

Su Ning: Promoting actively development of China's bond market

Speech by Mr Su Ning, Deputy Governor of the People's Bank of China, at the First China Bond Market Forum, Beijing, 15 July 2005.

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Ladies and Gentlemen,

It is a great pleasure to join you for a discussion on issues related to bond market development. China's bond market has a history of more than 20 years, and the rapid growth of the OTC market, which constitutes the main pillar of the bond market, in the recent eight years has enabled the bond market to serve as an important platform for macro financial control. With the reform on financial institutions being advanced and the financial services being improved, the bond market is bound to play an even more significant role in conducting financial reform and safeguarding financial stability. I'd like to take this opportunity to give a brief review of the efforts made by the People's Bank of China (PBC) so far in promoting the development of the bond market, and then share with you my observations on the current situation and some reflections on further developing the bond market.

I. Development of the inter-bank bond market in recent years

Since the inter-bank bond market established in 1997, it has been developed by the PBC in a steady and sequenced way according to the advanced international experiences and following the OTC market mode. In recent years, the inter-bank bond market has grown rapidly and emerged as an open OTC bond wholesale market for all institutional investors, which constituted a major pillar of China's bond market and played an important role in ensuring the effective transmission of monetary policy, sound performance of the macro economy and the effective allocation of financial resources. Since last year, the PBC has reinforced market infrastructure with emphasis on innovation of financial products, and has taken measures to promote and standardize the development of the inter-bank bond market. With these efforts, the inter-bank bond market has maintained its sound growth momentum and the product innovation and institutional building have also achieved new progress, which can be basically summarized as follows:

First, the market has seen a good growth momentum with the volume of bonds issued continuing to increase. From the beginning of 2004 to end-March of 2005, bonds issued in the inter-bank market reached RMB3561.7 billion yuan accumulatively, increasing by RMB1535.7 billion yuan over the end of 2003. By the end of this March, the stock value of bonds in inter-bank bond market amounted to RMB5214.3 billion yuan, growing by RMB1859.2 billion yuan over the end of 2003, up 35.65 percent. The total market turnover was RMB15.4 trillion yuan for the same period of time. Market participants increased rapidly in greater diversity. By the end of this March, there were altogether 5596 institutional participants in the market including banks, securities firms, mutual funds, insurance companies, and other non-banking financial institutions and enterprises, 1613 more than that recorded at the end of 2003.

Second, significant progress has been made in product innovation. Since last year, the PBC has made great efforts in promoting financial product innovation, expanding bond issuers and developing financing channels, including allowing commercial banks to issue subordinated bonds, supporting the implementation of the pilot share-holding reform of banks as approved by the State Council, introducing short-term financing bills to widen financing channels for the securities firms, encouraging international development institutions to issue RMB bonds in domestic market, improving the bond market and promoting the opening-up of the financial market. In the near term, by introducing short-term corporate financing bills, we have made important strides in enhancing the capability of enterprises to directly raise funds in the market. With the increase of bond issuers, bond products became more diversified. The pilot program of asset securitization was explored and advanced. To promote the pilot program on the securitization of mortgage loans and credit assets in the banking sector, the PBC, jointly with the China Banking Regulatory Commission, issued the *Administrative Rules on the Pilot Conduct of Credit Asset Securitization*, which advanced the financial innovation. In terms of bond issuance, The Agricultural Development Bank of China was approved to issue policy financial bonds to make its funding more market-oriented. A new bond product with floating interest rate based on the new benchmark rate was introduced in the market, which has enriched financial

products and investment instruments. In terms of bond transactions, certain types of corporate bonds such as railway construction bonds started to be traded in the inter-bank market, leading to extended market coverage. The introduction of outright repo business paved the way for interest rate derivatives transactions such as bond credit and forward transactions.

