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China's Super Regulator: What to Expect

In July 2017, Chinese President Xi Jinping ordered the establishment of a super regulator, a Financial Stability Development Committee that will coordinate between regulators of the banking, securities, and insurance industries.

After months of speculation, Chinese President Xi Jinping announced the setup of the Financial Stability Development Committee in China. Rather than replacing the current regulators, the new body will act as the regulator of regulators, working alongside the Central Bank, People's Bank of China (PBOC), to monitor overall financial stability in China.

Current Regulators

Financial regulatory authority is currently vested in four major regulatory bodies:

1) The China Banking Regulatory Commission (CBRC), which regulates organizations engaged in corporate, commercial and retail banking, and associated activities

2) The China Securities Regulatory Commission (CSRC), which is the nationwide regulator of the securities and futures market

3) The China Insurance Regulatory Commission (CIRC), which regulates the life, specialty, general insurance, and reinsurance market

4) The People's Bank of China (PBOC), which serves as the Central Bank in China, and implements monetary policy

Internationally, it is not uncommon to find multiple regulators in the financial industry. Some countries like Singapore, however, have a single regulator or central bank, eliminating the need for coordination between multiple regulatory bodies.

Implications

While detailed roles and responsibilities of the new body have not yet been revealed, the Chinese government continues to emphasize the need for political stability in China and, therefore, the importance of economic stability and growth. Achieving an overarching financial regulatory framework was initially highlighted as early as 2011 by

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the International Monetary Fund, which recommended setting up a committee with access to relevant supervisory and financial information across all financial industries.

As we wait for more information on the official mandate of the FSDC, items that are expected to be tackled immediately are:

- Financial technology firms: The current decade has seen the proliferation of startups and non-financial services firms that provide financial services like electronic payments, peer to peer lending, and activities loosely classified under shadow banking. The FSDC is likely to bring these under a regulatory framework to ensure that they take adequate steps to manage risk.
- Financial conglomerates: Financial holding companies, which have multiple entities that are regulated by various bodies, may also now be subject to a set of umbrella regulations.
- Areas of regulatory overlap: The FSDC is likely to pay special attention to cases where regulatory jurisdiction is not clear, e.g., insurance instruments that are treated as banking wealth management products and could be used in money laundering.
- Areas where regulatory arbitrage may exist: If a product is prohibited by one regulator, firms may still be able to run them under another entity where the regulator is less strict.

In addition to setting up the FSDC, the PBOC will retain its role and be given supplementary powers to curtail risks in the financial services industry.

Impact on Remuneration

According to the official announcement of the National Financial Working Conference, one of the primary purposes of setting up the committee is to "establish a sound and prudent incentive mechanism in China's financial institutions." Following the committee's creation, we can expect more consistent remuneration guidelines for all the key sectors in the financial industry.

Below is a snapshot of the key requirements for existing remuneration-related guidelines issued by each of the four regulatory bodies.

	CBRC	CIRC	CSRC
Pay Structure	▪ The base salary provided by a commercial bank shall be no more than 35% of the total compensation ▪ The performance-linked compensation for top executives of a commercial bank shall be no more than 3 times their base salary	▪ The performance-linked compensation of directors, supervisors, and senior executives shall be no more than 3 times their base salary ▪ Cash benefits and allowances of directors, supervisors, and senior executives shall be no more than 10% of their base salary	Not mentioned

	CBRC	CIRC	CSRC
Deferral Requirements on Variable Pay	▪ At least 40% of variable pay should be deferred for senior executives and other employees whose actions have material impacts on the risk exposure of the bank ▪ For senior-level management, no less than 50%, and where appropriate, up to 60% should be deferred ▪ Deferred over a period of at least 3 years ▪ Shall vest on a pro-rata basis ▪ Claw back arrangements shall be established	▪ At least 40% of variable pay should be deferred for directors, supervisors, senior executives, and employees in key positions ▪ No less than 50% should be deferred for the chairman and general manager of the Board ▪ Deferred over a period of at least 3 years ▪ Shall vest on a pro-rata basis	▪ At least 40% of variable pay should be deferred for senior executives ▪ Deferred over a period of at least 3 years ▪ Shall vest on a pro rata basis
Performance Assessment Indicators	The performance assessment indicators shall include: ▪ Financial performance indicators ▪ Risk control indicators ▪ Social responsibility indicators	The performance assessment indicators shall include: ▪ Financial performance indicators ▪ Risk and compliance indicators	Not mentioned

Although minor differences may exist, it is evident that current regulations are broadly similar. Multi-line financial firms, i.e., holding companies with multiple regulated entities, find it difficult to operate under a unified compensation structure while remaining compliant with all firms and competitive in the market. Streamlining pay regulations across regulators will level the playing field for remuneration across the three largest financial services sectors in China.

Parting Thoughts

One important function of the FSDC will be coordinating and streamlining all communications between various regulatory entities. This is seen as a positive step for the financial stability of China. We do not expect to see sweeping regulatory changes to any of the three regulated activities.

However, it is likely that previously unregulated firms may be subject to regulations related to risk management, transparency, disclosure, and even pay. Leading global economists have warned that if unchecked, China's rising debt could eventually lead to a financial crisis in China. The creation of the FSDC is just one attempt to manage systemic financial risk in the economy.

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