills registered RMB 23.2 trillion yuan, up 71.7 percent over 2008. Rediscounted bills amounted to RMB 24.9 billion yuan, rising 1.27 times y-o-y. At the end of 2009, outstanding commercial bills stood at RMB 4.1 trillion yuan, up 28.1 percent over end-2008. Outstanding discounted bills increased 26.3 percent y-o-y to RMB 2.4 trillion yuan. Outstanding rediscount bills saw a 6.84 times growth y-o-y to RMB 18.1 billion yuan.

The price on the bill market showed apparent different trends in the two phases of the year. At the end of 2009, the ICBC Bill Inter-bank Discount Price Index closed at 1 123 points, up 512 points from the beginning of the year (Figure 5.4). In the first 5 months, the inter-bank discount interest rate hovered at low level due to moderately loose monetary policy, adequate liquidity on the market and the enhanced

demands for bills. In the second half of the year, however, the bill market witnessed a raise of interest rate since the adjustments of macroeconomic policy and changing of market liquidity.

The Foreign Exchange Market Operated in a Stable Manner

In 2009, the turnover of RMB foreign exchange spot transactions grew steadily while turnover on the RMB foreign exchange forward market decreased. The turnover of RMB foreign exchange swaps saw relatively big increase and the market structure of the foreign currency pairs was optimized. The turnover of RMB foreign exchange forward fell 43.8 percent y-o-y to USD 9.8 billion. The turnover of RMB foreign exchange swaps raised 82.1 percent over 2008 to USD 801.8 billion. The expectation of RMB appreciation was regained since market expectation of RMB depreciation weakened and the quotations of RMB turned from premium to discount. The turnover of foreign currency pairs amounted to USD 40.7 billion, falling 35.8 percent y-o-y. The transactions made by market-making banks shrank, while market share of ordinary members expanded.

The Gold Market Grew Steadily

In 2009, the gold market based on Shanghai Gold Exchange operated in a sound manner. A total of 4 710.82 tons of gold was traded, up 5.53 percent y-o-y. The turnover of gold reached RMB 1.103063 trillion yuan, up 22.62 percent over 2008. The trading volume and turnover of silver reached 16 247.79 tons

and RMB 58.658 billion yuan, up 267.60 percent and 296.07 percent respectively y-o-y. The trading volume and turnover of platinum registered 56.66 tons and RMB 15.528 billion yuan, up 12.89 percent and down 5.02 percent respectively y-o-y.

In 2009, the price of gold on international market went upward, constantly breaking new historical highs to over USD 1 000 per ounce. With the narrowed spread, the movement of gold price home and abroad showed consistency. The average spread shrank RMB 0.31 yuan or 46.27 percent y-o-y to RMB 0.36 yuan per gram. The price of gold started at RMB 192.60 yuan per gram and closed at RMB 244 yuan per gram during the year 2009. Its peak and trough were RMB 269.25 yuan per gram and RMB 178 yuan per gram respectively. The market saw an increase of RMB 18.19 yuan in weighted average price of gold to RMB 215.35 yuan per gram.

Overview of Financing in the Market

Overview of Government Financing

In 2009, 59 book-entry treasury bonds amounting to RMB 1.3 trillion yuan, covering 13 types of bonds, with maturities from 91 days to 50 years were issued on the inter-bank bond market through market-oriented biddings. The term structure of bond market was further improved with a well-balanced coverage of the short-term, medium-term and long-term bonds, which optimized the yield curve of the

treasury securities and provided a benchmark for other bonds' pricing.

From March to September 2009, MOF, representing 30 provinces (excluding Tibet) and 5 cities with independent plans, issued 50 local government bonds through market-based bidding, with amount of RMB 200 billion yuan and 3-year maturity.

As a result of adequate liquidity in the market

and market-oriented issuance, cost of both book-entry treasury securities and local government bonds issued in 2009 stood at a relatively low level, which raised ample and cheap funds for the steady implementation of the proactive fiscal policy, ensuring the efforts of the state's macroeconomic management and regulatory policy and maintaining sound and rapid development of China's society and economy.