Third, market infrastructure was reinforced. The PBC has taken active steps to strengthen infrastructure construction, foster the development of qualified institutional investors and improve relevant legal framework. First, efforts were made to promote the development of money market fund. The PBC and the China Securities Regulatory Commission (CSRC) jointly released the *Provisional Rules for Money Market Fund Management* to support the development of money market fund business by fund management companies. Twelve money market funds have been launched so far. Second, fund business and the incorporation of fund management companies by commercial banks were encouraged. The PBC drafted and issued the *Administrative Rules on Incorporation of Fund Management Companies by Commercial Banks*. Allowing commercial banks to set up fund management companies would help to enhance the proportion of direct financing, advance the development of institutional investors, promote commercial bank reform and optimize resource allocation. Third, market maker system was established in the inter-bank bond market based on bilateral quotations. Apart from commercial banks, 2 securities firms were accepted as market makers for the first time. Currently, there are 15 market makers in the market and the market maker system has been further improved. Fourth, infrastructure construction of the inter-bank bond market was advanced. Under the guidance of the PBC, the China Government Securities Trust Depository and Clearing Company upgraded the bond trading system, and connected the bookkeeping system with the payment system. As a result, DVP settlement of bond transactions was preliminarily realized in the inter-bank market. Fifth, legal system was reinforced to regulate the fast development of financial market and new instruments. For instance, the Rules for Licensing Inter-bank Bond Transactions and Circulations was released to regulate the inter-bank bond transactions, and the Administrative Rules for Inter-bank Outright Bond Repo Transactions was issued to resolve certain legal issues regarding such businesses.

II. Seizing favorable opportunity to foster the development of the inter-bank bond market

The Third Plenary Session of the Sixteenth National Congress of CPC called for “actively developing bond market”, creating valuable opportunities for the development of the inter-bank bond market and allowing the market to play a more important role in financing restructuring, financial macro control and the reform of financial institutions.

First, developing the inter-bank bond market is in urgent need for financing restructuring. With the deepening of the financial reform, some deep-rooted problems gradually emerged, a serious one of which was the excessively high ratio of indirect financing. In the current financing structure, the proportion of indirect financing stands excessively high compared to that of direct financing, with bank loans accounting for 80 percent of the total financing in the non-financial sector and bank savings accounting for 70 percent of the household financial assets. The irrational financing structure not only fermented a formidable potential financial risk but also seriously hindered economic development. Therefore, the financial community has reached a consensus on improving financing structure, with emphasis on developing capital market especially the bond market, which shall allow enterprises and investors to directly raise funds from or invest in the market. In addition to promoting the steady development of the stock market, developing the inter-bank bond market provides us another effective way to reform the irrational financing structure. Thus, an improved financing structure is in great need and shall provide new opportunities for accelerating the inter-bank bond market development.

Second, improving financial macro control system and transmission mechanism calls for fostering the development of the inter-bank bond market. A well-functioned financial market is crucial for conducting indirect financial control. In recent years, the inter-bank bond market has grown rapidly and played a significant role in ensuring the effective transmission of monetary policy and improving macroeconomic control. However, the depth and breadth of the market still need to be developed, financial products and trading instruments are yet to be diversified, and the market liquidity remains low. Therefore, efforts should be made to strengthen market infrastructure, increase the diversity of financial products and improve market functions so as to ensure the effective implementation and transmission of financial control policies.

Third, upgrading the inter-bank bond market is vital for the reform of financial institutions. The inter-bank bond market should provide not only investment facility for commercial banks and other financial

institutions but also instruments for their liability management, flexible means to adjust asset structure, and source of funds to supplement the capital base and enhance the capital adequacy ratio. Moreover, it should offer more measures and various instruments for financial institutions to adjust their asset and liability structure and create a favorable market environment for their reform so as to enable them to transform their operating mechanism through market-based means and become micro financial entities commensurate with the market-oriented economy.

III. Some reflections on accelerating the inter-bank bond market development

In order to further develop the inter-bank bond market, under the guidance of the central government and the State Council, the PBC will deepen the reform with the priority in financial product innovation by following the principles of market economy and relying on the initiatives of market participants. Meanwhile, the PBC will also coordinate the development of product innovation and the market growth within the market capacity, foster the market infrastructure construction, and advance the development of the inter-bank bond market and the whole financial market.

