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Developments in China's interbank bond markets

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Since the beginning of China's economic reforms 40 years ago, China's domestic bond market has developed from virtually nonexistent into what is now the third largest in the world. As of the end of 2017, the market's outstanding volume reached RMB 75 trillion (almost $12 trillion), of which the credit market segment totalled RMB 18 trillion, making it the largest in Asia and the second largest in the world. Secondary market trading is active, with a spot trade transaction volume of RMB 108 trillion in 2017. Most products commonly seen in the international bond market are now available in China, including public offerings and private placements, and CP, MTN, ABS, perpetual bonds and derivatives such as CDS and CLN. In recent years, China's Central Government has continued to liberalise its financial market, in particular opening up the interbank bond market to foreign institutions.

Panda bond market development

As of May 2018, 56 panda bond issuers have entered the interbank market, 40 of which have registered panda bonds with NAFMII. Types of issuers include international development institutions, sovereign or municipal governments, financial institutions and non-financial enterprises. Such panda bond issuers have issued a total of RMB 169.54 billion through 83 transactions, of which RMB 137.01 billion (approximately $21.2 billion) remains outstanding.

The panda bond market is potentially attractive to overseas issuers, as outlined in the NAFMII-ICMA report *Panda Bonds and the Perspectives of Foreign Issuers.* However, to ensure continued development of the market, technical issues such as accounting standards, auditing recognition and taxation still need more clarity. Chinese regulators are actively working on addressing these issues. For instance, the Ministries of Finance of China and Japan exchanged letters on cooperation regarding audit oversight last December, which is expected to better facilitate both Panda and Samurai bond issuers, and better protect investors in both markets.

Development of market access for foreign investors

In July 2017, China and Hong Kong officially launched the Bond Connect scheme, which for the first time enables foreign investors to trade in China's interbank bond market from Hong Kong accounts under a streamlined process.

At present, there are three main programmes by which foreign investors can access the domestic bond market, namely the Qualified Foreign Institutional Investor (QFII) and RMB QFII(RQFII) schemes, direct investment in China's interbank bond market (CIBM Direct) and Bond Connect. (See comparison in Table 1).

Table 1: Comparison of three ways to access China's interbank bond market

	QFII/RQFII	CIBM Direct	Bond Connect
Regulatory requirements	CSRC: QFII/RQFII license; SAFE: QFII Quota	Pre-filing with PBOC	Pre-filing with PBOC, with help from CFETS, domestic custodies and interbank bond market settlement agencies
Investment quota	Only needs to pre-file with SAFE if requested quota is within the base quota or obtain approval if the requested quota exceeds base quota	No specific investment quota restrictions; applicant may pre-file with PBOC the anticipated investment value	No specific investment quota restrictions
Eligible fixed income products	All cash bonds	Cash bonds and onshore interest rate derivatives for all, but repo transactions are open to "three types of institutions[1]"	All cash bonds
Foreign exchange management	QFII: foreign currencies RQFII: RMB(CNH); not allowed to do hedging	Both RMB and foreign currencies; Allowed to do FX hedging in onshore FX market	Both RMB and foreign currencies; Allowed to do FX hedging via trade settlement banks in HK
Custody arrangement	Domestic custody	Domestic custody	HK CMU
Lock-up period or repatriation restrictions	3 months, but no restrictions on open-ended funds	No restriction	No restriction

Source: JP Morgan Asset Management, Hong Kong Exchange, People's Bank of China (PBOC)

1. On 16 August 2010, the PBC released a circular allowing three types of institutions to invest in China's interbank bond market, namely foreign central banks or monetary authorities/RMB clearing banks in Hong Kong SAR and Macau SAR/Overseas participating financial institutions engaging in RMB cross-border trade settlement.

The convenience offered by Bond Connect is that foreign investors do not have to open an onshore account, which would have taken months in the past. Due largely to the introduction of Bond Connect, outstanding volume of foreign holdings increased 29% over the year 2017 to more than RMB 1 trillion.

Bond Connect allows foreign investors to access the onshore primary markets as well as secondary markets. In July 2017, the government of Hungary issued its inaugural RMB 1 billion panda bond via Bond Connect with three-year maturity and a 4.85% coupon. The issuance received active subscription from domestic and overseas investors with 1.96 times oversubscription, while overseas investors' participation reached a record high of over 55% of the total issuance volume in the transaction. And in November 2017, when the Canadian province of British Columbia issued its second batch of panda bonds via Bond Connect, foreign subscription was about 70% of the total.

Foreign participation in the onshore credit rating industry

Credit rating is an integral part of bond market, providing necessary risk assessment and disclosure. There are eight major Chinese domestic credit rating agencies (CRAs) providing rating services based on local methodologies, models and criteria.

Table 2 Major credit rating agencies in China's bond market

Name	International Shareholder	Market segment		
		Interbank market products	Enterprise bond	Corporate bond
Dagong	None	√	√	√
Brilliance	None	√	√	√
Golden	None	√	√	√
Lianhe	GIC[1] 49%	√	√	
Lianhe	None			√
Chengxin	Moody's 30%	√	√	
Chengxin	None			√
Pengyuan	None		√	√
Far East	None			√

Source: NAFMII

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In July 2017, the PBOC announced the opening-up of the credit rating industry (see PBOC *No. 7 Announcement*, 2017*)*[2] allowing eligible foreign CRAs to provide credit rating services in the interbank bond market. This reform is expected to promote more accurate pricing in this market.

According to the PBOC announcement, NAFMII is authorized to establish a registration and market-oriented evaluation system for CRAs. In March 2018, NAFMII published *The Rules for Credit Rating Agencies' Registration and Participation in Market-based Evaluation in Interbank Bond Market*[3] which also specifies the required documentation.

Other specific measures have been taken to open up China's financial sector. For instance, in April 2017, China Securities Regulatory Commission officially released its *Administrative Measures for Foreign-Invested Securities Companies*, allowing foreign investors to increase their shareholdings in joint-venture security companies to 51%. As the recently appointed Governor of the PBOC, Gang Yi, has stated that the Government is "losing no time in translating China's plans to widen market access into reality." Just before this article was published, some measures were taken to streamline the filing requirements for foreign investors investing in China's interbank bond market.[4] (Both Chinese and English version of this *Notice* made by PBOC Shanghai Head Office can be found in the link below.)

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2. http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3337553/index.html
3. http://www.nafmii.org.cn/zlgz/201803/t20180327_68266.html
4. http://shanghai.pbc.gov.cn/fzhshanghai/113571/3560420/index.html