Box 14 Development of Municipal Bonds Worldwide

Municipal bonds refer to debt financing instruments issued by local governments or some authorized municipal agencies to meet the financing needs of municipal operations or construction. Generally, there are two kinds of municipal bonds, ordinary obligation bond using issuer's tax revenue as its sources, and revenue bond repaid by the project's future revenue.

Brief Introduction of the Development of Municipal Bonds

The development of municipal bonds is closely related to a country's industrialization and urbanization. The public infrastructure projects for urbanization and industrialization always require huge initial investment and benefit many generations. The funds they need are not only beyond the local government's current tax revenue but also cause unfairness in separating current taxpayers from future beneficiaries. Therefore, debt financing in public infrastructure proj-

ects can explore the sources of funds and solve the problem of cost sharing in economic development at the same time.

At present, the municipal bond markets in United States, Japan, Germany, Australia and Canada are most developed, while Poland, South Africa, Russia, Brazil and some other developing countries also witness some development in municipal bonds. Among them, the municipal bond market in US is the most market-oriented and enjoys the most comprehensive financial supporting system. Japan is a typical case that develops municipal bonds in unitary system. The municipal bonds of Poland are featured by both the characteristics of bond markets in developing countries and countries depending on indirect financing.

Development of US Municipal Bonds

In the federal political system, local governments in the US can issue bonds without

the approval by higher authority, while *Securities Acts* exempts their registration liability to SEC. Therefore, local government is the only decision-maker in municipal bond issuance. Meanwhile, its borrowing behavior is under the supervision of local legislative body through relevant legislation.

US municipal bond issuers include local governments (including state, county and city governments) and their authorized agencies. In addition to ordinary obligation bonds and revenue bonds, there are other innovative bonds such as double income guarantee bonds and special tax bonds traded on the municipal bond market. The bonds can be issued either publicly or privately. The investors include banks, funds, insurance companies, enterprises in all walks and individuals. Municipal bonds are traded in the OTC market, generally externally rated, and insured by both bond and ordinary insurance companies. Municipal bonds usually get federal tax exemption. If the bonds meet certain conditions, they can also exempt from state taxes. By the end of 2009, the outstanding municipal bonds in US amounted to about USD 2.67 trillion.

The municipal bond market is regulated by SEC and Municipal Securities Rulemaking Board (MSRB). The latter makes rules of municipal bonds under the authorization of SEC and has no specific regulatory enforcement powers.

Development of Municipal Bonds in Japan

Japan is a typical case that develops municipal bonds in unitary system. With the approval of local council, Japan's local governments can issue bonds without reporting to the central government, if the actual debt servicing rate is below 18 percent. Otherwise approval by the Ministry of Internal Affairs and Communications is required. In practice, most local governments will still choose to go through the procedure and get the approval of the central government before issuing bonds for a variety of preferential policy.

Japanese municipal bonds include municipal public bonds and municipal utility bonds¹. The issuance channels can be generally divided into public offering and private placement. Municipal bonds are mainly traded on OTC market, because according to Japanese law, only the bonds issued in Tokyo can be listed in the Stock Exchange, while others can only be traded on OTC market. Banks are the main investors of municipal bonds. Most public offering bonds had external ratings. By the end of fiscal year 2009, outstanding of municipal bonds in Japan was approximately JPY 138 trillion (about USD 1.5 trillion), only second to the scale in the United States.

Japan's municipal bond market is under the supervision of the Japan Financial Services Agency (JFSA), while the sale and investment

1 The municipal public bonds are direct liability of government while the municipal utility bonds are bonds issued by local utilities.

should comply with the regulations on securities market.

Development of Municipal Bonds in Poland

The issuance of municipal bonds in Poland is decided by the municipal council and should comply with relevant laws and regulations as following: First, debt can only be used for construction expenditures, while issuing bonds for covering deficits is forbidden. Second, the total scale of local government debt has a cap. Meanwhile, local governments need to get the approval of the Polish Financial Supervision Authority before public offering of securities.

The issuers include three tiers of governments as province, county and town. Generally, there are two types of bonds, ordinary obligation bonds and revenue bonds issued either by public offering or private placement. The public offering bonds are mainly traded on OTC market. Banks, pension funds, insurance companies, foreign investors, central banks and public enterprises are investors of municipal bonds, among which two-thirds are commercial banks. Up till now, rating on the municipal bond issuers' credit is unpopular, and only

a few of them have external ratings. By the end of the third quarter of 2009, there were 393 municipal bonds with a market volume of approximately USD 1.9 billion.