First, focusing on financial product innovation and further expanding direct financing channels. To satisfy the needs of the inter-bank bond market and provide instruments for market participants to conduct liability management and prevent risks, we will further conduct in-depth research and launch as soon as possible financial products which are based on corporate credit standings such as the financial bonds and asset backed securities, and gradually develop financial derivatives according to market conditions.

1. Actively promoting the issuance of financial bonds by financial institutions. While improving the management of subordinated bonds issued by commercial banks, steps will be taken to encourage financial institutions to issue financial bonds in the inter-bank bond market, provide instruments for commercial banks to enhance their liability management and ease the mismatch of their asset and liability term structure.

2. Speeding up the issuance of asset backed securities. Efforts will be made to improve the pilot program on credit asset securitization, accelerate the launch of asset securitization business on a pilot basis, and promote China Development Bank and China Construction Bank, as the pilot institutions, to make detailed plan on the securitization of credit assets and mortgage loans respectively so as to enable them to formally issue asset backed securities at an early date.

3. Promoting the issuance of RMB bonds by international financial institutions in domestic market. The issuance and trading of RMB bonds by international financial institutions will be regulated according to the promulgated *Administrative Rules on the Issuance of RMB Bonds by International Financial Institutions*.

4. Vigorously developing short-term corporate financing bills. Following the promulgation of the *Administrative Rules for Short-term Financing Bills* and the successful introduction of the first batch of short-term corporate financing bills, the development of short-term corporate financing bills market will be further promoted and regulated so as to reduce the reliance of enterprises' financing on bank loans.

5. Fostering the circulation of corporate bonds in the inter-bank bond market. Bidding for corporate bond issuance by institutional investors in the inter-bank market will be publicized and promoted to further develop the corporate bond market.

6. Gradually introducing financial derivatives. To enhance market liquidity and provide instruments for market investors to hedge risks, bond credit and forward business will be launched according to the development of market, and operating patterns and institutional framework will be determined for bond credit and forward products. Meanwhile, relevant rules and regulations will be revised to provide legal support for these two kinds of products.

Second, fostering the development of qualified institutional investors. The development of money market fund business and the establishment of fund management companies by commercial banks will be supported. Currently, the *Provisional Rules for Money Market Fund Management* and the *Administrative Rules for the Establishment of Fund Management Company by Commercial Banks* have been released. The PBC, jointly with other relevant government departments, will further promote the pilot project according to the rules so as to enable commercial banks to establish fund management company and issue funds at an early date. Meanwhile, to enhance the opening up of the

inter-bank bond market, qualified foreign institutional investors such as the Asian Bond Fund will be allowed to invest in the market.

Third, strengthening the infrastructure construction of the inter-bank bond market. To ensure the smooth introduction of various new types of financial products, efforts will be made to reinforce market infrastructure and improve the legal system so as to provide legal and technical support to the healthy development of the inter-bank bond market. Relevant rules and regulations will be further improved. In addition to the existing regulatory rules, the *Administrative Rules for the Inter-bank Bond Market* will be drafted. Meanwhile, the PBC will specifically define its supervisory functions, and clarify certain important principles based on which bond is issued and traded. Steps will also be taken to further improve development of rules, contracts and system regarding the DVP settlement in the inter-bank bond market, explore the ways of adopting DVP settlement by non-banking financial institutions, and establish relevant systems. Certain issues such as the data exchange and sharing will be coordinated so as to foster the linkage between the bookkeeping system and the trading system. The management of the trading information in the inter-bank bond market will be strengthened. The PBC will also further improve the market-maker system, increase policy support to the market makers and gradually put in place a inter-bank bond market with the market makers as the core, the brokers and financial institutions as the mainstay, and the non-financial investors as the major participants.

I am confident that, with the efforts of all parties in China's bond market, the Chinese bond market is bound to see a rapid and healthy development.

Thank you!