

nine major areas, including overall requirements, stock market, bond market, private equity, futures market, the competitiveness of the securities and futures sector, capital market openness, financial risks and market regulation. The policy is also referred as the "New National Nine Rules", in contrast to the earlier "National Nine Rules" issued in 2004. Under the nine broad guidelines, details on the directions and goals of reforms for thirty-three areas are specified, signaling the unprecedented resolution of Chinese government to push forward the comprehensive capital market reforms. It is government's aim to establish multi-layer capital markets, enlarge corporate and household investment channel, encourage efficient capital allocation as well as promote the economic restructuring. From macroeconomic perspective, we highlight the below reforms:

Further opening up China's capital markets

Following the recent announcement of Shanghai-Hong Kong Stock Connect Scheme on Apr 10, the Guideline again emphasizes on opening up the capital markets, with an aim to facilitate the cross-border investment and financing activities. Both inward and outward investment quotas under QFII and QDII programs will be increased. The shareholding limits for foreign capital in listcos will be relaxed. Domestic capital market will be steadily opened up for the direct investment of foreign individuals, and the domestic individuals investing in foreign capital market will be orderly pushed forward. Moreover, Xiao Gang, chairman of CSRC said this March that the potential QFII expansion is huge, and he mentioned that CSRC has been working on the QFII tax policy with other government agencies, as part of the effort to help facilitate QFII expansion this year.

We believed that this proposal will help inject more liquidity into China A share market, as well as expedite China's progresses in capital account liberalization in a boarder sense, including a) further relaxing the foreign investment management like holding period and remittance; b) implementing and expanding the Stock Connect scheme (see our Apr 11 note "A leap in China's efforts to liberalize capital accounts"); c) establishing capital account convertibility in SHFTZ and developing a domestic RMB offshore market; d) permitting cross-border RMB remittances by individuals and broadening channels for offshore banks to borrow/lend RMB in domestic market.

Promoting direct-financing

To develop a multi-layer capital market with proper structure, complete function and effective regulation by 2020, the Guideline highlighted the development of direct financing, which includes three major areas of bond market, equity market and private equity.

On bond market, the Guideline aimed to a) develop a scheme of local government bond issuance; 2) enrich bond products suitable for various investors; 3) develop bond types for SMEs; 4) connect different bond exchanges and 5) improve issuance procedure, rating mechanism as well as 6) promote asset securitization. To develop a multi-layered equity market and cultivate a healthy private equity market are other two major areas in promoting the direct-financing.

In A share stock market, the approval-based stock issuance system will be replaced by a registration-based one, and such move will be accompanied by the new IPOs governing rules published by the Securities Association of China the same day of the Guideline. Regulators will crackdown insider trading, enhance information disclosure, improve delisting regime, and support pension funds investments into capital markets by preferential tax policies.

The State Council also said it will foster the market for private equity funds and venture capital funds. Going forward, the placement of private equity won't be subjected to administrative approval and funds of private equity and venture capital will be encouraged to support SMEs and newly-emerging industries.

We believe that such reforms will substantially help to improve financial stability and capital allocation in China. According to CSRC, 42.3% of financing in China belonged to the direct-financing category by end of 2012, lower than that of developed economies like the US (87.2%), Japan (74.4%), Germany (69.2%) and emerging markets like India (66.7%) and Indonesia (66.3%). As a result, risks are highly concentrated in banking system. And financing is expensive and hard to access for small borrowers. We expect that the reforms of promoting direct-financing will help enrich the investment channels for individuals and corporate, disperse risk in financial system, meet financing needs of SMEs and lower the funding cost for them.

Under such endeavor, China capital markets will be much more diverse, structured and transparent in the future, and will a) mobilize massive private savings; b) encourage inward portfolio flows; and c) lift market sentiment and valuation.

Promoting mixed ownership reform