Polish Public Debt Department and Financial Supervision Authority are responsible for the management of the municipal bond market. The former, which is subordinated to the Ministry of Finance, is in charge of supervising the debt of central and local governments in Poland, forecasting and reporting the contingent liabilities and budget management. The latter is responsible for supervision of the municipal bond market.

As China's rapid advancement of urbanization and industrialization, there is growing funds demand for local construction. For a long time, however, China's local construction has mainly depended on fiscal appropriation and bank credit, which not only restricted the capital amount, but also led to risk concentration in the banking system. Drawing on international experience, development of municipal bonds is beneficial to establishing institutionalized and diversified financing channels for local governments, promoting the efficiency of resource allocation, and improving social financing structure.

Overview of Enterprise Financing

Debt financing of enterprises grew strongly. In recent years, China's bond market experienced well development as rapid ex-

pansion, increasing market depth, notably growing bond issuance and diversified bond types. At present, enterprise debt financing products including enterprise bond, short-term financing bill, medium-term note, asset-

backed security, corporate bond, convertible bond and separable bond, etc. In 2009, China's non-financial enterprises issued a total of RMB 1.66377 trillion yuan bonds for direct debt financing, up 78.2 percent y-o-y (Table 5.1). At the end of the year 2009, outstanding direct debt financing of non-financial enterprises amounted to RMB 2.64152 trillion yuan, an increase of 86.6 percent y-o-y (Table 5.2). For the first time, 3 SMEs collec-

tive bonds were launched on the inter-bank bond market successfully, providing an operating capital of RMB 1.265 billion yuan for 23 SMEs. Medium-term notes with warrants imbedded or denominated in foreign currency were also introduced to the market. The medium-term notes denominated in USD amounted to USD 1.5 billion were issued by 2 companies during the year.

Table 5.1 Direct Debt Financing by Non-financial Enterprises

(100 million of RMB yuan)

Year	Short-term financing bills	Medium-term notes	Enterprise bonds	Corporate bonds	Convertible bonds	Separable bonds	Total
2004	—	—	307.0	—	209.0	—	516.0
2005	1 392.5	—	654.0	—	0	—	2 046.5
2006	2 944.0	—	995.0	—	43.9	99	4 081.9
2007	3 356.1	—	1 709.4	112	106.5	188.8	5 472.7
2008	4 298.5	1 672	2 366.9	288	77.2	632.9	9 335.5
2009	4 627.1	6 950	4 252.3	731.7	46.6	30	16 637.7

Source: www.chinabond.com.cn, Wind Info.

Table 5.2 Outstanding Direct Debt Financing by Non-financial Enterprises

(100 million of RMB yuan)

Year	Short-term financing bills	Medium-term notes	Enterprise bonds	Corporate bonds	Convertible bonds	Separable bonds	Total
2004	—	—	1 242.5	—	334.9	—	1 577.4
2005	1 380.5	—	1 851.5	—	248.8	—	3 480.8
2006	2 667.1	—	2 831.5	—	120.7	99	5 718.3
2007	3 203.1	—	4 479.4	112	98.6	287.8	8 180.9
2008	4 203.1	1 672	6 821.3	400	139.2	920.7	14 156.2
2009	4 561.1	8 622	11 029.6	1 131.7	120.1	950.7	26 415.2

Source: www.chinabond.com.cn, Wind Info.

Market Institutional Construction

Stock and Futures Markets

In 2009, with the progress of the market-oriented reforms, basic institutional arrangements and market discipline mechanisms on China's capital market were further strengthened, while foundation for healthy growth was further consolidated.

First, the IPO system has been reformed and improved. Following the “step by step, gradually improve” principle, China laid foundation for further reform by several measures: deepening its reform of the IPO scheme, improving the price inquiry and purchase mechanisms, optimizing the online issuance arrangement, attaching importance to the participating willing of medium and small investors, enhancing the risk warning and making the issuers, investors, underwriters and other market participants do their own job responsibly.

Second, institutional arrangements on the futures market have been improved. *The Administrative Rules on Opening Accounts of Clients in the Futures Market* was published and the unified scheme of opening accounts in the futures market was established to enhance the risk prevention and strengthen the real-name system of opening accounts in the futures market and thus increase the efficiency of the market.

Third, trading and settlement arrangements have been improved. The amendment of *Administrative Measures on Securities Registration and Clearing* clarified the rules for partnership enterprises in opening a securities account, established the data exchange channels between China Financial Futures Exchange and institutions for securities registration and settlement and created the conditions for cross-market supervision.

Inter-bank Bond Market

First, fundamental institutions and system constructions for the inter-bank bond market have been enhanced. In March 2009, the *Administrative Measures on the Registration, Custody and Settlement of Bonds on the Inter-bank Bond Market* was published in order to standardize the functions and management of the bond registration, custody and settlement institutions. The Measures covered procedures during the bond registration, custody and settlement business and defined the legal rights and responsibilities of participants in the inter-bank bond market. As one of the fundamental rules of the market, it had profound significance on the healthy and sound development of China's bond market by standardizing the business of bond registration, custody and settlement, reinforcing investor protection and risk prevention, and enhancing the function of the bond market. As an improvement of the inter-bank bond market infrastructure and accompanied with rapid development of the market, the new Domestic Currency Trading System on Inter-bank Bond Market went into service successfully in June

2009. Taking advantage of the old system, the new one made a great improvement on system structure, transaction functions, customer management and extended functions etc.

Second, the entrance of unincorporated institutional investors into the inter-bank bond market has been encouraged.

In March and July 2009, PBC released the No. 5 and 11 Notice respectively to allow fund management companies and securities companies to open accounts in the inter-bank market. The Notices defined that fund management companies can make investment and trade through specific asset management portfolios while securities companies through asset management plans (including collective asset management plans, specialized asset management plans and directional asset management plans). In addition, the Notices standardized the institutional arrangements and transaction management. The orderly entrance of these unincorporated entities into the inter-bank bond market diversified the types of investors, met the market demands of differentiation and diversification and further improved the market liquidity.

Third, issuance and trading management and information disclosure on financial bonds have been improved, while scope of bond issuers has been expanded. Several regulations including the *Administrative Procedures for Issuance of Financial Bonds on the National Inter-bank Bond Market* and the announcements on bond issuance of auto finance companies and finan-

cial leasing companies have been released, which further regulated the issuance of financial bonds, expanded the scope of bond issuers steadily, enhanced the transparency of financial bond issuance examination, improved market discipline and risk-sharing mechanisms. In addition, the floor of RMB 500 million yuan for bonds to be issued on the inter-bank market was rescinded, which raised a favorable policy environment for bond financing of SMEs.

Fourth, master agreements on OTC financial derivatives have been unified.

In March 2009, the new *Master Agreement on the Trading of Financial Derivatives on the Inter-bank Market* was released by the National Association of Financial Market Institutional Investors (NAFMII), which improved the standardization of China's OTC financial derivatives transactions and trading efficiency, and reduced the legal risks.

Fifth, the Inter-bank Market Clearing House Co., Ltd. has been founded.

On November 28th 2009, China Foreign Exchange Trading System (CFETS), China Government Securities Depository Trust & Clearing Co. (CDC), China Banknote Printing and Minting Co. (CBPMC) and China Gold Coin Co. co-initiated the Inter-bank Market Clearing House Co., Ltd. (hereafter referred to as the Shanghai Clearing House) with registered capital of RMB 300 million yuan. The Shanghai Clearing House generally provided direct and indirect clearing services for the financial transactions in both domestic and foreign currency and some relevant derivatives transac-

tions, including clearing, settlement, delivery, margin management, collateral management, information services, consulting and others. As an important intermediary of China's inter-bank bond market, Shanghai Clearing House promoted the independence and cooperation of three core businesses:

trading, clearing, and settlement through centralizing the counterparty risk and providing clearing facilities for market participants. By doing this, it could play a role in improving the clearing efficiency and market transparency, preventing systematic risks and maintaining financial stability.